CNSM

The National Committee for Macroprudential Oversight

Annual Report

2020

Annual Report
of the National Committee
for Macroprudential Oversight
for the year 2020

N O T E

National Bank of Romania
25, Lipscani St., postal code 030031, Bucharest – Romania
Telephone: 40 21/312 43 75; Fax: 40 21/314 97 52
http://www.cnsmro.ro/

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Organisation

The National Committee for Macroprudential Oversight (NCMO) comprises:

The National Bank of Romania. The NBR has an intrinsic role in maintaining financial stability, given its responsibilities arising from its double capacity as monetary and prudential authority. Financial stability objectives are pursued both by way of its prudential regulatory and supervisory functions exerted on the institutions under its authority, and by the design and efficient transmission of monetary policy measures, as well as by overseeing the smooth functioning of systemically important payment and settlement systems.

The Financial Supervisory Authority. The FSA contributes to the consolidation of an integrated framework for the functioning and supervision of non-bank financial markets, of the participants and operations on such markets.

The Ministry of Finance. The MF is organised and run as a specialised body of central public administration, with legal status, subordinated to the Government, which implements the strategy and Government Programme in the field of public finance.

Overview

The year 2020 was marked by the outbreak of the COVID-19 pandemic, which led to major changes in short-term risks to financial stability and heightened some of the existing vulnerabilities of the global economy. The authorities' response was prompt, with comprehensive measures to support the economy being taken as early as the first part of the year, including those regarding the macroprudential policy framework. Most European states released in part or in full some of the macroprudential capital buffers introduced in earlier periods. The response consisted both in the easing of specific requirements of the cyclical component of systemic risk, 12 countries resorting to a reduction in the countercyclical capital buffer, and in measures specific to the structural component, with recalibrations of the capital buffer for other systemically important institutions, as well as of the systemic risk buffer. The aforementioned measures triggered the release of capital reserves built up during previous years, which the banking sector was able to use in order to support the real economy in a period marked by uncertainty.

On the domestic front, the authorities stepped in promptly to cushion the potential financial effects of the public health crisis. From a prudential perspective, the National Bank of Romania decided to allow credit institutions to temporarily use the capital buffers built up previously, while keeping in place the legal requirements for such flexibilities. Measures addressed to non-bank financial institutions were also implemented. Thus, in its first meeting of 2020, the National Committee for Macroprudential Oversight (NCMO) decided on the one-year extension of the IFRS implementation plan by NBFIs. Moreover, the NCMO analysed the macroprudential policy stance on a regular basis, with capital buffers witnessing the following developments:

- the countercyclical capital buffer (CCyB) was maintained throughout 2020 at 0 percent, based on quarterly recalibrations. Keeping the CCyB rate at this level is due to both the absence of excessive credit growth and the NCMO decision not to put pressure on the banking sector in building up additional capital, in the context of the current public health crisis;
- looking at the buffer for other systemically important institutions (O-SII), eight systemically important institutions were identified; they are applied a differentiated buffer ranging between 1 and 2 percent of the total risk exposure amount;
- the systemic risk buffer (SyRB) posted downward dynamics in 2020, given the improvement in the indicators based on which it is applied, namely the non-performing loan ratio and the coverage ratio.

During the year under review, the NCMO issued nine recommendations, i.e. five on the recalibration of macroprudential instruments and four on other aspects pertaining to macroprudential policy, such as:

- monitoring the financial stability implications of debt moratoria, and public guarantee schemes and other measures of a fiscal nature taken to protect the real economy in response to the COVID-19 pandemic (transposition of Recommendation ESRB/2020/8);
- restriction of dividend distributions during the COVID-19 pandemic (transposition of Recommendation ESRB/2020/7 issued by the macroprudential authority at EU level);
- reducing vulnerabilities from the widening of the agri-food trade deficit;
- the one-year extension of the IFRS implementation plan by NBFIs.

Furthermore, the inter-institutional working group on reducing vulnerabilities from the widening of the agri-food trade deficit carried out its activity within the NCMO, preparing an analysis that approaches the issue from both a macro- and microeconomic perspective, as well as in terms of access to finance. In addition, a new working group was set up for identifying possible solutions to support green finance.

In line with its mandate and complying with the principle of transparency and institutional accountability, the NCMO continued its communication with the public in 2020, by posting on its website, in Romanian and in English, press releases after each General Board meeting, the issued recommendations, as well as the *2019 Annual Report* of the National Committee for Macroprudential Oversight.

1. The National Committee for Macroprudential Oversight's activity in 2020

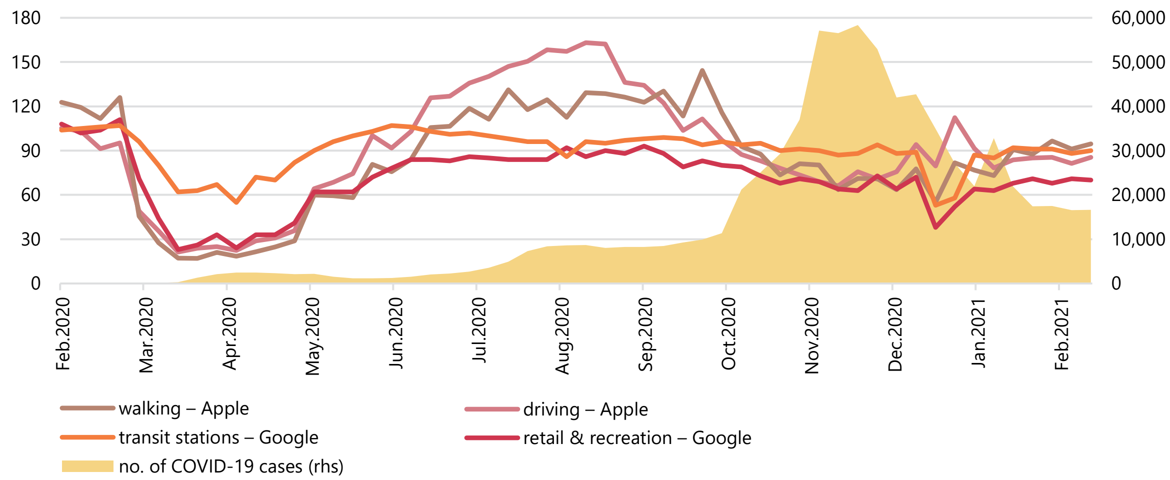
1.1. Macroprudential policy framework in Romania and the European Union

The outbreak of the COVID-19 pandemic is undoubtedly one of the greatest challenges having faced policymakers in the recent past. The unique characteristics of the health crisis, such as the swift materialisation of effects globally, the simultaneous impact on demand and supply in the economy, the asymmetric effect of lockdown measures and the significant uncertainty surrounding short- and medium-term developments, prompted a strong and coordinated response from fiscal, monetary and prudential authorities at national and EU level.

The peculiarity of SARS-CoV-2, namely its spreading at a much faster pace than that of other notorious 21st century epidemics, is the reason why most government authorities imposed lockdowns and restricted social interaction from the early phases of the pandemic, in line with the evolution of epidemic waves (Chart 1.1). These measures had severe social and economic effects. Therefore, although the COVID-19 pandemic was initially considered a health crisis, once with all the measures adopted to contain the spread of the virus, it quickly turned into an economic crisis.

Unlike other economic crises emerging against the backdrop of imbalances generated by endogenous factors, this time economic tensions are the result of a shock exogenous to the macrofinancial framework. The sharp decline in industrial output occurred starting in 2020 Q2, as a natural consequence of the substantial reduction in demand, but also following the lockdown measures imposed to contain the spread of the virus. Due to the very high uncertainty in this period, most consumers decided to postpone the purchase of durables. Instead, they shifted towards precautionary saving, a trend that was also steepened by falls in income following layoffs or furlough schemes. In quantitative terms, the International Labour Organization (ILO) shows that in 2020 Q2 working-hour losses were equivalent to almost 500 million full-time jobs in this period, accounting for 14 percent of global working hours. The unemployment rate in the US hit a record high of 14.7 percent in April 2020, a peak that was last reached in 1940, amid the fallout from the Great Depression of 1929.

Chart 1.1. Evolution of the COVID-19 pandemic and household mobility in Romania



Note: Mobility indices are measured against their pre-pandemic levels (January 2020).
Source: Google Mobility Reports, Apple Mobility Trends, ECDC

Labour market disruptions led to authorities' interventions such as the launch of the European Commission's instrument for Support to mitigate Unemployment Risks in an Emergency (SURE)[1] or of the Coronavirus Aid, Relief, and Economic Security (CARES) Act[2] in the US, a USD 2 trillion package providing direct assistance for American workers, families, and small businesses, in the wake of the novel coronavirus pandemic.

At the EU level, Member States adopted sizeable support packages, which brought about a significant widening of budget deficits even for the countries that had large fiscal space before the onset of the pandemic crisis. In this context, given that the emergence of the COVID-19 pandemic is an unusual event outside the control of governments, the European Commission activated the general escape clause within the Stability and Growth Pact (SGP), which implies more flexible fiscal rules meant to allow governments to make substantial expenses with a view to supporting households and the economy. The widening of budget deficits prompted an increase in sovereign debt in all EU Member States, the EU-27 average moving up by approximately 10 percentage points, to almost 90 percent of GDP at the end of 2020 Q3. Even though these developments may result in rising vulnerabilities to financial stability, the support measures adopted, i.e. the Next Generation EU programme, and the reforms envisaged at the EU level are likely to back the resilience of European economies. The unprecedented support measures taken in 2020 contributed to further financing and to avoiding adverse macroeconomic effects. Nevertheless, vulnerabilities to financial stability have intensified in some countries, chiefly amid the higher indebtedness of non-financial corporations, but also following the upward trend in budget deficits amid the financing measures to support the economies.

On the monetary side, given the novel macrofinancial environment induced by the current COVID-19 pandemic, central banks responded promptly, using a mix of standard and

1 https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/financial-assistance-eu/funding-mechanisms-and-facilities/sure_en

2 https://home.treasury.gov/policy-issues/cares

non-standard monetary instruments. According to the database of the European Systemic Risk Board (ESRB) on measures taken in response to coronavirus (COVID-19) pandemic, most Central and Southeastern European countries resorted to reference rate cuts and the implementation of asset purchase programmes to enhance the structural liquidity of markets and to lower short-term tensions stemming from the surge in investor risk aversion. Other instruments employed in the area of international coordination to maintain financial stability are swap and repo lines. In this context, the National Bank of Romania and the European Central Bank concluded a framework arrangement to provide euro liquidity via a repo line, in order to address possible euro liquidity needs in the presence of market dysfunctions due to the COVID-19 shock.

In comparison with the financial crisis of 2008, an important aspect to be noted is that this time the source of the shock is outside the financial system. Consequently, the COVID-19 pandemic may be a great opportunity for economic recovery to rest on a sound financial system, far stronger than a decade ago and capable of allocating liquidity to the most distressed and solvent entities in a fast and efficient manner. At the same time, the current context may allow the validation of the effectiveness of the EU macroprudential policy framework in terms of both the coordination and the use of capital reserves built up during the pre-pandemic period.

Apart from the specific measures adopted by each national macroprudential authority, described in detail in Chapter 3 of this *Report*, following the onset of the COVID-19 crisis, the ESRB, in its capacity as European macroprudential authority, issued a number of recommendations. In the 37th meeting of the ESRB's General Board, the first after the pandemic outbreak, analyses and debates focused on the manner in which the economic fallout of the health crisis on the financial system could be mitigated. The general principles underlying the ESRB's decisions were, first, that the national macroprudential measures should not generate adverse effects on the common European market and, second, that the flexibilities built into the current regulatory framework should be used as much as possible. Following this meeting, the General Board of the ESRB decided to focus its attention on five priority areas, among which:

- Implications for the financial system of guarantee schemes and other fiscal measures to protect the real economy. This objective refers to improving cooperation and information exchange between the relevant national fiscal and macroprudential authorities so that the implications of the implemented measures for financial stability can be monitored. Moreover, given that EU economies are highly integrated, the different measures implemented by individual countries might have an impact on other countries. Therefore, an EU-wide framework to monitor these measures is needed.
- Market illiquidity and implications for asset managers and insurers. Asset prices fell sharply, which caused a deterioration of financial market liquidity. In this sense, the purpose is to assess the current state of preparedness of these two market segments (asset managers and insurers) to potential future shocks that could lead to declines in market liquidity or increased uncertainty in the valuation of financial assets.

- Procyclical impact of downgrades of corporate bonds on markets and entities across the financial system. This objective refers to conducting a top-down analysis with the European Supervisory Authorities (ESAs) and the ECB to assess the potential impact of large-scale downgrades of corporate bonds across all parts of the financial sector (banks, investment funds, insurers, pension funds, etc.).
- System-wide restraints on dividend payments, share buybacks and other pay-outs. This ESRB objective complements the initiatives of the ECB, the EBA and national authorities to encourage banks, investment funds, insurers, reinsurers and central counterparties to restrain voluntary pay-outs so that these financial sectors should be able to support the real economy in the current period.
- Liquidity risks arising from margin calls. The COVID-19 pandemic and other economic shocks such as oil market disruptions have caused a sharp drop in asset prices and increased volatility, resulting in significant margin calls. This situation could have a possible adverse impact on both financial system and non-financial sector. Therefore, the aim is to conduct an assessment of liquidity needs of central counterparties in the European Union in order to limit the liquidity constraints related to margin collection.

In the context of the debates concerning the five priority areas, the General Board of the ESRB adopted the following recommendations:

1. Recommendation ESRB/2020/4 on liquidity risks in investment funds;
2. Recommendation ESRB/2020/6 on liquidity risks arising from margin calls;
3. Recommendation ESRB/2020/7 on restriction of distributions during the COVID-19 pandemic;
4. Recommendation ESRB/2020/8 on monitoring the financial stability implications of debt moratoria, and public guarantee schemes and other measures of a fiscal nature taken to protect the real economy in response to the COVID-19 pandemic.

1.2. Topics discussed during the NCMO meetings

During 2020, the Chairman of the NCMO convened, pursuant to the legislation in force, four meetings of the National Committee for Macroprudential Oversight, on 8 May, 15 July, 14 October and 18 December. All the meetings were held by written procedure, taking into account the measures imposed by the Romanian authorities in the context of the COVID-19 pandemic.

On the agenda of the first ordinary meeting were: (i) the regular analysis on the recalibration of the countercyclical capital buffer, (ii) the draft *Annual Report* of the National Committee for Macroprudential Oversight for 2019, and (iii) the one-year extension of the IFRS implementation plan by NBFIs, and the related postponement of intermediate steps. In addition, during the meeting, the NCMO General Board was informed of: (i) the actions taken by the addressees in order to implement the recommendations issued by the National Committee for Macroprudential Oversight in the period from December 2018 to December 2019, as well as those issued in the previous period, which have not been completed or are applicable on a permanent basis, (ii) the possible impact on the financial system generated by the legal acts providing for loan repayment holidays, and (iii) the preliminary assessment of the banking sector's capacity to weather adverse developments of a higher intensity. The following macroprudential policy measures were approved:

- NCMO Recommendation No. R/1/2020 on the countercyclical capital buffer in Romania, whereby the National Bank of Romania is recommended to maintain the countercyclical buffer rate at 0 (zero) percent;
- NCMO Recommendation No. R/2/2020 amending the strategy regarding the implementation of the International Financial Reporting Standards (IFRS) by non-bank financial institutions as a basis of accounting and for preparing individual financial statements, so that the plan to implement the IFRS by NBFIs, as set forth in NCMO Recommendation No. R/2/2019, be extended by one year, and the intermediate steps be accordingly postponed.

The second ordinary meeting focused on the following: (i) the regular analysis on the recalibration of the countercyclical capital buffer, (ii) the assessment of materiality of third countries for the Romanian banking sector in relation to the recognition and setting of countercyclical buffer rates, (iii) the implementation of the Recommendation of the European Systemic Risk Board on monitoring the financial stability implications of debt moratoria, and public guarantee schemes and other measures of a fiscal nature taken to protect the real economy in response to the COVID-19 pandemic (ESRB/2020/8), (iv) the implementation of the Recommendation of the European Systemic Risk Board on restriction of distributions during the COVID-19 pandemic (ESRB/2020/7), as well as (v) the analysis of the NCMO Working Group on reducing vulnerabilities from the widening of the agri-food trade deficit. In addition, the NCMO General Board was informed of: (i) the results of the regular analysis on the systemic risk buffer, (ii) the estimated developments in Romania's sovereign rating and the possible direct effects of its downgrade on the banking sector in the context of the current COVID-19 crisis, (iii) the systemic risks identified across the domestic financial system, and (iv) version 2.0 of the Methodology for identifying credit institutions' critical functions. The NCMO meeting ended with the approval of the macroprudential policy measures below:

- NCMO Recommendation No. R/3/2020 on the countercyclical capital buffer, whereby the National Bank of Romania is recommended to maintain the countercyclical buffer rate at 0 (zero) percent;
- NCMO Decision No. D/3/2020 on the assessment of materiality of third countries for the Romanian banking sector in relation to the recognition and setting of countercyclical buffer rates;

- NCMO Recommendation No. R/4/2020 on the implementation of Recommendation ESRB/2020/8 on monitoring the financial stability implications of debt moratoria, and public guarantee schemes and other measures of a fiscal nature taken to protect the real economy in response to the COVID-19 pandemic, whereby the national authorities, namely the National Bank of Romania (NBR), the Financial Supervisory Authority (FSA) and the Government, are recommended to monitor, assess and inform the NCMO about the implications of the measures taken to protect the real economy in response to the COVID-19 pandemic;
- NCMO Recommendation No. R/5/2020 on the implementation of Recommendation ESRB/2020/7 on restriction of distributions during the COVID-19 pandemic, whereby the NBR and the FSA are recommended to request financial institutions under their supervisory remit to refrain, at least until 1 January 2021, from undertaking any of the following actions: (i) make a dividend distribution or give an irrevocable commitment to make a dividend distribution; (ii) buy-back ordinary shares; (iii) create an obligation to pay variable remuneration to a member of a category of staff whose professional activities have a material impact on the financial institution's risk profile, which has the effect of reducing the quantity or quality of own funds at the consolidated and/or individual level;
- NCMO Recommendation No. R/6/2020 regarding the NCMO Working Group analysis on reducing vulnerabilities from the widening of the agri-food trade deficit, whereby ten key measures are recommended, such as: developing programmes, through close dialogue with representatives of relevant associations, to implement the European Union's Farm to Fork Strategy and the Declaration of cooperation on "A smart and sustainable digital future for European agriculture and rural areas"; enhancing the role of credit guarantee funds and of the Romanian Counter-Guarantee Fund in supporting agriculture and food industry firms; revising the certificates-of-deposit mechanism; improving the legislation on certifying and promoting agri-food products; designing a strategy for promoting high-quality food items, also via an increased role of quality schemes; implementing an industrial policy for the food sector. A methodology is also proposed for identifying firms that could be viewed as potential agri-food national champions, while the regular dissemination of additional statistical data is recommended for agri-food firms' improved access to finance.

The agenda of the meeting of 14 October 2020 brought to the attention of the NCMO General Board the following issues: (i) the regular analysis on the recalibration of the countercyclical capital buffer and (ii) the manner of implementing the buffer for other systemically important institutions in 2021. In addition, the NCMO General Board was informed of: (i) the results of the regular analysis on the systemic risk buffer, (ii) the implementation of the Recommendation of the European Systemic Risk Board on monitoring the financial stability implications of debt moratoria, and public guarantee schemes and other measures of a fiscal nature taken to protect the real economy in response to the COVID-19 pandemic (ESRB/2020/8), (iii) the systemic risks identified across the domestic financial system,

(iv) the measures taken by the National Bank of Romania (NBR) in the context of the COVID-19 pandemic, and (v) the ESRB's risk outlook and recommended policy proposals. During the meeting, the following measures were approved:

- NCMO Recommendation No. R/7/2020 on the countercyclical capital buffer, whereby the National Bank of Romania is recommended to maintain the countercyclical buffer rate at 0 (zero) percent;
- NCMO Recommendation No. R/8/2020 on the manner of implementing the buffer for other systemically important institutions (O-SII buffer) in Romania, whereby the NBR is recommended to impose, starting 1 January 2021, a capital buffer for other systemically important institutions (O-SII buffer), on an individual or consolidated basis, as applicable, calculated based on the total risk exposure amount for all the credit institutions identified as having a systemic nature based on the data reported as at 31 December 2019;
- the setting-up of a working group tasked with identifying possible solutions to support green finance.

During the last meeting of 2020, Board members examined analyses and adopted measures concerning macroprudential policy and systemic risk, namely the regular analysis on the recalibration of the countercyclical capital buffer. In addition, the NCMO General Board was informed of: (i) the characteristics, manner of implementation and implications for financial stability of the measures taken to protect the real economy in response to the COVID-19 pandemic, (ii) the impact of funding plans of credit institutions on the flow of credit to the real economy, (iii) the solvency stress test results for the banking sector, and (iv) the systemic risks identified across the domestic financial system. On that occasion, the Board approved:

- NCMO Recommendation No. R/9/2020 on the countercyclical capital buffer, whereby the National Bank of Romania is recommended to maintain the countercyclical buffer rate at 0 (zero) percent.

In line with its mandate and complying with the principle of transparency and institutional accountability, the NCMO continued its communication with the public in 2020, by posting on its website press releases after each General Board meeting. The NCMO General Board members discussed and agreed on the contents of press releases during the meetings.

NCMO Recommendation No. R/4/2020

The COVID-19 pandemic has caused an economic shock of unprecedented magnitude in recent history. Faced with this challenge, European countries had to adopt a number of unconventional measures. The most innovative were the fiscal measures, i.e. all government measures that fall outside the scope of monetary or macroprudential policy (e.g. tax exemptions, legislative moratoria, public guarantees, direct grants to firms). Although new measures have proved somewhat effective in the short run, their impact remains uncertain over the medium and long term. This is the main reason why the European authorities have launched a series of actions to closely monitor and assess the adopted measures. In this respect, it is worth mentioning the EBA's new reporting requirement for banks[3] in the EU, aimed at reflecting credit institutions' exposures subject to moratoria on loan repayments and public guarantees schemes.

The ESRB has also played an important role in ensuring consistency at EU level, primarily by maintaining a database of all measures taken by the Member States in the context of COVID-19. Secondly, the ESRB issued Recommendation ESRB/2020/8 on monitoring the financial stability implications of debt moratoria, and public guarantee schemes and other measures of a fiscal nature taken to protect the real economy in response to the COVID-19 pandemic, which was transposed at national level by NCMO Recommendation No. R/4/2020. Both recommendations are divided into two sections: Section A covers the monitoring and assessment of fiscal measures and Section B the reporting of fiscal measures to the ESRB.

In Section A, the NCMO recommends the NBR, the Government (represented by the MF) and the FSA to monitor, assess and inform the NCMO about the implications of the measures taken to protect the real economy in response to the COVID-19 pandemic, e.g. debt moratoria, public guarantee schemes and other measures of a fiscal nature. For this purpose, it is recommended that national authorities monitor the design features and uptake of these measures, as well as the possible implications for financial stability. To achieve this, the NCMO Recommendation also includes a number of key indicators for the design features and uptake of measures, on the one hand, and for the implications for financial stability, on the other hand.

The NCMO General Board meetings held in 2020 examined disclosures on fiscal measures. Specifically, the analyses on the loan payment moratorium and the "IMM Invest Romania" public guarantee programme ensured both the monitoring of measures at national level and the identification of potential effects on financial stability.

In Section B, the NCMO recommends the NBR, the Government (represented by MF) and the FSA to submit information about the impact of the measures taken in response to the COVID-19 pandemic, which will be centralised by the NCMO Secretariat and submitted to the ESRB. The authorities will report the information by filling in the templates published by the ESRB, thus establishing also the tasks of filling in the templates, based on the data available to each authority. For this purpose, the NCMO Secretariat centralised the filling-in of reporting templates and submitted all available information to the ESRB. In 2020, two reports were drawn up, in July and October, a quarterly reporting frequency being set until January 2022.

The monitoring and assessment of fiscal measures will continue throughout 2021 as well, at both national and EU level. The ESRB set up a working group to assess the financial stability implications of the fiscal measures taken in response to the COVID-19 pandemic.

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[3] Guidelines on reporting and disclosure of exposures subject to measures applied in response to the COVID-19 crisis (EBA/GL/2020/07).

The working group completed its mandate at end-2020 by publishing a final *Report*[4]. In addition to an assessment of the tax measures adopted by European countries, the working group's *Report* also contains a list of indicators that the ESRB will use to monitor the measures. Many of the indicators included in this list have also been taken up at national level in the analyses submitted to the NCMO, in order to capture the dynamics of fiscal measures implementation, as well as developments in the real and banking sectors.

According to the reports submitted to the ESRB, loan moratoria cover on average 5 percent of EU Member States' GDP and 5.4 percent of total loans. Public guarantees at end-2020 Q3 amounted to 2.6 percent of aggregate GDP at the SME level, but these programmes were announced to account for 9.5 percent of GDP in 2019. The significant difference between the announced value and the actual value may indicate the existence of administrative obstacles to granting government-backed loans or an overestimation by the states of the actual market demand for this type of financing. ESRB reports show that no other kind of fiscal measures exceeded 1 percent of Member States' total GDP.

As at June 2020, European comparisons ranked Romania seventh as concerns the ratio of the volume of moratoria requests from non-financial corporations to total loans granted to this sector and fifth in the case of households. Romania's public guarantee programme for corporate lending came in ninth at EU level in mid-2020, as regards the ratio of the volume of the measure to total corporate credit. Overall, the countries that were the most affected by the first wave of the pandemic have taken more far-reaching actions in granting public guarantees.

The protracted pandemic has extended the validity of fiscal measures. This additional time horizon gives the real sector the opportunity to recover some of the revenues lost during the state of emergency and the state of alert. This also leads to a lower cliff effect risk, whereby the expiry of measures causes the default of a great number of debtors. More attention should be paid to the so-called "zombie" firms (see Box B on this topic), which are kept alive via government support measures, although they no longer have a viable business model. The relatively large number of firms that have deferred payment of their loan instalments shows this phenomenon may occur in Romania.

Box A. Key fiscal measures adopted in Romania as a result of the COVID-19 pandemic, with an impact on financial stability

Support measures for large companies and small- and medium-sized enterprises with a turnover of above lei 20 million

Eximbank was mandated to implement the following support measures for large companies and small- and medium-sized enterprises with a turnover of above lei 20 million:

4 https://www.esrb.europa.eu/news/pr/date/2021/html/esrb.pr210216~4d9cec6a0b.en.html

1. guarantees, in the name and on behalf of the State, for companies affected by the COVID-19 pandemic, to cover up to 90 percent of the required guarantees on new loans or loans already granted by commercial banks;
2. financing with a State aid component, in the name and on behalf of the State, for companies affected by the COVID-19 pandemic;
3. de minimis products, namely the relief of interest on outstanding loans, subsidised interest rate on new loans and de minimis guarantee ceilings for working capital loans granted by commercial banks.

As at 31 December 2020, the guarantees amounted to lei 246.1 million, while the loans with subsidised interest rate totalled lei 33 million.

Support programme for small- and medium-sized enterprises and for small enterprises with medium market capitalisation – "IMM Invest Romania"

The programme aims to provide facilities in the form of State guarantees for loans granted by credit institutions to small- and medium-sized enterprises. The maximum term of financing is of 72 months for investment loans and 36 months for working capital loans/credit lines. Through this programme, the government offers guarantees issued by the National Credit Guarantee Fund for SMEs in the name and on behalf of the State for one of the following types of loans:

a) one or more investment loans and/or one or more working capital loans/credit lines, for which the Government offers guarantees of up to 80 percent of the value of financing, excluding bank interest, fees and commissions applying to the guaranteed loans. The maximum value of investment loans is lei 10 million, while that of working capital loans/credit lines is lei 5 million;

b) one or more working capital loans/credit lines, excluding bank interest, fees and commissions applying to the State guaranteed loans granted to microenterprises or small enterprises, for which the guarantees offered are of up to 90 percent. The maximum value of the working capital loans/credit lines is lei 500,000 for microenterprises and lei 1 million for small enterprises. A beneficiary can cumulate the guarantee facilities under letters a) and b) on condition of complying with the cumulative maximum value of lei 10 million.

The interest on loans/credit lines granted under this programme is capped at the level of 3M ROBOR + fixed margin, i.e. a margin of up to 2.0 percent per annum for investment loans and a margin of up to 2.5 percent per annum for working capital loans/credit lines. Moreover, the Ministry of Finance fully subsidises the interest for a period of 8 months since the loan origination date, as well as the management and risk fees. The validity of the State aid scheme was extended until 30 June 2021 and the grant payment until 30 June 2022. To this end, the change in the State aid scheme was notified to the European Commission, which gave its approval on 23 December 2020. Starting 2021, the "Agro IMM Invest" sub-programme was included in the "IMM Invest Romania" programme with a view to supporting SMEs and small enterprises with medium market capitalisation (called 'small mid-caps') in agriculture, fishery, aquaculture and the food sector, after the EC approved the change in the State aid scheme, enabling grants to be provided under the EC sub-programme. This programme is envisaged to have a guarantee ceiling of lei 15 billion in 2021, out of which lei 1 billion for the "Agro IMM Invest" sub-programme.

Since the programme was implemented, i.e. in May 2020, until 31 December 2020, 25,586 guarantees in amount of lei 11.9 billion were granted.

Support programme for small- and medium-sized enterprises – "IMM Leasing for equipment and machinery"

The programme aims to provide State guarantees, via the Ministry of Finance, for the financial leases intended for the purchase of new and/or used movable assets, as follows: (i) in amount of up to 80 percent of the lease value, excluding interest, commissions and other expenses related to the guaranteed financing, for the purchase of ICT equipment and technology under a financial lease, and (ii) in amount of up to 60 percent of the lease value, excluding interest, commissions and other expenses related to the guaranteed financing, for the purchase of machinery and technological equipment, vehicles for freight and passenger transport used for commercial purposes under a financial lease.

The maximum cumulative value of State guaranteed financing that can be accessed by a beneficiary under this programme is lei 5 million, the maximum duration of the financial lease is 72 months, the interest on the financial lease is subsidised in a proportion of up to 50 percent for a period of 8 months since the loan origination date, while the management and risk fees are fully subsidised over the entire loan duration.

Since the programme was implemented, i.e. in November 2020, until 31 December 2020, two guarantees in amount of lei 175,209 were granted.

"IMM Factor" programme – Commercial credit guarantee product and State aid scheme to support the activity of SMEs associated to the programme (under implementation)

The "IMM Factor" government programme was approved via GEO No. 146/2020. The programme aims to support the access to financing of small- and medium-sized enterprises by granting State guarantees for the short-term loans intended to finance commercial credit. It provides State guarantees in favour of each beneficiary participating in the programme for factoring products with recourse. The financing is granted by lenders, based on invoices, under a renewable financing ceiling, guaranteed by the State via the Ministry of Finance, up to a maximum of 50 percent of the value of the factoring product provided by lenders to the eligible beneficiaries, excluding interest, commissions and other expenses related to the guaranteed factoring, and may be extended a maximum of three times, for periods up to 12 months.

The guarantee ceiling is maximum lei 5 million per beneficiary, and the maximum guarantee for a factoring facility, granted to the beneficiary for an assigned debtor, is maximum lei 750,000. The guarantee ceilings can be supplemented after using at least 80 percent of the ceiling initially allocated to the beneficiary, without exceeding the maximum limit of lei 5 million per beneficiary.

For the factoring facilities, the Ministry of Finance provides a grant that covers the guarantee costs (risk and management fees), in a proportion of 100 percent of the Ministry of Finance's budget, as well as financing costs (interest) of factoring facilities in amount of 50 percent of the State budget, under a State aid scheme. The validity of the State aid scheme was extended until 30 June 2021 and the grant payment until 30 April 2022. To this end, the change in the State aid scheme was notified to the European Commission, which gave its approval on 23 November 2020.

A guarantee ceiling of lei 1 billion is estimated for this programme in 2021.

Programme regarding relief measures for debtors to credit institutions and non-bank financial institutions

The government programme regarding relief measures for certain categories of debtors to credit institutions and non-bank financial institutions, approved by GEO No. 37/2020, as subsequently amended and supplemented, created the possibility for debtors, individuals or legal entities, to apply for an up to 9-month suspension of loan instalments representing payments of principal, interest and fees.

The maximum 9-month period covers both the loan suspension period on the basis of the previous legislative moratorium and the suspension period based on a non-legislative moratorium (deferral of loan instalments decided by banks in a private manner).

Under this programme, the debtors that may benefit from the suspension of the obligation to pay the instalments related to mortgage loans, interest and commissions are individuals whose income has been affected directly or indirectly by the serious situation created by the COVID-19 pandemic, on condition that the debtor submits the application to the creditor no later than 15 March 2021. Subsequently, the lender makes the assessment and issues the decision no later than 31 March 2021.

The beneficiaries of these facilities are debtors who signed agreements for loans that have not reached maturity and have not been called due by the lender by 31 December 2020, and who have no past-due liabilities at the date of application.

Debtors, except for individuals, should declare under penalty of perjury the decrease in income/receipts by at least 25 percent over the past three months before applying for the suspension of payment obligations as compared to the similar period in 2019/2020.

Repayment of deferred interest on the mortgage loans taken by individuals

As concerns the mortgage loans of individuals, the interest applicable in the suspension period is calculated based on the provisions of the loan agreement and is a distinct and independent liability as compared to the other obligations stipulated in the loan agreement.

The debtor will pay in 60 equal monthly instalments the liability representing the total interest applicable in the suspension period set forth in GEO No. 37/2020, starting with the first month after the termination of the suspension period, with no interest charged for this mortgage loan component. The payment of this debt is 100 percent guaranteed by the Romanian government.

Repayment of suspended payment obligations related to loans taken by debtors, except for the mortgage loans of individuals

The interest owed by debtors in the suspension period is capitalised on the existing loan balance at the end of the suspension period, while the principal thus increased is paid in instalments starting with the first month after the termination of the suspension period until the new maturity of the loan or until the initial maturity in the case of loan restructuring.

In the new repayment schedule issued after granting the payment deferral facility, the interest rate will remain unchanged at the level set forth in the initial loan agreement concluded between the debtor and the creditor.

Since the measure has been implemented, i.e. in April 2020, until 31 December 2020, 25 letters of guarantee in amount of lei 261.3 million were issued.

NCMO Recommendation No. R/5/2020

One of the key measures taken in order to strengthen the resilience of the financial system was to suspend financial institutions' dividend distribution. The European authorities, namely the ECB[5], EBA[6], EIOPA[7], supported this position via press statements as early as March 2020. Subsequently, the ESRB decided to join the other authorities by issuing Recommendation ESRB/2020/7 on restriction of distributions during the COVID-19 pandemic in May.

Recommendation ESRB/2020/7 was transposed at national level by NCMO Recommendation No. R/5/2020 concerning the implementation of Recommendation ESRB/2020/7 on restriction of distributions during the COVID-19 pandemic approved by the NCMO's General

[5] Recommendation of the European Central Bank of 27 March 2020 on dividend distributions during the COVID-19 pandemic and repealing Recommendation ECB/2020/1 (OJ C 102 I, 30.3.2020, p. 1).

[6] https://www.eba.europa.eu/eba-provides-additional-clarity-on-measures-mitigate-impact-covid-19-eu-banking-sector

[7] https://www.eiopa.europa.eu/content/eiopa-statement-dividends-distribution-and-variable-remuneration-policies-context-covid-19_en

Board in its meeting of 15 July 2020. Specifically, the NBR and the FSA are recommended, in their capacity as competent authorities, to request financial institutions under their supervisory remit to refrain, at least until the end of 2020, from undertaking any of the following actions that have the effect of reducing the quantity or quality of their own funds: a) make a dividend distribution or give an irrevocable commitment to make a dividend distribution, b) buy-back ordinary shares, and c) create an obligation to pay variable remuneration to a member of a category of staff whose professional activities have a material impact on the financial institution's risk profile.

The European authorities' work on dividend distribution continued with the issuing of Recommendation of the European Systemic Risk Board amending Recommendation ESRB/2020/7 on restriction of distributions during the COVID-19 pandemic (ESRB/2020/15) at end-2020. The new ESRB recommendation extends the deadline whereby financial institutions are requested to refrain from making dividend distributions until 30 September 2021. Another important amendment was to set a conservative threshold. Thus, institutions are given the opportunity to remunerate their shareholders within a prudent limit, set on the basis of clearly-defined principles and through an active dialogue with the supervisory authorities. The General Board of the NCMO decided in its first meeting of 2021 to transpose Recommendation ESRB/2020/15 by issuing NCMO Recommendation No. R/2/2021 for the implementation of Recommendation ESRB/2020/15 amending Recommendation ESRB/2020/7 on restriction of distributions during the COVID-19 pandemic.

1.3. The activity of working groups within the NCMO

1.3.1. Working group on reducing vulnerabilities from the widening of the agri-food trade deficit

The working group rounded off its activity in June 2020 by issuing a recommendation[8]. The working group carried out an analysis on reducing vulnerabilities from the widening of the agri-food trade deficit in macroeconomic, microeconomic and access to finance terms. The analysis shows that the agri-food trade balance has become a potential systemic vulnerability. This is supported by the evidence on the close link between the worsening of the current account deficit and the outbreak of a financial or balance of payments crisis, as well as by the important role of the need to ensure food security in the context of the COVID-19 pandemic. The analysis looks at ten proposals whose implementation is to be monitored in accordance with the provisions of Law No. 12/2017 on the macroprudential

8 In its meeting of 15 July 2020, the NCMO General Board issued NCMO Recommendation No. R/6/2020 on reducing vulnerabilities from the widening of the agri-food trade deficit.

oversight of the national financial system. In addition, it contains other possible measures the authorities are encouraged to implement in various policy documents (e.g. the National Strategic Plan 2021-2027), broken down into seven categories: structural reforms; boosting exports; enhancing value added; innovation; quality; disseminating statistical data; financing. The proposed measures cover topics such as sustainability, digitalisation, improving relevant legislation, promoting local products and quality schemes, as well as support schemes for companies committed to complying with certain conditions, in line with the objectives advanced by the working group (Table 1.1).

Table 1.1. The measures proposed by the NCMO working group on reducing the agri-food trade deficit

Sustainability	• develop and budget, under the next Multiannual Financial Framework, programmes that implement the European Union's Farm to Fork Strategy, also in line with the specific climate risk objectives of the future Common Agricultural Policy; • recommended amount of at least lei 45.5 billion; • the programmes should be developed so as to also facilitate green bond issues by the authorities, banks or other investors.
Digitalisation	• develop and budget, under the next Multiannual Financial Framework, primarily programmes that can use the potential of digital technologies, in compliance with the Declaration of cooperation on "A smart and sustainable digital future for European agriculture and rural areas" to which Romania is a signatory party; • recommended amount of at least lei 2.5 billion.
Legislation	• improve the legislation on certifying and promoting agri-food products through close dialogue with representatives of relevant associations and ensure adequate budgeting for these programmes.
Promoting local products and quality schemes	• the authorities should design and implement, through close dialogue with representatives of relevant associations, a strategy for promoting high-quality food items, also via an increased role of quality schemes. Where the products of the local sector satisfy the quality requirements, the authorities should promote primarily the said goods.
Corporate support schemes	• assign markedly higher scores in any support scheme provided by the authorities (state aid, guarantees from credit guarantee funds, financing through EU funds, promotion of investments, exports, etc.), to firms that: (i) create food chains, (ii) generate local clusters, (iii) produce organic goods, (iv) produce goods listed in Top-10 food imports, (v) are listed among potential national champions, (vi) play an active part in the programmes designed for achieving the objectives in the Declaration on "A smart and sustainable digital future for European agriculture and rural areas" or those adopting digital technologies on a large scale, or that (vii) play an active role in the programmes designed for achieving the objectives of the European Union's Farm to Fork Strategy or which help fulfil the climate change agenda in the agricultural sector.

1.3.2. Working group on identifying solutions to support green finance

Considering the importance of climate risk for several sectors of the financial system, the NCMO General Board decided, during its meeting of 14 October 2020, to set up a working group on green finance, consisting of representatives appointed by the Presidential Administration, line ministries, other public authorities (NBR, FSA), credit institutions and international donors (EBRD, EIB), but also representatives of the private sector, which makes it necessary to involve all the authorities with financial responsibilities, under the coordination of the NCMO, in order to establish clear lines of actions.

The mandate of the working group is to identify climate-sustainable financial solutions to mitigate the negative effects of (physical and transition) climate risk on the real sector and the financial system, and to identify and capitalise on the opportunities arising from the transition to an environmentally sustainable economy. The solutions shall be compliant with country-level objectives as well as with the principles of the new European agenda.

The activity of the NCMO working group will be presented in a report comprising possible proposals for recommendations to: (i) the Government, if issues falling within the institution's area of expertise are identified (examples may include the operationalisation of the framework for green financial instruments, the revision of firms' reports by incorporating information on their sustainable activities or other measures to reduce data gaps); (ii) the National Bank of Romania and the Financial Supervisory Authority, where identifying structural disruptions of the credit market and the financial markets or other obstacles that have added to the aforementioned vulnerability and fall within their competence.

The first meeting of the Working Group took place on 27 November 2020, the consultations covering the perspective on the topic under discussion of public authorities, the private sector and lenders. A decision was adopted to set up six working subgroups, in line with the proposed structure of the *Report* to be drawn up, specifically: (i) International and European context of green finance; (ii) Implications for the Romanian economy and financial system; (iii) Identification of projects to create and develop the green finance market; (iv) Taxonomy, transparency and non-financial reporting; (v) Green finance via the local banking sector; (vi) Green finance via the local capital market. The *Report* will include also a table with proposals for policy solutions or recommendations. The working group continued to meet throughout December as well.

In order to fill the gaps in the data necessary for its analyses, the NBR submitted a request for available information on green finance to 15 credit institutions. In addition, the NBR sent a questionnaire to banks to assess their potential of investing in green government securities.

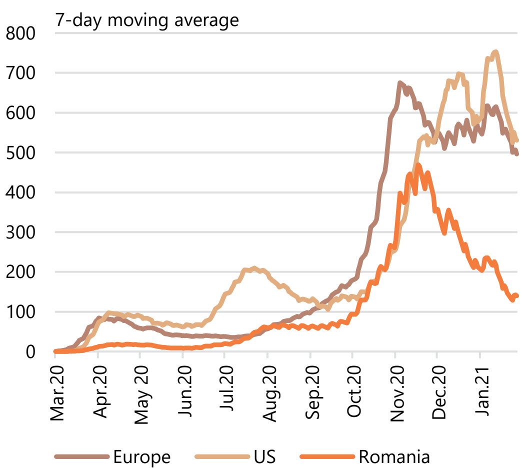
In the same context, the FSA circulated a questionnaire on green finance to insurance companies, private pension fund managers and investment fund managers, whose centralised results are to be discussed and analysed in the chapter entitled "Green finance via the local capital market" of this *Report*.

2. Overview of the main risks and vulnerabilities to financial stability

2.1. Assessment of risks and vulnerabilities at global level

The year 2020 was marked by the advent of the COVID-19 pandemic[9] (Chart 2.1), which changed markedly the short-term risks to financial stability and heightened some of the vulnerabilities in the global economy. The direct effects of the pandemic and the measures taken to contain the spread of the illness led to a severe retrenchment in economic activity (Chart 2.2), a significant increase in uncertainty, supply-chain disruptions, the contraction of trade and sizeable adjustments in risky asset prices. To counter these effects, the authorities intervened with broad-based measures in terms of both purpose and size. The introduction of vaccines fuelled expectations of economic recovery at global level, sending the prices of risky assets higher, despite uncertainties associated with the latest waves of infection. Nonetheless, the uneven distribution of vaccines may exacerbate financial vulnerabilities in border markets in particular.

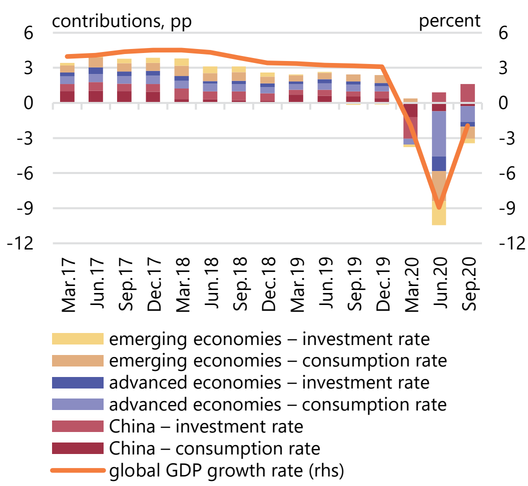
Chart 2.1. The number of new SARS-CoV-2* infections



*) the number of new cases per 1 million persons

Source: Refinitiv Datastream, Fathom Consulting

Chart 2.2. Global economic growth and contributions from consumption and investment

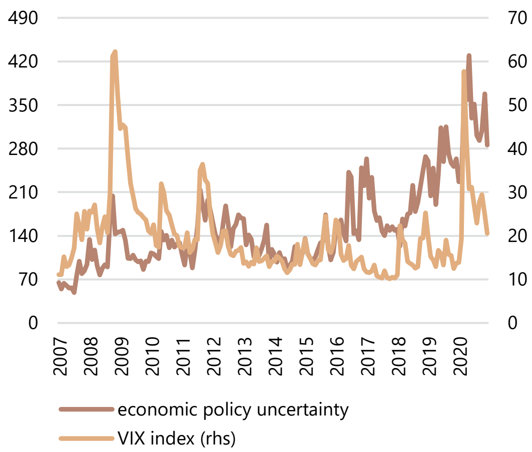


Source: International Monetary Fund, *World Economic Outlook Update*, January 2021

9 The first cases of SARS-CoV-2 infection were reported on 31 December 2019 in Wuhan, China, with the first confirmed cases in Europe emerging in less than a month (24 January 2020 in France). The World Health Organization declared the COVID-19 pandemic on 11 March 2020. The total number of infections worldwide in 2020 surpassed 83 million, of whom 2.2 percent died. In Romania, the first case was confirmed on 26 February 2020 and 632,263 infections were confirmed by the end of the year, with 89 percent of the patients being cured and 2.5 percent being deaths. Mass vaccination started globally in December 2020, with Romania counting among these countries.

The global economy contracted by 3.5 percent in 2020, while international trade shed 9.6 percent, according to IMF estimates[10]. Significant uncertainties still linger over the period ahead. The global economy is expected to resume growth, yet the recovery to the pre-pandemic level will be a lasting process (5.5 percent and 4.2 percent in 2021 and 2022 respectively). Moreover, international trade is foreseen to recover in the coming years and post sustained growth rates (8.1 percent in 2021 and 6.3 percent in 2022). In Europe, the economic contraction was pronounced (-6.3 percent in 2020[11]), with notable diverging developments across countries. For 2021, estimates show a rate of increase of 3.7 percent. These forecasts are riddled with elevated uncertainty.

Chart 2.3. Risk aversion indicators and economic policy uncertainty



Source: Refinitiv Datastream, Baker, S.R., Bloom, N. and Davis, S.J., „Measuring Economic Policy Uncertainty", *The Quarterly Journal of Economics*, 131(4), 2016, pp. 1593-1636

Financial markets experienced major adjustments in risky asset prices and significant bouts of volatility in the period immediately after the declaration of the COVID-19 pandemic (Chart 2.3). The severity of the illness and the greater-than-expected magnitude of the pandemic led to massive sales in financial markets, with investors turning to low-risk assets. The extraordinary measures implemented by the states helped limit these risks. Thus, after the measures were announced, financial market developments normalised, the losses being mostly recovered by the end of the year. Volatility in financial markets returned to values closer to those seen before the medical crisis (e.g. the VIX fell to nearly 20 percent in the second part of 2020, after having exceeded 80 percent in March 2020).

The measures to support the economy were exceptional, covering the entire range of policies. Fiscal measures were in the form of transfers and funding granted to the affected sectors and vulnerable groups, as well as of guarantees and moratoria on delays in the repayment of credit obligations. The budgetary effort was substantial (the value of these measures at global level is estimated at USD 14,000 billion, according to the IMF). Public debt was assessed at 98 percent of GDP at end-2020 (+16 percentage points compared to the 2020 forecast released in 2019)[12], while the general government deficit was estimated at -13 percent in advanced economies and -10 percent in emerging economies.

At European level, the European Commission launched several economic support programmes such as SURE (to preserve the number of employees in the economy, up to EUR 100 billion) and Next Generation EU (EUR 750 billion). In addition, Member States were

10 IMF, *World Economic Outlook Update*, January 2021.

11 European Commission, *Winter 2021 Economic Forecast*, February 2021.

12 IMF, *Fiscal Monitor Update*, January 2021.

able to access funding under the 2021-2027 Multiannual Financial Framework (in amount of EUR 1,074.3 billion), which, alongside economic recovery measures, also includes projects aimed at achieving a sustainable growth pattern such as environment protection and digital integration. Romania benefits from large amounts from the European Commission-financed programmes, as follows: EUR 46.3 billion under the 2021-2027 Multiannual Financial Framework, EUR 33.5 billion available under the Next Generation EU (70 percent of these funds being allocated for the 2021-2022 period) and EUR 4.1 billion under SURE.

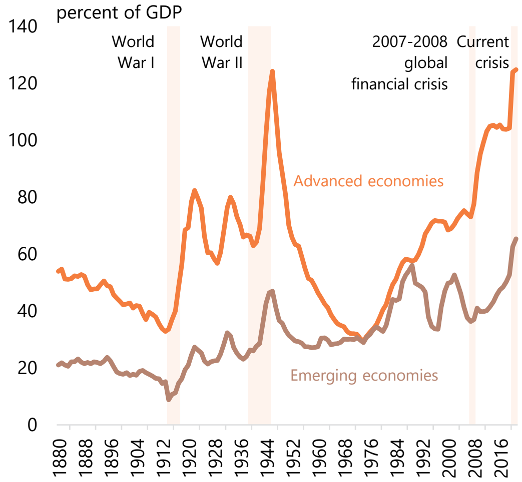
On the monetary front, central banks also intervened with exceptional measures such as asset purchase programmes, credit lines to keep in place USD- and EUR-denominated funding, as well as policy rate cuts. With a view to supporting lending to the economy and reducing liquidity-induced pressures on Europe's banking sector, the European Central Bank (ECB) launched a Pandemic Emergency Purchase Programme (PEPP) with a total envelope of EUR 1,850 billion. By the end of 2020, the ECB had used more than EUR 750 billion of PEPP. Another ECB tool widely used by European banks during this period concerned the targeted longer-term refinancing operations (TLTROs), the conditions for this type of credit being eased early in 2020. The ECB also made available EUR-denominated financing lines in the form of swap and repo operations. Romania is one of the countries benefiting from these funds, with the highest amount of borrowings being set at EUR 4.5 billion.

Significant changes were also made to the regulatory and supervisory framework. At European level, the European Commission adopted two packages of measures on the regulatory and supervisory framework for the banking sector and capital markets in April and July 2020. Some countries also used macroprudential instruments to support banking sectors, such as the reduction of countercyclical capital buffers (France, Ireland, Lithuania) or systemic risk buffers (Estonia, Finland, the Netherlands), changes to the buffer for other systemically important institutions (the Netherlands, Finland, Croatia) or the adjustment of risk weightings (Finland). The European banking sector showed a good capacity to withstand such a crisis, and the steps taken at micro- and macroprudential level improved the loss absorption capacity, the additional capital buffers rising from 2.8 percent to 5.3 percent in 2020 Q3.

Accommodative and economic support policies cushioned liquidity pressures and temporarily contained the solvency risk. The countries' capacity to continue the budgetary effort in 2021 as well will be conditional on their access to finance. The persistence of large public deficits and the risk of public debt downgrading can lead to negative adjustments in investor confidence and hence higher risk premiums. Against this backdrop, the countries with the hardest financial constraints are expected to take broader fiscal adjustment measures over the medium term. The too early exit from the fiscal policy package may lead to swift increases in the number of bankruptcies, disruptions in production chains and market functioning. Conversely, the permanent effects of the pandemic on business models may result in a spurt of "zombie" firms (for further details, see Box B). It is therefore necessary to coordinate the withdrawal of measures so that they are gradually achieved, with a minimal impact on the economy.

In case of a slow-paced economic recovery, the liquidity squeeze may fuel the risk of insolvency, as small- and medium-sized enterprises are more vulnerable than large companies with access to capital markets. Overall, the global banking sector is well capitalised, yet some banking markets could face difficulties in this respect, the implemented government policies notwithstanding[13]. Furthermore, funding-related challenges could arise in emerging or border economies, which could be reflected in debt escalation and financial instability, calling for official support.

Chart 2.4. Public sector debt



Source: International Monetary Fund, *Fiscal Monitor*, October 2020

The key vulnerabilities (exacerbated by the medical crisis) that will persist into the period ahead are: (i) the high level of indebtedness, especially in the public sector (Chart 2.4), (ii) pressures on credit institutions' solvency and liquidity, given the prospects for profitability and asset quality, (iii) closer interdependencies between public and banking sectors, (iv) lack of clear-cut policies to support inclusive and sustainable economic growth; and (v) the slow-paced digitalisation, including in the financial sector. The calibration of policies for the period ahead will have to consider these vulnerabilities that contain their room for manoeuvre.

Box B. Potential measures for a post-pandemic scenario envisaging a rise in insolvencies

The COVID-19 pandemic wave will leave many firms highly indebted – this is the assumption used by the authors of the paper *Preparing for the post-pandemic rise in corporate insolvencies*[14], members of the Advisory Scientific Committee of the ESRB. Moreover, a large number of firms are faced with completely rethinking their business models, following the permanent changes triggered or at least accelerated by the outbreak of the most serious sanitary crisis in recent history.

Post-pandemic recovery will be marked by the challenge to distinguish efficiently and promptly between viable firms, whose business models remain valid and whose assets and organisation require no significant structural changes, and firms whose liquidation could essentially free up assets from obsolete undertaking, for a more efficient allocation subsequently.

13 IMF, *World Economic Outlook*, October 2020.

14 https://www.esrb.europa.eu/pub/asc/insights/shared/pdf/esrb.ascinsight212101_2~534e2c6120.en.pdf

The literature coined the term "zombie" firms for those in the latter category, referring to their ambivalent nature: although they have serious issues regarding profitability and adaptability to the new requirements of the economic environment, they do not cease to exist.

The faster increase in the number of so-called corporate "zombies", characterised by the persistent inability to service their debt from the resulting profit, does not, however, correspond to the worsening and prolonging of the COVID-19 pandemic; the current health problem is more likely a catalyst of an issue that had already been present before 2020. The 2007-2009 post-crisis period was a breeding ground for "zombie firms", the results of the negative externalities of a long period of historically low interest rates and an easing of lending conditions.

By definition, "zombie" firms are less productive, and the suboptimal allocation of assets leads to an opportunity cost for the whole economy, while a part of the financing potential or talent that might be attracted by viable firms is shared with the "zombie" firms that cannot capitalise on them at the same level as the former.

The authors suggest differentiating by size the insolvency procedures companies should comply with. SMEs are impacted more strongly by the pandemic wave compared to large companies not only in terms of fewer opportunities to attract capital and undergo restructuring, but also due to the fact that restrictions hit the very core of their business models. Small- and medium-sized enterprises have a smaller area of service, their business models are built around a local specificity, proximity and face-to-face interaction with customers being *sine qua non* characteristics for the economic success of such enterprises. The same asymmetric nature of the shock and heterogeneity of credit risk are also present in the sectors in which companies operate, the most affected being those whose activity is strictly dependent on interaction or mobility (restaurants, transportation, hotels, artistic activities, etc.). Even among large companies, whose shares are traded on capital markets, there is an asymmetry of pandemic effects. The authors highlight that although return on equity at European level remained positive in 2020 H1 (over 2 percent) for half of the companies listed, the difference between the first and third quartile of company distribution widened, showing that bottom-ranked firms were much more affected than top-ranked firms.

Given this heterogeneous environment, the authors point out the importance of an approach focused on targeted interventions, depending on the specifics and potential of each business model to remain viable in a post-pandemic world. Solving restructuring or liquidation problems within a reasonable time frame will have beneficial effects on the economy. What should be avoided during this process is the congestion of the insolvency system, which is often represented by the crowding of the courts for example, or the emergence of labour market shocks and of asset reallocation following sudden changes, thus risking, in this case, the incidence of fire sales externalities.

2.2. Main challenges at national level

The major systemic risks to financial stability in Romania at end-2020 were as follows: (i) worsening of domestic macroeconomic equilibria, also a result of the COVID-19 pandemic (severe), (ii) default risk for loans to the private sector (high), (iii) lingering global uncertainty amid the COVID-19 pandemic (high), and (iv) access to finance of the real economy (moderate). Some of these risks declined in strength during 2020. Specifically, the risk associated with the rise in global uncertainty and the fast deterioration in investor sentiment towards emerging economies was downgraded from severe to high. The outlook for risks was maintained on the upside as regards the risk of worsening of macroeconomic equilibria and the default risk for loans to the private sector, while for the other two risks the outlook was changed to stable for the next period.

Similarly to the developments seen globally, economic activity in Romania was affected by the COVID-19 pandemic. Supply-side shocks were felt acutely during the state of emergency (15 March – 15 May 2020) following the introduction of restrictive measures. They were corroborated with demand-side shocks, amid flagging consumer confidence and mounting uncertainty about economic developments. Unlike consumption, gross capital formation was less affected (Chart 2.5); the unfavourable developments in this case were offset by investment in ICT equipment, purchases of transport equipment (due to the adjustment to new working conditions), but also by the sustained activity in construction (the volume of works stood 15.9 percent higher in 2020). The second wave of the pandemic (emerged at end-October 2020) was no longer accompanied by severe containment measures, which allowed a further rebound in economic activity in both third and fourth quarters of 2020. Thus, part of the severe second-quarter adjustment (down 12.2 percent in quarterly terms) was recovered in the following quarters (up 5.8 percent and 5.3 percent in 2020 Q3 and Q4 respectively). Romania's economy contracted by 3.9 percent in 2020. For 2021, forecasts show a growth rate of 3.8 percent[15], but uncertainty over future developments still lingers.

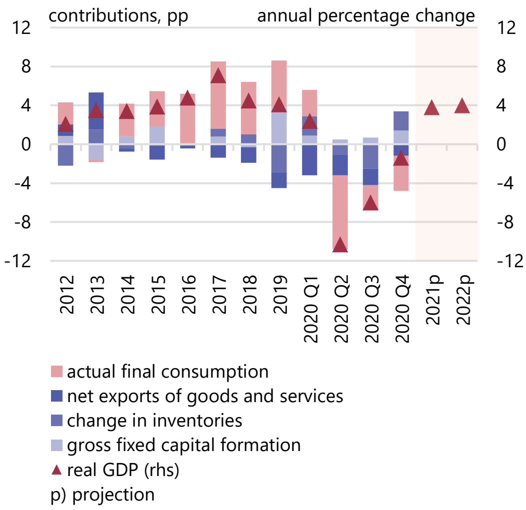
The contraction in economic activity also affected the labour market, albeit to a lower extent, due to the government programmes implemented with EU support (SURE programme) aimed at preserving the existing jobs. Unemployment rate stood at 4.9 percent[16] at end-2020, after peaking at 5.5 percent in July.

Sizeable effects were also felt on the trade balance. The containment measures taken by Romania's trading partners as well as domestically drove exports sharply lower, especially in 2020 Q2. The impact on imports was more limited, with the reduction in domestic demand for certain products being offset during this period by the stronger demand for essential goods. Thus, exports of goods fell by 9 percent in 2020, while imports were down 6.6 percent. Against this backdrop, the trade deficit widened in 2020 to EUR 18.8 billion

[15] European Commission, *Winter 2021 Economic Forecast*, February 2021.

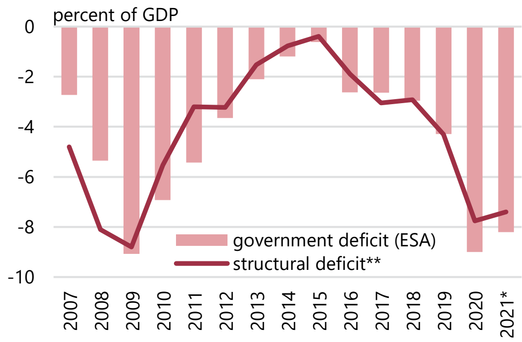
[16] Unemployment rate calculated in accordance with ILO standards.

Chart 2.5. GDP growth and its determinants



Source: NIS, European Commission, *Winter 2021 Economic Forecast*, February 2021

Chart 2.6. Government deficit and structural deficit



*) forecasted values

**) the structural deficit is the general government deficit adjusted for the cyclical component, net of one-off and other temporary measures, calculated as a percentage of nominal potential GDP, i.e. the highest economic output that does not create inflationary pressures

Source: MF, European Commission

(up 7.8 percent from 2019). The less favourable developments on the goods segment were countered by the performance in the services sector, which rang up a surplus of EUR 9.6 billion in 2020 (up 11.3 percent against 2019).

Behind the limited current account widening stood also the positive dynamics of direct investment income (lower dividend payments) and an improved absorption rate of EU funds[17].

Government measures implemented with a view to supporting economic activity, additional investment needed to manage the medical crisis and the increase in social transfers (also a result of higher pensions and child benefits) translated into a considerable budgetary effort, with public expenditure rising by approximately lei 55 billion in 2020, of which about lei 8 billion for preserving the existing jobs. The budgetary effort of 2020 was made at a time when Romania already had limited fiscal space.

In view of the pro-cyclical fiscal policy, Romania has recorded a significant deviation from the medium-term objective (MTO) since 2016, and the European Commission opened the excessive deficit procedure (EDP) in March 2020, as Romania's government deficit equalled 4.4 percent in 2019. Given that Romania is under the corrective arm of the SGP, the general escape clause activated by the European Commission allows it a different treatment for the expenses generated by the COVID-19 pandemic. In 2020, the pandemic-related support measures had a budget impact of 3.65 percent of GDP and the government deficit in ESA terms is estimated at about 9 percent of GDP (9.8 percent of GDP in cash terms), while the structural deficit ran at 7.76 percent of GDP. The support measures will continue in 2021, their estimated impact amounting to 1.29 percent of GDP, according to the draft budget.

[17] For the programmes allocated in the period from 2014 to 2020 and financed from the European structural and investment funds (ESIF), the Fund for European Aid to the Most Deprived (FEAD) and payments made from the European Agricultural Guarantee Fund (EAGF), the absorption rate added 15 percentage points to 57 percent in 2020.

In 2021, Romania will embark on a fiscal adjustment path, the ESA-defined government deficit being projected at 8.2 percent of GDP (7.42 percent of GDP in structural terms). The gap looks set to narrow gradually by 2024, when it is seen reverting below the 3 percent threshold established by the SGP. Fiscal consolidation efforts may adversely affect economic recovery after the medical crisis is over, but Romania may attract sizeable funds under the Recovery and Resilience Facility and the new multiannual financial framework.

In terms of (gross) government debt, it came in at 35.3 percent of GDP at end-2019, well below the 60 percent ceiling set by the Maastricht Treaty. However, amid the widening fiscal deficit, government debt climbed to 47.7 percent of GDP at end-2020 (domestic and external debt hold roughly equal shares in GDP, i.e. 23.4 percent and 24.3 percent respectively). According to the medium-term 2021 draft budget report (2021-2024), amid fiscal consolidation, gross government debt based on EU methodology is to be maintained at a sustainable level, namely below 55 percent of GDP. Nonetheless, external debt expanded significantly, which, under certain conditions, could pose a risk to financial stability.

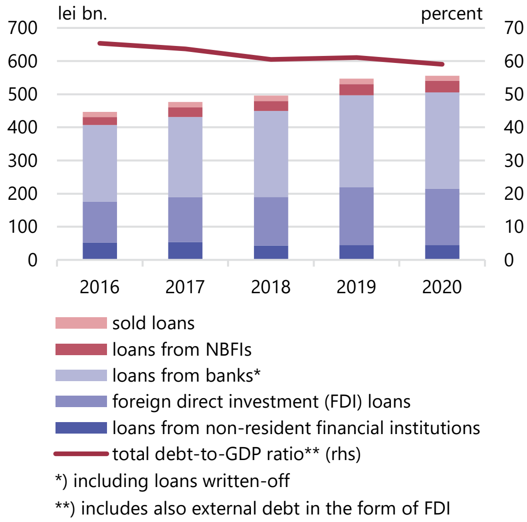
Financing of public expenditure needed in the new context from foreign financial resources entailed a notable rise in the external debt stock, which reached EUR 120 billion in November 2020 (up 9 percent against end-2019), the highest increases being recorded by public and publicly guaranteed debt (up 31 percent) and medium- and long-term debt (up 15 percent).

The economy's access to financing was supported by government programmes ("IMM Invest Romania", "IMM Leasing" and "IMM Factor"), but also by the NBR's monetary policy measures and liquidity-providing operations. During 2020, the NBR Board decided to cut the policy rate from 2.5 percent to 1.5 percent (in March, July and August) and by another 0.25 percentage points in January 2021, as well as to cut the minimum reserve requirement ratio on foreign currency-denominated liabilities of credit institutions to 5 percent from 6 percent (in November 2020). In order to narrow the liquidity deficit, the NBR conducted repo operations and purchased government securities, with asset purchases surpassing lei 5 billion. Moreover, the central bank adopted measures to make the regulatory and supervisory framework for financial institutions more flexible so as to ensure the ongoing financing of the real sector while retaining an appropriate level of prudence, similarly to the measures adopted across Europe.

Total financial debt of the private sector[18] came in at lei 385 billion in December 2020, accounting for 41 percent of GDP. When adding loans taken from non-resident companies in the same group (foreign direct investment – FDI) to the debt stock, total debt of the non-financial sector amounts to lei 555.7 billion, or 59 percent of GDP (Chart 2.7). Comparatively, private sector credit in banks' balance sheets made up 26 percent of GDP at end-2020.

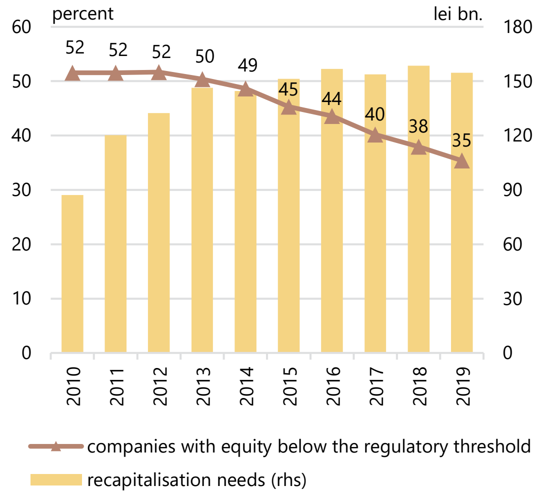
[18] Calculated as the sum of loans granted by resident or non-resident banks and NBFIs, loans written off and loans sold by banks to residents.

Chart 2.7. Private sector debt



Source: NIS, NBR, NBR calculations

Chart 2.8. Share of companies with capital shortfalls and capitalisation needs



Source: MF, NBR calculations

The non-performing loan ratio moved within a narrow range after the outbreak of the COVID-19 pandemic, peaking at 4.4 percent in June 2020 (up 0.3 percentage points from December 2019), as the measures to support borrowers alleviated temporarily the pressures from loan quality deterioration. Subsequently, it resumed a downward path, reaching 3.9 percent at end-2020.

For the period ahead, the default risk for the loan portfolio remains elevated. On the one hand, the end of the moratorium period may enhance credit risk given the heavy resort to these facilities (550,000 borrowers whose loans amount to lei 41.4 billion, i.e. approximately 14 percent of the total credit, December 2020). With a view to precluding sudden increases in non-performing exposures, creditors should assess the debt servicing capacity of borrowers at the end of the moratorium period and lend them support (for instance, by consolidating, restructuring or rescheduling loans). Debtors (individuals) with high levels of indebtedness, i.e. over 50 percent in terms of the debt service-to-income (DSTI) ratio, accounted for 27 percent and 38 percent respectively of the number of consumer loans and housing loans for which the suspension of instalments was requested.

On the other hand, the existing structural vulnerabilities associated with the non-financial corporations sector may put additional upward pressure on credit risk and insolvencies after the exit from measures to support the economy. Companies facing a higher solvency risk hold a sizeable share in both the sector's activity (38.5 percent of turnover and 40.4 percent of the number of employees) and credit institutions' exposures (55.9 percent of the loan portfolio). Even before the pandemic struck, non-financial corporations faced significant deficiencies in terms of capitalisation and payment discipline. At end-2019, 35.4 percent of non-financial corporations posted equity below the regulatory threshold (244,100 companies), the capitalisation need being estimated at lei 154.6 billion (Chart 2.8). These companies may exert notable effects on the economy and the banking sector and contribute to maintaining weak payment discipline in the economy. They hold 14 percent of total assets economy-wide, 12 percent of the loans granted by credit institutions to non-financial corporations, and hire 15 percent of the staff in the non-financial corporations sector. Moreover, the undercapitalised companies account for half of the overdue payments to trading partners (lei 24.9 billion), 80 percent of the overdue payments to the government budget (lei 12.6 billion, December 2019) and approximately 55 percent of the volume of bank loans more than 90 days past due (September 2020).

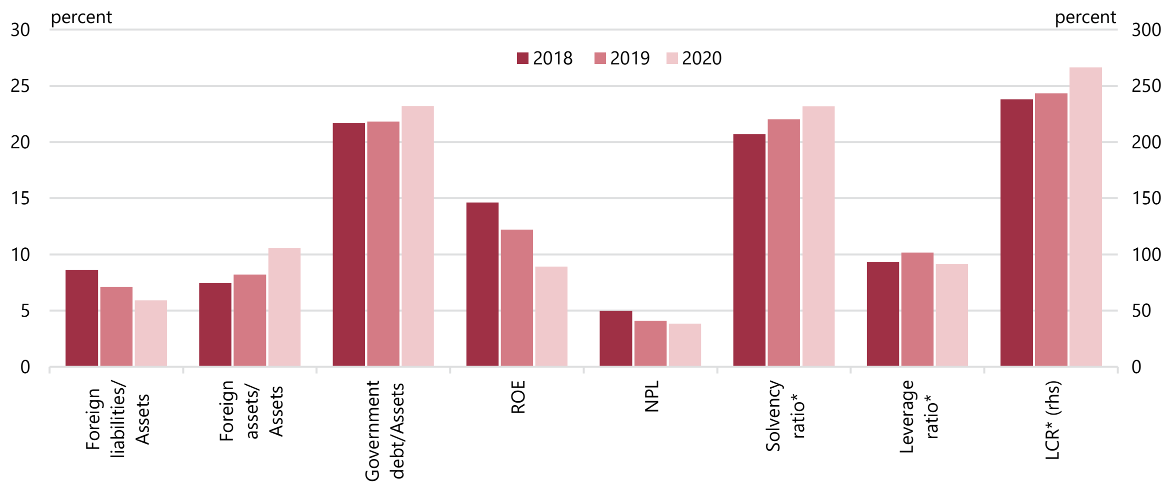
The difficulties posed by the COVID-19 pandemic may amplify these vulnerabilities, the same as in the previous crisis, but at the same time they may provide an opportunity for implementing structural reforms that can fundamentally change Romania's growth pattern via an improved harmonisation with the EU agenda, focusing on the companies active in sectors that can consolidate these changes. The consequences of climate change and the efforts undertaken at European and international level to shift to a green economy will play a growing role in the economy.

2.2.1. Banking sector

Prudential and financial indicators for the banking sector strengthened over the past years, and after the outbreak of the COVID-19 pandemic further posted adequate levels, ensuring a good absorption capacity of potential shocks (Chart 2.9).

The measures taken by the NBR, in line with the EBA and ESRB guidelines and recommendations, as well as the package of measures adopted by public authorities to support the economy in the context of the sanitary crisis stimulated further lending and allowed the deferred payment of loans for debtors affected by the pandemic. The banking sector maintained its capacity to withstand the main risks arising from highly severe macroeconomic developments, as shown by the latest results of solvency and liquidity stress tests.

Chart 2.9. Banking sector indicators



*) 2020 prudential data (before the auditing of reports) relative to credit institutions, Romanian legal entities

Source: NBR

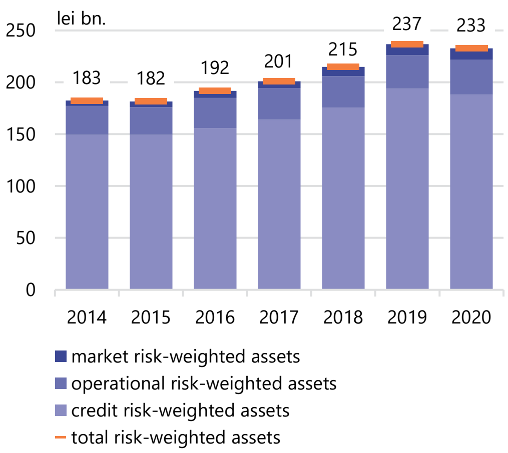
Assets posted a substantial annual growth in 2020, i.e. 13.8 percent (lei 73 billion). These dynamics were sustained by deposits raised from households and non-financial corporations, with increases being reported by deposits in both lei and foreign currency, following the depositors' stronger tendency to save during the pandemic. The debt-to-equity ratio (8.1) remained within a prudent range, according to the criteria established by the EBA. However, the declining loan-to-deposit ratio (67.1 percent, December 2020) gives further concerns about the marked underutilisation of funds raised by credit institutions from the economy, thus causing the persistence of the lowest level of financial intermediation in the EU. Banks focused more on increasing exposures to the public sector and the external market (Chart 2.9), amid fewer investment opportunities generated by the sanitary crisis and the policy to decrease foreign currency lending promoted in recent years. Lending was more substantial for non-financial corporations, being driven by the "IMM Invest Romania" programme, as well as for the housing component in the case of households.

Bank capitalisation remained adequate, the total capital ratio standing at 23.2 percent at end-2020, up by more than 1 percentage point compared to end-2019 (Chart 2.9). This level of solvency, as well as the prevalence of Common Equity Tier 1 capital (over 90 percent) ensures, at least in the short and medium term, a good capacity of the Romanian banking sector to cope with challenges posed by the pandemic-hit economic environment.

This paves the way for the banking sector's active participation in finding solutions for the management of the current economic crisis, via the possible channelling of necessary resources towards the financing of the real and government sectors, amid the maintenance of a sufficiently high level of capital to absorb potential losses and contribute to preserving the confidence in the banking sector.

The effects of the sanitary crisis translated into a drop in risk-weighted assets (Chart 2.10), after a sustained growth over the past 5 years. This evolution was triggered by a significant decline in risk appetite, due not only to the uncertainty surrounding the macroeconomic environment, but also to the adjustment of eligible demand, and occurred on account of credit institutions' shift in focus towards lower risk-asset classes (especially exposures to central government and housing loan exposures).

Chart 2.10. Risk-weighted assets



Note: According to preliminary reports, prior to the decisions on the profit distribution taken in the general assemblies of shareholders.

Source: NBR

At the onset of the sanitary crisis, the NBR, as well as several international regulatory authorities (ECB, IMF, ESRB) made efforts to preserve and increase the capital of credit institutions by recommending to refrain from making a dividend distribution or undertaking other similar actions. In the case of the Romanian banking sector, these actions, taken both at the recommendation of the authorities and in a proactive manner by credit institutions, led to an approximately 2 percentage point rise in total capital ratio (from 20 percent to 22 percent, following the decisions of the general assemblies of shareholders in the first part of 2020). At the same time, the NBR decided at end-March 2020 to allow banks to temporarily use the previously built capital buffers, while also keeping in place the legal requirements for such flexibilities. Adapting capital buffers to the new conditions means releasing approximately lei 10 billion of own funds, thus helping banks preserve their support role for the real economy.

The leverage ratio of the Romanian banking sector, calculated based on the full definition, has average values considerably above the 3 percent minimum requirement (9.1 percent, September 2020, Chart 2.9), which reinforces the idea of a good capacity to increase financial intermediation in the future.

Looking at liquidity, the shock generated by the COVID-19 pandemic did not produce major imbalances at the level of the banking sector, in the context of recent developments in the balance sheet structure favouring risk management, and of the measures initiated by the NBR. The high uncertainty at the onset of the pandemic crisis resulted in a step-up in customers' cash withdrawals from credit institutions in March 2020, the volatility of financing sources remaining within normal limits subsequently. Thus, not only did the funding risk not materialise, but there was also a consolidation of deposits from the real sector. The negative effects on the liquidity of credit institutions, manifest since the outbreak of the pandemic and then as a result of the public moratorium and the broad contraction of economic activity, were mitigated by the NBR's actions to sustain an adequate level of liquidity, such as: (i) the gradual lowering of the monetary policy rate (from the pre-pandemic level of 2.5 percent to 1.5 percent at end-2020), (ii) bilateral repo operations (at the request of credit institutions) and (iii) purchases of leu-denominated government securities on the secondary market. In order to cover the potential financing requirements in euro, the ECB and the NBR agreed to set up an arrangement for the contingent provision of euro liquidity via a repo line[19]. The NBR also deemed it appropriate to render prudential regulations more flexible (until a date to be subsequently communicated) regarding the liquidity coverage ratio (LCR) requirements.

The key liquidity indicators remained above the minimum required levels and the European averages, witnessing an improvement after March 2020. The liquidity coverage ratio rose from 245 percent in March 2020 to 266 percent at end-2020 (Chart 2.9). Compared to end-2019, the ratio went up by more than 20 percentage points, on account of a stronger increase in the liquidity reserve as compared to the dynamics of net cash outflows taken into consideration when calculating the LCR. The results of the latest stress tests

[19] It was initially agreed that the repo line would remain in place until 31 December 2020; the agreement was subsequently extended twice – until end-June 2021 and until March-2022 respectively. Under the repo line, the BNR will be able to borrow up to EUR 4.5 billion from the ECB in exchange for eligible collateral.

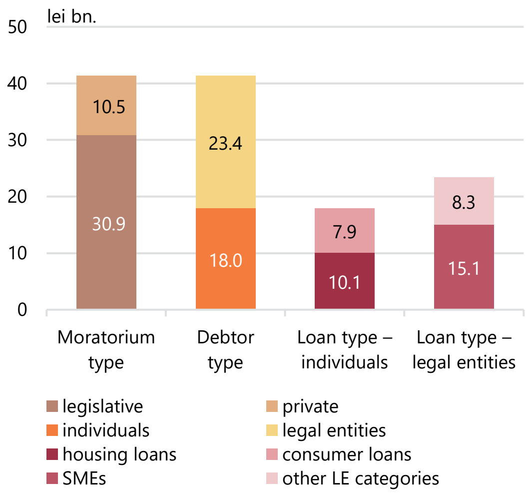
carried out (December 2020) confirm the good capacity of the banking sector to withstand unfavourable liquidity developments. A comparison to the results obtained after the onset of the pandemic crisis (June 2020) shows positive developments in the results of short-term liquidity stress tests, while the number of affected banks (generally small banks) remains low, with no potential systemic impact.

The special context of 2020, influenced by the sanitary crisis, as well as the structural characteristics of the banking sector may generate a series of risks and challenges: (1) an increase in credit risk in the coming period, amid the significant uncertainties surrounding the economy's speed of recovery; (2) the low operational efficiency of some banks, associated with the smaller size of bank assets in relation to capital, due to weak financial intermediation and polarised profitability by market share; (3) the high share of exposures to the government sector, enhancing the concentration risk.

1. The uncertainties surrounding the economy's speed of recovery, amid the COVID-19 pandemic, translate into expectations on the deterioration of households and non-financial corporations' probability of default, leading to a rise in new non-performing loans. The gradual removal of protective measures to alleviate the pandemic effects in 2021 (public and private moratoria establishing temporary loan repayment delays) fuels these expectations, given that, in accordance with the EBA Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis (EBA/GL/2020/02), resorting to the facilities granted via the moratoria, for an overall length of 9 months, does not automatically classify the relevant exposures in the restructured or non-performing loan category. The legislative moratoria resulted in limiting the deterioration of the quality of the portfolio of loans granted to the real sector in the period elapsed from the onset of the pandemic.

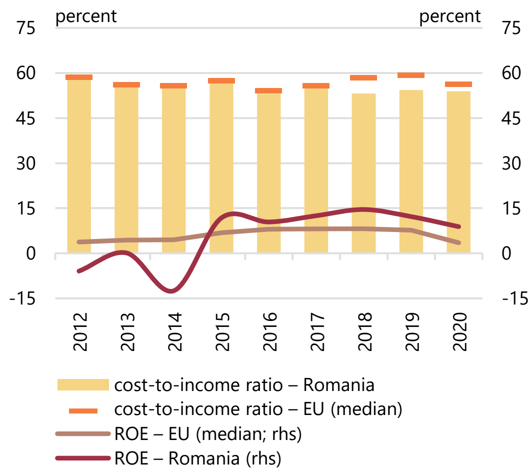
   The challenges of the new economic context were reflected in the slacker downward trend of the non-performing and restructured loan ratios. However, the dynamics were favoured by the furthering of the balance-sheet clean-up, which resumed starting with 2020 Q3, and by the positive growth of lending. Non-performing asset indicators place the banking sector into the EBA-defined intermediate risk bucket (non-performing loan ratio of 3.8 percent and restructured loan ratio of 2.4 percent respectively, December 2020, Chart 2.9). One good aspect is the improved NPL coverage by provisions (63.3 percent, December 2020), which stands in the lowest risk bucket according to the EBA and is higher than the EU average (45.5 percent). The share in total of loan loss provisions for assets classified in stage 2 of impairment (whose credit risk has significantly increased since the initial recognition in the balance sheet) widened considerably following the outbreak of the pandemic, i.e. up to 27.7 percent in September 2020, consistent with the worsening expectations on the macroeconomic framework, while also reflecting banks' proactive stance.

Chart 2.11. Composition of deferred loans (31 December 2020)



Source: NBR

Chart 2.12. Efficiency and profitability indicators in Romania and the EU



Source: NBR (individual data), ECB (consolidated data; EU data for 2020 include only the first three quarters of the year)

The total balance of deferred loans in the context of the COVID-19 pandemic was lei 41.4 billion, i.e. 14 percent[20] of total financing from the banking sector (December 2020). Up until then, the initial period for deferring loan repayments had expired for approximately 94 percent of the volume of loans subject to moratoria. The breakdown of deferred loans (Chart 2.11) shows that over 75 percent of loans were subject to the legislative moratorium (GEO No. 37/2020) and only a quarter were subject to private moratoria set up at individual level by credit institutions. Legal entities resorted to such facilities to a higher extent compared to individuals, the main beneficiaries being small- and medium-sized enterprises. Depending on the share of deferred loans by business sector, the most affected sectors were manufacturing, real estate activities, and wholesale and retail trade. Accommodation and restaurants, construction, and transport and storage activities were impacted to a lesser extent.

In the absence of measures such as moratoria, according to stress test estimates (baseline scenario), the NPL ratio for just the exposures to the real sector would have been 3.2 percentage point higher at end-2020 than the actual level recorded in December 2020.

2. A recurring vulnerability of the national banking sector is the positioning of operational efficiency, measured by the cost-to-income ratio, in the medium risk bucket according to the EBA's prudential limits of 50-60 percent, yet below the EU median (Chart 2.12). Operational efficiency is impacted negatively by the small size of bank assets, being correlated with low financial intermediation. However, the market share of banks with a cost-to-income ratio above 60 percent (16.6 percent[21]) or that of banks that report operating losses (3.8 percent) dropped by 2.4 percentage points and 0.1 percentage points respectively from 2019.

[20] Loans and related interest (gross) to non-bank customers granted by credit institutions, Romanian legal entities, and foreign bank branches.

[21] Data as at end-2020 are not audited.

The polarisation of profitability persisted, the positive aggregate financial result being concentrated among large banks[22] (90.9 percent). The market share of banks reporting losses remains low (4.6 percent), albeit on the rise (up by 0.6 percentage points).

The contraction of real sector activity caused by the COVID-19 pandemic boosted the increase in credit risk cost, which significantly eroded a slightly growing operating profit, having an adverse effect on the net financial result. The Romanian banking sector remained profitable (lei 5.1 billion) at end-2020. Nevertheless, compared to 2019, the sector's net profit decreased (by 18.7 percent), as did the profitability indicators: return on assets (ROA – by 0.4 percentage points to 1.0 percent) and return on equity (ROE – by 3.3 percentage points to 8.9 percent)[23]. Declines were reported by the median ROA and the ratio of operating income to average assets of large banks.

Net interest income, the main component of operating income (67.3 percent), strengthened its dominant contribution, concurrently with a slowdown in the annual growth rate. This evolution was ascribable to several factors. On the one hand, the dynamics of interest income further followed a downtrend. On the other hand, the impact on net interest income was mitigated by the sizeable adjustment of the pace of increase of interest expenses. These evolutions incorporate effects of the successive policy rate cuts decided by the NBR following the outbreak of the pandemic.

Net annual expected credit losses (lei 3.8 billion) went up by 229.2 percent in 2020 compared to the previous year, reflecting the prospects for a deterioration of assets. Large banks account for 76.9 percent of these expenses (slightly below their market share). The upward trend in the volume of net expenses (0.7 percent of average assets) will most likely continue, especially after the expiry of the period covered by public and private moratoria, enhancing the adverse impact on the net financial result.

3. The large share of exposures to the government sector contributed to a further high concentration risk, yet favoured the prudential and financial position of the banking sector, on the back of the gradual adjustment of interest rates. Banking sector claims on the government sector accounted for 23.2 percent of total assets in December 2020, i.e. one of the highest values at EU level. In addition, the banking sector is also exposed indirectly to potential unfavourable developments in the sovereign risk, as a result of state guarantees for loans under the "First Home" or "IMM Invest Romania" programmes.

   The significant amount of government securities – fixed-interest assets – in banks' balance sheets contributes to the rise in interest rate risk, against the background of asset-liability duration mismatch. The analysis of the impact of certain shocks on the yield curve shows a potential loss of up to 14.9 percent of own funds at the aggregate

22 Large banks have net assets of over 5 percent of total bank assets.

23 The aggregate financial result in 2019 was affected adversely by an event related to the method used by a savings and loan bank to allocate the state subsidy, which caused the significant hike in provisions for litigation costs.

level of the interest rate-sensitive assets and liabilities of the banking sector[24]. Losses are unevenly distributed across credit institutions, depending on the specific balance sheet structure, yet due to the stable retail funding structure, the Romanian banks are able to cover part of this shock by gradually adjusting interest rates on deposits.

The risk of an uncertain and unpredictable legislative framework in the financial and banking sector was manifest throughout 2020, albeit not as intensely as in previous years. A series of legislative initiatives went through various stages of parliamentary procedure, which, if implemented, may have negative effects on the stability of the banking sector and of the national financial system. However, during 2020 and at the beginning of 2021, the Constitutional Court deemed that the draft laws aimed at protecting debtors, with an impact on financial stability, contained unconstitutional provisions: (i) Law approving GEO No. 37/2020 setting forth relief measures for certain categories of debtors as concerns the loans granted by credit institutions and non-bank financial institutions (PL-x No. 143/2020); (ii) Law approving GEO No. 48/2020 on some financial and fiscal measures (PL-x No. 281/2020); (iii) Law setting forth state aid for granting compensation to agricultural producers affected by adverse weather phenomena (PL-x No. 288/2020); (iv) Law on consumer protection against excessive interest rates (PL-x No. 664/2019). Another aspect that mitigated legislative risk is the adoption of GEO No. 1/2020 removing the tax on assets imposed by GEO No. 114/2018 and amended by GEO No. 19/2019.

2.2.2. Non-bank financial markets

2020 was marked by the emergence of a new risk related to the outbreak of the COVID-19 pandemic, with a significant social and economic impact, which has turned, in a very short time, into the greatest cause for concern worldwide with respect to economic activity since the global financial crisis. International macroeconomic and financial developments were deeply affected by the adverse effects triggered by the COVID-19 pandemic, on the back of an already depressed economy as early as 2019, when global economic growth decelerated.

The non-bank financial markets in Romania, which are regulated and supervised by the Financial Supervisory Authority, proved to be resilient to the shocks arising from the current health crisis. Against the background of elevated volatility and spillover effects, the capital market witnessed pronounced declines in March-April 2020, before stabilising however in the short run. The effects of the COVID-19 pandemic were also felt in the investment fund industry, raising uncertainties for investors about the future evolution of asset prices and leading to net capital outflows from investment funds. January through September 2020, the insurance market generally recorded positive dynamics, without extreme fluctuations in

[24] The simulations took into account solely credit institutions, Romanian legal entities, according to the most severe scenario considered, which foresees an upward shift in the leu-denominated yield curve by 250 percentage points.

the indicators concerning financial stability and developments in specific risks. The private pension system withstood challenges even in adverse circumstances, overcoming the shock and further yielding positive returns for its participants.

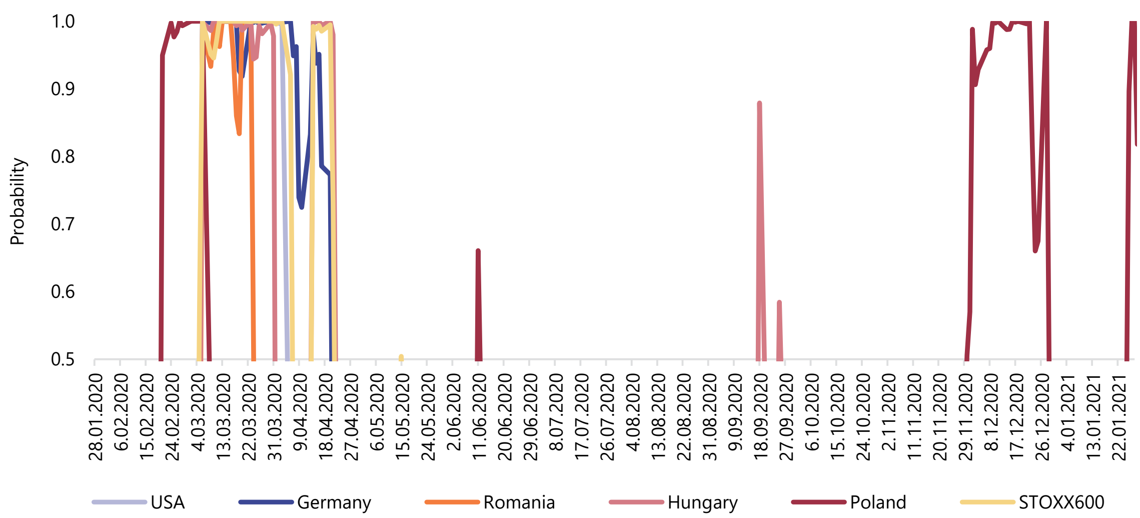
In this environment, marked by high uncertainty spreading fast across the financial system, both companies and financial market regulators were confronted with unprecedented challenges and situations, their main concern being to mitigate the negative fallout from the COVID-19 pandemic-induced crisis.

Interconnection of non-bank financial markets

The economic impact of the pandemic is enhanced by the interconnection of global economy. The pandemic affected long-distance travels and cross-border transports and lowered the density of supply chains and hence of inventories, which are very vulnerable to supply disruptions.

Using a Markov-Switching model[25], the volatility of stock market indices was decomposed into three regimes of volatility: a regime with low volatility, a regime with average volatility and a regime with high volatility (Chart 2.13). The regime with high volatility occurs at a low frequency and it emerges when volatility surges. Its analysis showed that March and April 2020 witnessed strong contagion across international stock market indices. In the following months, volatility declined, except for the German stock market, which recorded a fast drop in the stock market index in October.

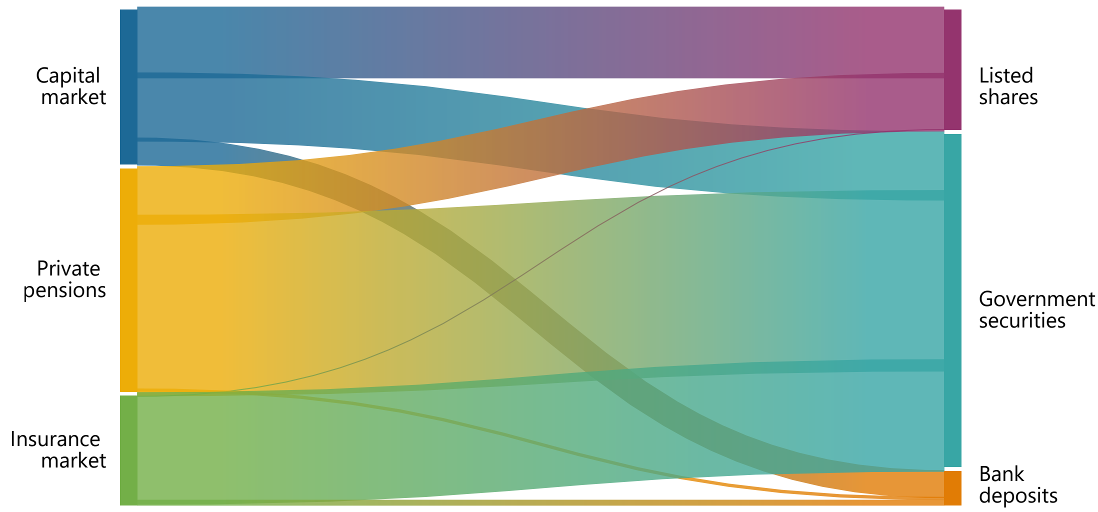
Chart 2.13. Contagion spread: regime with high volatility (Markov-Switching model)



Source: Refinitiv, FSA calculations

25 Kim, S., Kim, S.Y. and Choi, K., *Modeling and Analysis for Stock Return Movements along with Exchange Rates and Interest Rates in Markov Regime-switching Models*, *Cluster Computing* 22 (1), 2019, pp. 2039-2048.

Chart 2.14. Network of exposures of non-bank financial entities by asset class as at 31 December 2020



Source: FSA, FSA calculations

One of the already traditional methods employed to monitor the level of market interconnection is the analysis of on-balance sheet exposures between sectors or between individual entities (Chart 2.14). In particular for the non-bank financial entities, mostly institutional investors, the exposure to a number of major asset classes and the markets they are traded on (government securities, bank deposits or stocks) is relevant.

The capital market, which consists of open-end and closed-end investment funds, Fondul Proprietatea and financial investment companies, held approximately 27 percent of listed shares as at 31 December 2020. At the same time, listed shares accounted for about 22 percent of the investment portfolio of private pensions (private pension funds and voluntary pension funds). The insurance market, which includes insurance companies operating as at 31 December 2020, invested 0.4 percent in listed shares.

It is deemed that the interconnection of FSA-supervised entities with stock markets is average to low.

Due to the particularities of the activity of insurers, investment funds and pension funds, the holdings of financial assets play an extremely important part in their capacity to meet the obligations assumed to insured persons/investors/participants. Moreover, a shock felt by one issuer of such instruments or by one market on which they are traded, with a significant share of the aggregate assets held by one of the non-bank financial sectors supervised by the FSA, might implicitly impact the performance or the stability of the said sector.

Undertakings for collective investment have the largest exposure to the banking sector, accounting for 10 percent of bank deposits, whereas private pension funds and insurance companies hold 1 percent and 2 percent of bank deposits respectively. The interconnection with the banking sector (in terms of bank assets) is considered to be low.

The network of exposures of non-bank financial entities shows that, for all the three non-bank financial sectors under FSA supervision, the main risk exposure is to the Romanian government via the sovereign bonds held in their portfolios. Specifically, government bonds account for approximately 26 percent of the investment portfolios of undertakings for collective investment, 67 percent of the investment structure of private pension funds and 42 percent of the asset investments of insurance companies.

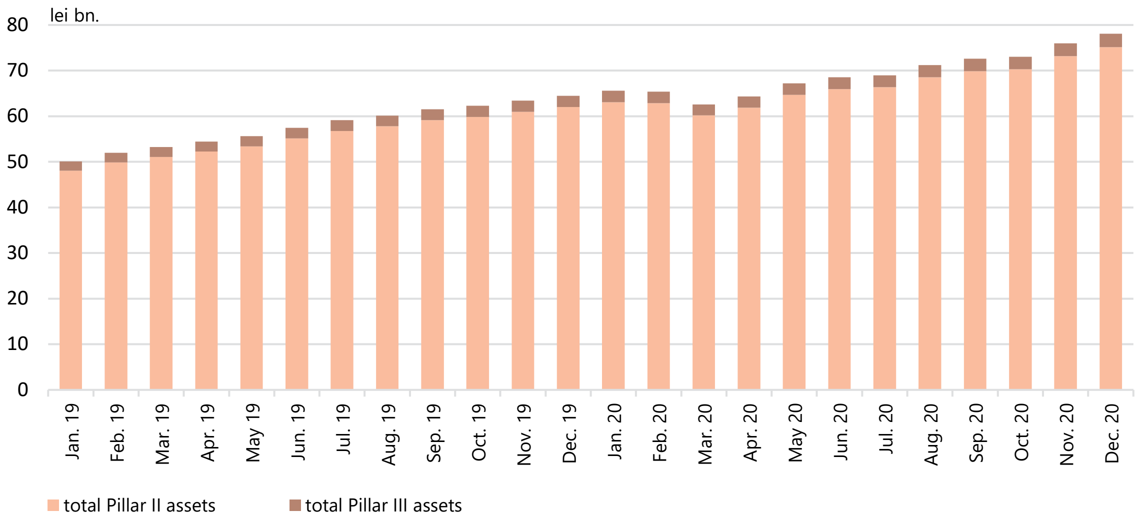
2.2.2.1. Private pension market

The total assets of the private pension system and its number of participants have been growing steadily ever since its establishment. Specifically, at end-December 2020, the total assets of private pension funds (Pillar II and Pillar III) amounted to lei 78.07 billion, up by 21 percent from the same year-ago period, accounting for 7.41 percent of GDP (Chart 2.15).

As at 30 December 2020, the investment policy of private pension funds further focused on the local capital market. The share of investments in fixed-income securities accounted for 74 percent of the total investment portfolio of private pension funds, whereas equity investments made up 22 percent.

The private pension system remained one of the least affected segments amid the uncertainty generated by the COVID-19 pandemic, given its particularity of long-term saving and investing. In the context of a prudent, balanced and diversified investment policy, pension funds remained in positive territory while going through the times of turmoil since their establishment, constantly adapting to new financial market conditions.

Chart 2.15. Total assets of the private pension system



Source: FSA

In 2020, private pension funds were exposed to the following risks:

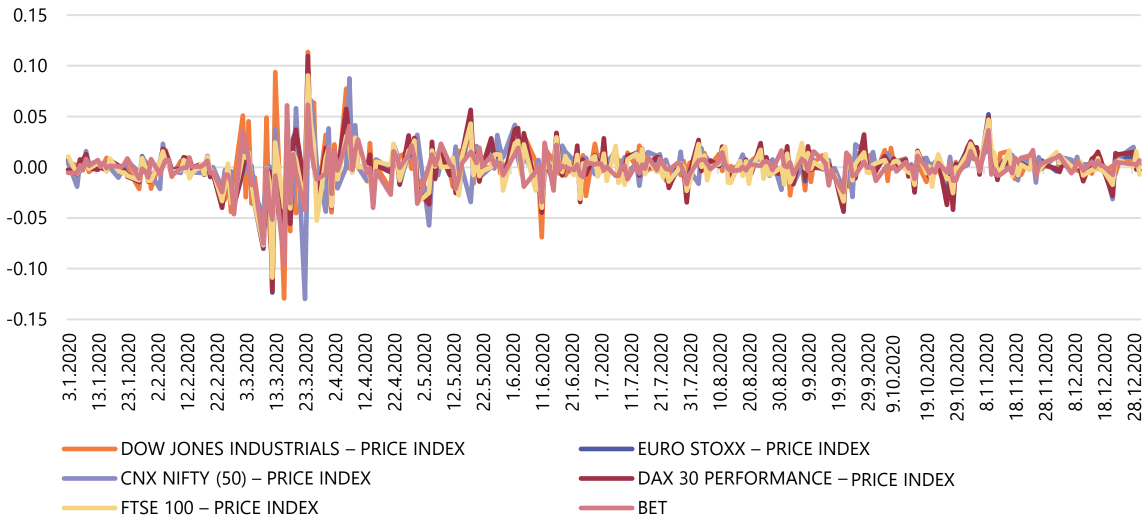
- Credit risk continues to be medium to low, given the fluctuations in financial asset prices generated by the COVID-19 pandemic. However, the largest exposure in private pension funds with guaranteed contributions is to the Ministry of Finance (67 percent as at 30 December 2020). Liquidity risk remains low, as the private pension system furthers its accumulation stage, the level of payments and outflows being very modest, due to the demographic structure of the population that is years away from when the number of retirement requests would become relevant to liquidity management.
- Market risk continues to be relevant to pension funds with defined contributions, such as that in Romania, but managers handled it prudently by diversifying portfolios and focusing on fixed-income instruments, with medium- and long-term maturities.
- Solvency risk for private pension fund managers remains low, given that there is an increase in technical reserves specific to the private pension system (Pillar II) in the case of all 7 private pension fund managers, which confirms the managers' capacity to fulfil their obligations towards participants, which stem from guaranteeing the latter's contributions.
- Profitability risk for private pension fund managers is medium, trending downwards, as a result of the adjustment of legal provisions on the level of management fees constituting operating income for Pillar II pension fund managers.
- Concentration risk is structural and is further high for private pension funds in Romania and their depositories. Nevertheless, the regulation framework was developed to allow numerous check mechanisms and increased transparency, in order to eliminate from the very beginning potential vulnerabilities that may arise from concentration risk.

2.2.2.2. Capital market

The beginning of 2020 saw local indices running high, yet due to the swift upsurge in global financial market volatility, amid the spreading of the COVID-19 virus, stock exchange indices fell markedly, owing to contagion effects on financial markets and the projected economic downturn worldwide (Charts 2.16 and 2.17).

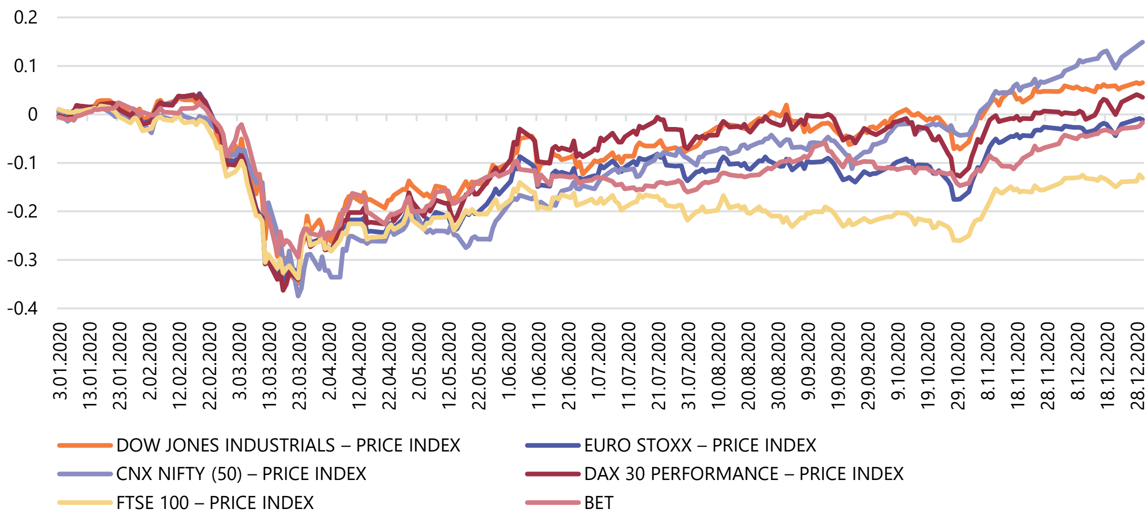
The Romanian stock exchange indices posted mixed developments in 2020 Q4 against end-2019. The BET benchmark, which captures developments in the most heavily traded companies on the BSE regulated market, stood 1.72 percent lower at end-2020 against end-2019. The BET-NG index, which reflects the evolution of companies listed on the BSE regulated market whose core business covers energy and related utilities, recorded on 31 December 2020 the most significant decline, i.e. approximately 12 percent. The fastest growth pace, i.e. 3.39 percent, was that of the BET-TR index, which captures developments in prices of the companies included therein, as well as the dividends they pay (Chart 2.18).

Chart 2.16. Profitability of stock exchange indices, January-December 2020



Source: BSE, Refinitiv, FSA calculations

Chart 2.17. Profitability of stock exchange indices, January-December 2020 (2019=100)

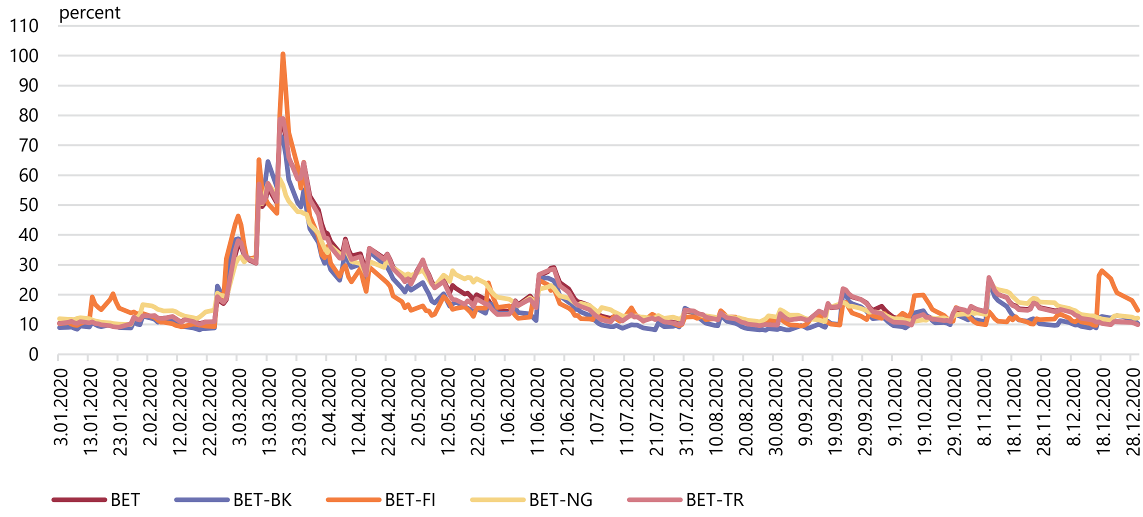


Source: BSE, Refinitiv, FSA calculations

At the end of 2020 Q4, regulated market capitalisation reached lei 154.37 billion, down by approximately 15 percent compared to the end of 2019. It should be pointed out that, in March 2020, the BSE market capitalisation (shares alone) plunged markedly, amid investors' concerns about the COVID-19 pandemic. Stock market capitalisation recorded the lowest level, i.e. lei 113.85 billion, on 18 March 2020.

At end-2020, 18 investment management companies, 82 open-end investment funds, 26 closed-end investment funds, 5 financial investment companies, Fondul Proprietatea and 4 depositaries were operating in Romania.

Chart 2.18. Volatility of local stock exchange indices



Source: BSE, FSA calculations

Assets of UCIs in Romania totalled lei 41.42 billion at end-December 2020, up around 5 percent from the previous quarter.

The second pandemic wave, which surpassed the first wave in terms of effects and number of infections, prompted a renewed lockdown in many countries, thus fuelling investor uncertainty.

Overall, risk remains elevated on the Romanian capital market and is seen increasing since, structurally, stock exchanges react swiftly and anticipatively to any stress factor that could disrupt economic, social, political developments, etc. Moreover, the Bucharest Stock Exchange continues to be the main link, together with the Romanian government, between non-bank financial entities, as market shocks feed through to a greater or lesser extent, depending on individual and aggregate investment strategies adopted by insurance companies, investment funds and private pension funds.

Liquidity risk on the Bucharest Stock Exchange is further assessed as medium. Daily traded value in 2020 grew by 26 percent versus the 2019 average. Furthermore, the BSE capitalisation could not fully regain the ground lost in 2020, falling about 15 percent over December 2019.

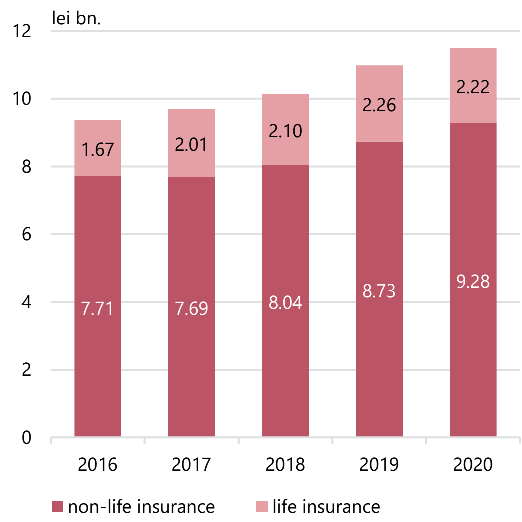
The concentration of depository services remains high, due to the same structural reasons as in the case of pension funds.

The latest developments regarding the promotion, in September 2020, of the BSE to the emerging market status by the FTSE Russell rating agency paves the way for the evolution of the capital market, thus allowing a higher number of investors and, implicitly, enhancing liquidity and diversification of issuers and traded instruments.

2.2.2.3. Insurance market

In 2020, gross written premiums by insurance companies authorised and regulated by the FSA amounted to approximately lei 11.5 billion, up by around 4.6 percent from the previous year (Chart 2.19).

Chart 2.19. Volume of gross written premiums



Source: FSA

The insurance market in Romania remains focused on non-life insurance, which holds an 81 percent share in total gross premiums written by insurance companies authorised and regulated by the FSA. The non-life insurance market is further dominated by motor vehicle insurance, which includes class A3 (motor third-party liability insurance for land vehicles, other than railway rolling stock) and class A10 (compulsory motor third-party liability insurance).

Health insurance continued to post positive dynamics in 2020 as well, with a subscription volume of over lei 451 million, up by approximately 18 percent versus the previous year, increasing its share in total gross premiums written by insurance companies authorised and regulated by the FSA to 3.9 percent from 3.5 percent in 2019.

The current context, marked by heightened uncertainties surrounding the future evolution of economic activity, exacerbated by the negative effects of the COVID-19 pandemic, led to a rising interest in suretyship insurance (class A15). Guarantee insurance recorded a volume of gross premiums written of approximately lei 465 million in 2020, up by 68 percent from 2019, thus contributing to the diversification trend of the insurance market in Romania.

The high concentration of the insurance market is a vulnerability from the perspective of not only exposure by class of insurance, but also of the significant market shares held by a relatively small number of insurance companies.

The local insurance market's reliance on motor vehicle insurance brought about losses over time. In 2018-2020, class A10 (RCA – compulsory motor third-party liability insurance and CMR – Convention Relating to the Contract of Carriage of Goods by Road) and class A3 (CASCO – voluntary motor third-party liability insurance) recorded combined ratios above one, which indicates corporate losses for these insurance categories. As a positive aspect, there is a tendency towards diversifying consumer interest for health insurance products, which implicitly leads to the development of these insurance segments. A more detailed analysis of this market shows an increase in the volume of gross premiums written for health insurance (both related to non-life insurance and life insurance), i.e. from a share of 1.3 percent in the first nine months of 2015 to 3.9 percent as at 31 December 2020 in total gross premiums written on the entire insurance market in Romania. In the long term, the development of the health insurance market may entail the improvement in profitability of insurance companies by reducing the reliance on higher loss-incurring insurance, which leads to ensuring the financial stability of the entire insurance market in Romania.

As at 31 December 2020, two out of the nine insurance companies authorised by the FSA to offer RCA, i.e. City Insurance and Euroins, held a cumulative market share of approximately 75 percent, showing that concentration on the RCA market in Romania remains high in 2020, increasing from the previous years.

Conduct risk is medium to high on the insurance market in Romania, the number of petitions and notifications registered with the FSA witnessing a rise. Most petitions are registered concerning the RCA and are mainly about non-compliance with the legal provisions in the field and with the rules of the Financial Supervisory Authority/contractual terms and conditions.

Given the most recent developments and trends on the insurance market in Romania and the FSA's fundamental objectives related to safeguarding the stability of the markets supervised and to consumer protection, the authority performed unannounced inspections, including at the two insurance companies with the largest market shares. These inspections revealed a series of deficiencies based on which the FSA imposed sanctions.

3. Measures implemented for achieving national macroprudential objectives

The measures taken to contain the spread of the COVID-19 pandemic consisted mainly in social distancing, total or partial lockdown in certain economic sectors, travel restrictions or the closing of borders. At the same time, public authorities also took action to support economic activity and safeguard financial system resilience, with a view to preserving financial stability.

A specific feature of the current situation is the adoption of targeted fiscal measures for firms and households whose income has been impacted in this context. Most Member States decided to provide financial assistance to individuals who lost their jobs and instituted debt moratoria. In order to support companies, the authorities introduced public guarantee schemes targeting new loans, tax deferrals, as well as liquidity injections to rescue severely hit enterprises. Numerous other measures were taken to prop up the healthcare sector, education, and tourism.

The crisis has prompted a strong response from micro and macroprudential supervisors. On 12 March 2020, the European Banking Authority[26] (EBA) announced it would postpone to 2021 the EU-wide stress test exercise it had already launched in January 2020, to allow banks to prioritise operational continuity. In addition, the EBA recommended national authorities to make use of flexibility embedded in the regulatory framework. Moreover, it recommended supervisory authorities to avoid any measures that may lead to the fragmentation of funding markets.

On the same date, the European Central Bank (ECB)[27] announced that its directly supervised banks could fully use capital and liquidity buffers, while also benefiting from the temporary relief in the Pillar 2 capital requirements. The ECB stressed that it would consider operational flexibility in the implementation of bank-specific supervisory measures. In addition, banks were given the possibility of keeping the liquidity coverage ratio below the 100 percent minimum level. The euro area macroprudential authorities sent notifications on the easing or lowering of capital buffer requirements, as well as on the postponement or cancellation

26 "EBA statement on actions to mitigate the impact of COVID-19 on the EU banking sector", 12 March 2020, and "Statement on dividends distribution, share buybacks and variable remuneration", 31 March 2020.

27 "ECB Banking Supervision provides temporary capital and operational relief in reaction to coronavirus", 12 March 2020, and the Recommendation of the European Central Bank of 27 March 2020 on dividend distributions during the COVID-19 pandemic and repealing Recommendation ECB/2020/1 (ECB/2020/19) addressed to significant institutions and groups supervised by the ECB, as well as to the national competent authorities and designated authorities with regard to less significant supervised entities and less significant supervised groups within the Single Supervisory Mechanism.

of previously announced measures. Additionally, at a microprudential level, the ECB recommended that significant institutions and groups (under its direct supervision), but also less significant ones (under the supervision of the national competent authorities) refrain from making irrevocable commitments to dividend distribution, and from share buy-backs to remunerate shareholders for the 2019 and 2020 financial years. This recommendation was publicly endorsed by the European Banking Federation, the ESRB and the EBA.

On 9 June 2020, the European Parliament adopted a package of measures to facilitate lending to households and non-financial corporations by amending EU banking rules, in order to ensure temporary favourable conditions for banks and mitigate the severe economic consequences of the COVID-19 pandemic. The new amendments to the Capital Requirements Regulation (CRR) entered into force on 27 June 2020.

The adopted measures include: (i) deferred application of the leverage ratio buffer by one year to January 2023, so as to allow banks to increase the amount they would be able to loan, (ii) more favourable prudential conditions for loans to pensioners or employees with a permanent contract, (iii) banks will be able to treat some software as their own capital to support the accelerated digitalisation, (iv) liquidity measures provided by central banks will be channelled by banks to the real economy, (v) extension by two years of the transitional arrangements for IFRS 9 and further relief measures to ensure that banks can provide credit to the real economy and (vi) alignment of minimum loss coverage requirement for publicly guaranteed non-performing loans with those guaranteed by export credit agencies. In order to support funding options in non-euro Member States fighting the consequences of the COVID-19 pandemic, the Economic and Monetary Affairs Committee reintroduced transitional arrangements for the preferential treatment of sovereign bonds denominated in currencies other than that of the Member State concerned.

On 24 March 2020, the National Bank of Romania's Supervisory Committee issued a press release announcing the manner in which banks and NBFIs in Romania should apply the regulations in force amid the COVID-19 pandemic, namely:

- Payment delays[28] generated by the pandemic situation should not be associated with the notion of borrower's financial distress. The loan should not be reclassified and the bank should not set up provisions for loans. Nonetheless, whenever a credit institution negotiates a payment delay measure, which is not linked to the COVID-19 pandemic, this operation should be classified as restructuring.
- Temporary use of previously built capital buffers to help banks preserve their support role for the real economy, this measure being conditional on the non-distribution of dividends. Measures to make capital requirements more flexible have been implemented in 10 other EU countries[29].

[28] The Government took several relief measures for individual and corporate borrowers facing payment difficulties by adopting GEO No. 37/2020.

[29] According to the information collected by the ESRB on the financial system implications of prudential and fiscal measures implemented across the EU in response to the COVID-19 pandemic.

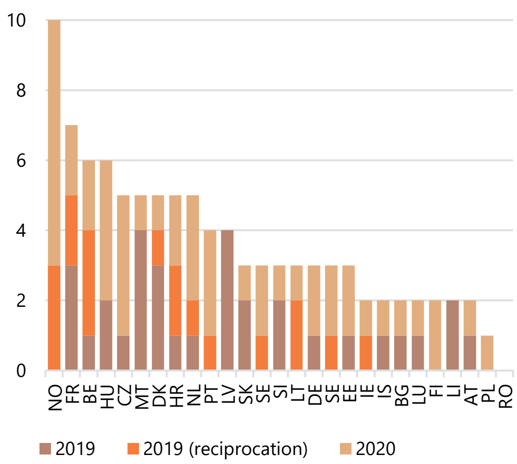
- Temporary non-compliance with the minimum liquidity coverage ratio (LCR) to allow banks to provide sufficient liquidity to businesses and households, these measures being conditional on the non-distribution of dividends. Temporary non-compliance with liquidity ratio requirements is allowed in 12 other EU countries[29].

3.1. Macroprudential measures adopted in the EU in 2020

In 2020, macroprudential policy measures were implemented on a large scale in the European Economic Area (EEA), as part of the policy toolkit that policymakers have at their disposal to reduce the negative effects of the COVID-19 pandemic on the financial system and the real economy (Chart 3.1). The uniqueness of the pandemic-induced shock, in light of the cyclical or structural nature of the resulting systemic risk, has led to the release of the countercyclical capital buffers built up over the last years, but also to the recalibration of structural buffers (SyRB and O-SII buffers) in some European countries (Chart 3.2). Other instruments used are liquidity monitoring tools, borrower-based measures (limits to debt service-to-income or loan-to-value ratios) or extensions of the flexibility measures implemented in previous years.

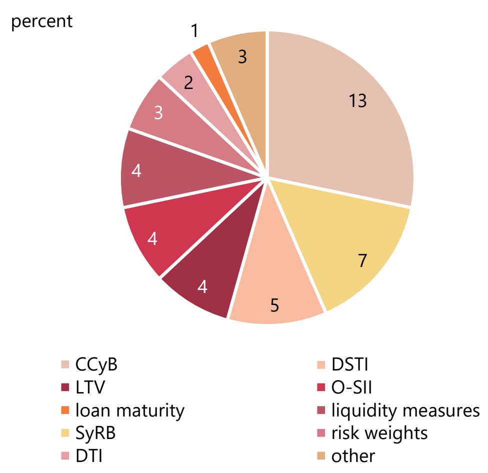
According to the information reported to the ESRB, 24 EEA countries implemented macroprudential measures in 2020, in line with the specific macro-financial context and the scale of the COVID-19 pandemic-induced shock, the general trend being towards an easing of requirements and limits (Table 3.1). The main arguments in favour of the recalibration of instruments refer to the need to support the banking sector in order to avoid disruptions in

Chart 3.1. Number of macroprudential measures notified in 2019 and 2020



Source: ESRB, *A Review Of Macroprudential Policy in the EU in 2020*

Chart 3.2. Number of macroprudential measures implemented in 2020 by type of instrument



Source: ESRB, *A Review of Macroprudential Policy in the EU in 2020* real economy financing and facilitate the access to finance of businesses and households, given the significant impact of the COVID-19 pandemic on the financial position of these sectors. Nevertheless, a number of countries have implemented restrictive measures with a view to mitigating specific systemic risks or have recalibrated structural buffers to comply with the entry into force of CRD V provisions (Norway, United Kingdom). The extent of the macroprudential capital buffer releases varies mainly by geographical location, with countries in the EEC region and Nordic countries implementing large reductions in a range between 2 and 4 percentage points (Finland, Poland, Sweden, Denmark, Hungary), while Western European countries have resorted to recalibrations by less than 0.5 percentage points (Belgium, France, Germany).

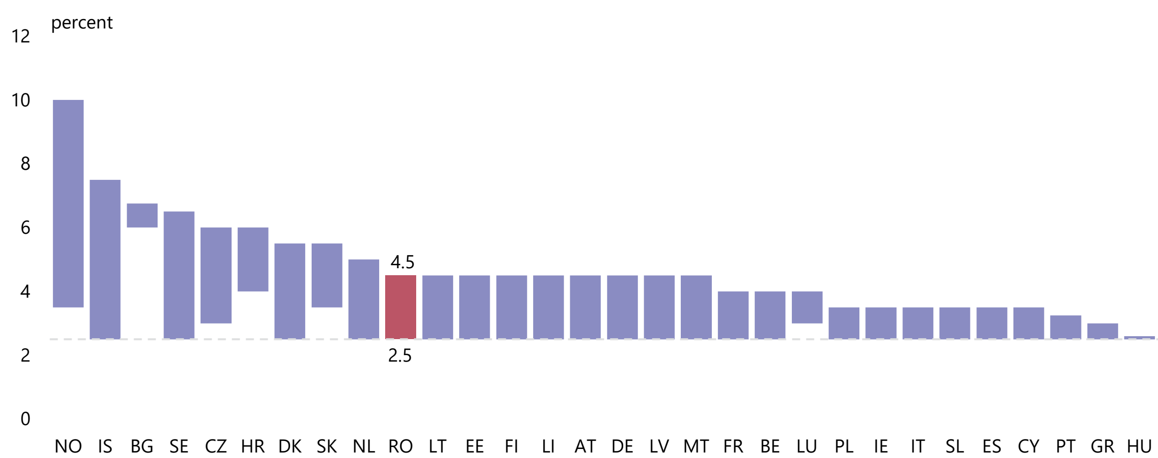
Table 3.1. Macroprudential policy stance in 2020

	AT	BE	BG	HR	CY	CZ	DK	EE	FI	FR	DE	GR	HU	IE	IT	LV	LT	LU	MT	NL	PL	PT	RO	SK	SI	ES	SE	IS	LI	NO
CCyB		green	green			green	green			green	green			green			green	red						green			green	green		green
Real estate						green			green									red	green		green				green		green			yellow
SyRB				green				green	green				green							green	green									yellow
O-SII/G-SII					green				green		green	green	green				green		green	yellow		green					green			
Other									green				yellow									yellow								

Note: Green shows an easing of the macroprudential policy, red indicates a strengthening of the policy, while yellow signals measures with mixed effects.

Source: ESRB, *A Review of Macroprudential Policy in the EU in 2020*

Chart 3.3. Combined capital buffer applicable in January 2021 – European comparison



Note: For Romania, the structural systemic risk buffer was calculated based on the maximum level between the buffer for other systemically important institutions (O-SII) and the systemic risk buffer (SyRB).

Source: ESRB, *A Review of Macroprudential Policy in the EU in 2020*

As to the macroprudential policy stance with respect to borrower-based measures, the heterogeneity of application does not allow the identification of a clear trend regarding the easing or tightening of requirements. Specifically, in 2020, several countries implemented borrower-based measures, such as limits to the loan-to-value ratio (Belgium), maximum loan maturity (France, Latvia) or level of indebtedness (Slovakia, Latvia). By contrast, four countries eased requirements for borrowers by recalibrating the level of indebtedness (Malta, Slovenia, Czechia) or increasing the share of loans that do not comply with certain regulatory requirements (Norway).

A comparative analysis of the combined buffer level shows that, following the easing of the macroprudential requirements adopted in 2020 in response to the COVID-19 pandemic, Romania moved up from the second third of the ranking in 2019 to the first third, given that, at the time of drafting this *Report*, the macroprudential capital requirements were unchanged from the previous year (Chart 3.3).

3.2. Macroprudential measures adopted in Romania in 2020

3.2.1. Capital buffers

As regards the specific context of Romania, the banking sector entered this crisis being prepared, in terms of capital and liquidity reserves, to manage the effects of a medium- or high-intensity shock on the economy. As compared to the beginning of the previous financial crisis, the capital level of banks in Romania is much higher, due also to the implementation of the macroprudential policy framework for capital buffers, specifically:

- the capital conservation buffer (CCoB) applies to all banks in the system with a view to creating a primary loss-absorption capacity, supporting the continued provision of financial services to the real economy in periods of distress. Currently, this buffer runs at a rate of 2.5 percent of total risk exposure amount;
- the countercyclical capital buffer (CCyB) has as an objective to enhance the banking sector's resilience to potential losses generated by excessive credit growth, acting towards smoothing the financial cycle. The CCyB rate currently stands at 0 percent; the buffer level was kept unchanged due to the absence of excessive credit growth, as well as to the NCMO's decision not to put pressure on the banking sector to build up additional capital amid the current health crisis;
- the other systemically important institutions buffer (O-SII) aims to avoid the moral hazard generated by the largest banks in the system. The O-SII buffer applies to systemically important banks, being currently set at values ranging between 1 and 2 percent of total risk exposure amount;

- the systemic risk buffer (SyRB) was introduced by the National Bank of Romania at the NCMO recommendation, for the purpose of dealing with the systemic dimension of non-performing loans. At present, the SyRB rate ranges between 0 (zero) and 2 percent of total risk exposure amount, depending on the non-performing loan ratio and the coverage ratio.

By applying the flexibility measures, the Romanian banking sector will have available capital of lei 10.7[30] billion to support the economy. It is worth noting that, in addition to the own funds held to cover the overall capital ratio (OCR threshold), credit institutions also have substantial voluntary capital reserves of lei 18.6 billion, accounting for 8 percent of risk-weighted assets. Additionally, at end-2020 the banking sector recorded a profit of approximately lei 4.5 billion (making up 1.9 percent of risk-weighted assets), resources that could be incorporated in credit institutions' own funds, given that they are recommended to refrain from dividend distribution until at least September 2021.

3.2.1.1. The countercyclical capital buffer

The implementation framework of the macroprudential instrument

Particularly relevant in defining a country's macroeconomic context are the concepts of business and financial cycles. Recent economic history has confirmed that cyclical movements of high amplitude may aggravate the severity of crisis episodes. In this case, it is necessary to timely identify each stage while setting the appropriate macroprudential measures. The countercyclical capital buffer (CCyB) counts among the most significant macroprudential instruments that can be used, its role being that of alleviating the potential systemic risk that may arise from the cyclical developments in credit in the economy.

Table 3.2. Subrecommendations in Recommendation ESRB/2014/1

Subrecommendation	Subrecommendation content
A	The principles that designated authorities should adhere to when assessing and setting the CCyB rates applicable in Member States
B	Guidance on the measurement and calculation of the credit-to-GDP gap, calculation of the benchmark buffer rate and the buffer guide
C	Guidance on variables that indicate the build-up of system-wide risk associated with periods of excessive credit growth
D	Guidance on variables that indicate that the buffer should be maintained, reduced or fully released

Source: ESRB

30 Calculations made based on data reported at individual level.

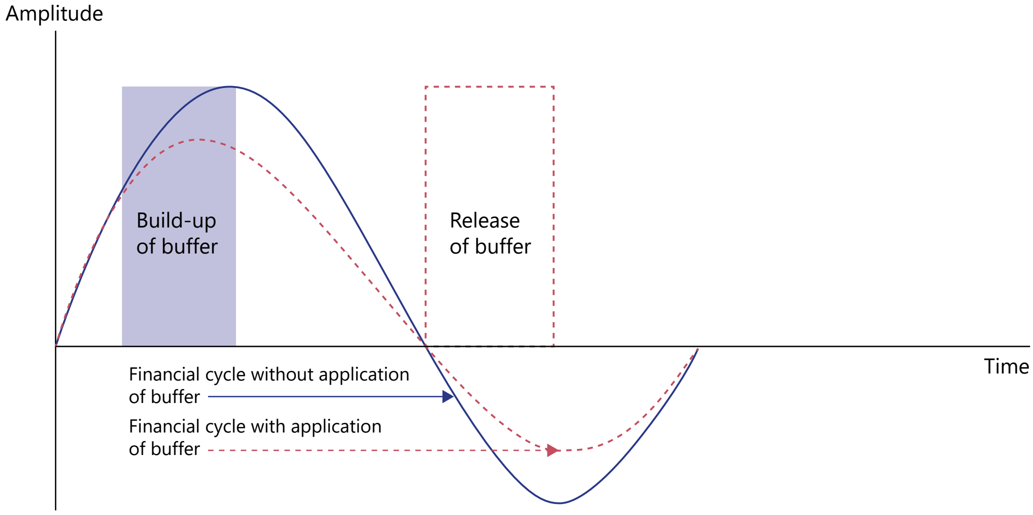
The implementation framework for the countercyclical capital buffer is based on Recommendation on guidance for setting countercyclical buffer rates (ESRB/2014/1) whereby a common action was taken to implement this macroprudential instrument at European level. Recommendation ESRB/2014/1 is composed of four subrecommendations detailed in Table 3.2.

The manner in which EU Member States implemented Recommendation ESRB/2014/1 on guidance for setting countercyclical buffer rates was subject to analysis by the European Systemic Risk Board (ESRB) in May 2019. The assessment was based on the specific analysis of compliance with each of the four subrecommendations. Throughout the assessment process, Romania was graded as being Fully compliant with subrecommendations A, B and C. The assessment results for subrecommendation D show that a large part of the Member States, including Romania, were graded Sufficiently explained, as the CCyB had remained at 0 (zero) percent since implementation until assessment and no methodology was needed to reduce or release the buffer. Based on the overall results of the compliance assessment for the four subrecommendations, Romania was found to be Fully compliant with Recommendation ESRB/2014/1. In January 2020, the National Bank of Romania published *Occasional Papers* No. 50 – "The implementation of the countercyclical capital buffer (CCyB) in Romania". This paper refers to the European framework for the implementation of the CCyB, as well as to the methodology for introducing, maintaining, reducing or releasing the CCyB at national level. By supplementing the methodology for the decision to maintain, reduce or release the countercyclical capital buffer in this study, compliance is ensured with subrecommendation D, leading to a grade reassessment to Fully compliant.

The CCyB helps achieve the macroprudential policy intermediate objective on mitigating and preventing excessive credit growth and leverage. Apart from the countercyclical capital buffer, other instruments employed to fulfil the same intermediate objective refer to the limits on debt service-to-income (DSTI) and loan-to-value (LTV) ratios. All these play an important part in reducing the amplitude of the financial cycle, as well as in enhancing the resilience of the banking sector to potential losses generated by the unfavourable dynamics of the financial cycle.

The name of the instrument also indicates the strong countercyclical role of the CCyB, which is set during the financial cycle's expansion phases, when credit in the economy sees significant increases. During the financial cycle's contraction phases, when credit in the economy is on a downward course, the CCyB is recommended to be reduced or even fully released (Figure 3.1). A significant credit growth refers to a level in the upper range of its long-term trend (which is not directly observable, so that, in practice, it is estimated based on quantitative methods). Relative to effects, the increase in the CCyB rate triggers higher capital requirements and a lower bank loan supply (where credit institutions have no voluntary capital reserves to comply with the new requirements), whereas the buffer rate reduction has an opposite effect. Consequently, the use of this buffer helps smooth the credit cycle, by building up reserves in the expansion phases and using them to finance real economy during contraction phases.

Figure 3.1. The mechanism for setting and releasing the countercyclical capital buffer



Source: ESRB, *Flagship Report on Macroprudential Policy in the Banking Sector*

The CCyB is an important instrument aimed at addressing credit market risks, but the ESRB recommends to additionally use other instruments, whose concurrent implementation could lead to higher effectiveness. They include: (i) sectoral capital requirements, (ii) macroprudential leverage ratio, (iii) limits on loan-to-value (LTV) ratio, as well as (iv) limits on loan-to-income ratio (LTI) and on debt service-to-income ratio (DSTI). The same as the CCyB, the first two categories are bank-based instruments, while the last two are borrower-based instruments. What distinguishes the CCyB from the other instruments referred to is the predictability of the NCMO measure imposition as shown by the time limit for the implementation of measures to change the buffer rate, i.e. 12 months from the date it was announced on the NCMO's website.

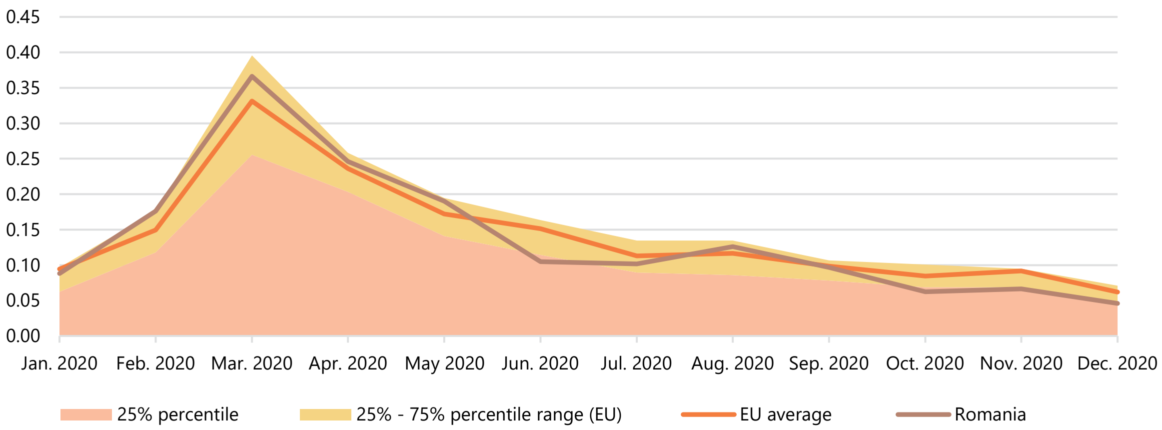
The experience across the EU

The year 2020 will go down in the economic history because of the COVID-19 pandemic effects on global economy, including on the evolution of countercyclical capital buffer rates. When using the CCyB as a macroprudential instrument, during periods of economic turmoil (Chart 3.4), the buffer rate should be reduced or even fully released in order to provide a direct incentive to the banking sector and real economy. The severe recession induced by the COVID-19 pandemic showed the necessity to take relevant measures, being also the first event of this kind since the introduction of the macroprudential instrument.

In view of the high uncertainties about the future evolution of the economy, possibly leading to notable declines, the Member States that activated the countercyclical capital buffer in the previous years took action to reduce the buffer rates applied to exposures in their jurisdictions (Charts 3.5 and 3.6).

During 2020, 12 out of 30 EEA countries reduced the CCyB rate in place/planned for that year, namely two thirds fully released the buffer (Belgium, Denmark, France, Germany, Iceland, Ireland, Lithuania and Sweden), while a third recalibrated the declining CCyB rate, keeping it, however, at a positive level (Bulgaria, Czechia, Norway and Slovakia).

Chart 3.4. Country-Level Index of Financial Stress (CLIFS) estimated by the ECB for EU Member States



Note: CLIFS (Country-Level Index of Financial Stress) is a composite index which measures the level of financial stress based on three financial market segments: equity markets, bond markets and foreign exchange markets. For methodological information, see Duprey, T. and Klaus, B., "Dating systemic financial stress episodes in the EU countries".

Source: ECB

Chart 3.5. CCyB rate in the EEA countries before the outbreak of the COVID-19 pandemic

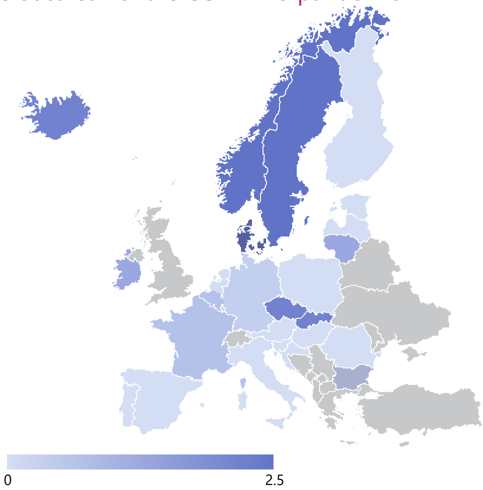
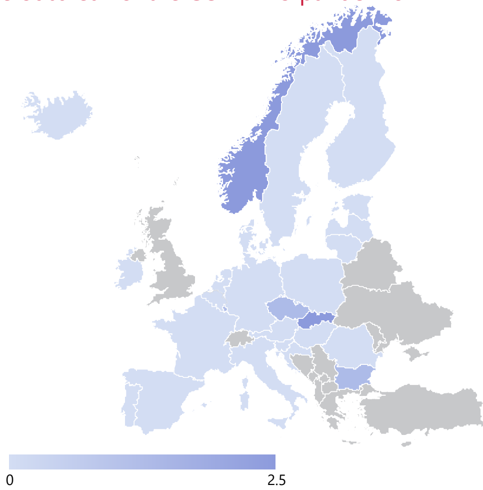


Chart 3.6. CCyB rate in the EEA countries after the outbreak of the COVID-19 pandemic



Note: The CCyB rate before the pandemic refers to the level notified by Member States. The data on the CCyB rate after the outbreak of the COVID-19 pandemic refer to January 2021.

Source: ESRB

Sweden made the most notable change, reducing the buffer rate from a maximum of 2.5 percent to 0 (zero) percent. This was mainly due to the fact that, although risk aversion went up following the step-up in the uncertainties caused by the COVID-19 pandemic, both companies and households still need to take loans for production, investment and consumption purposes. Therefore, on 16 March 2020, the macroprudential authority in Sweden decided to lower the CCyB rate; as a result of this measure, capital requirements in the Swedish banking sector were reduced by approximately SEK 45 billion, which gave credit institutions an incentive to carry on smoothly their lending activity. The second largest change was implemented by Denmark and Iceland which diminished the CCyB rate from 2 percent to 0 (zero) percent. Mention should be made that both countries took this decision in spite of the negative Basel standard measuring the deviation of the credit-to-GDP ratio. This is warranted by the fact that particularly when strong macroeconomic shocks occur, the buffer can be calibrated based on additional indicators. The third largest change was the reduction in the buffer rate by 1.5 percentage points, envisaged by Czechia and Norway, whereas the other countries diminished the buffer rate by at most 1 percentage point (Table 3.3).

Table 3.3. The CCyB rates in place and those implemented in the EEA countries in 2020

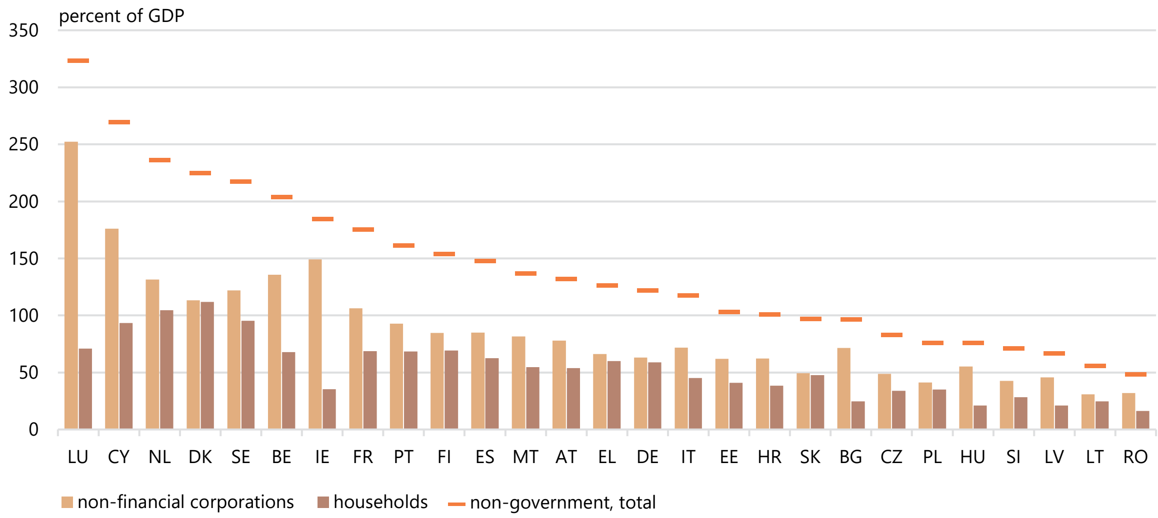
Country	CCyB rate (%) planned to be implemented in 2020	CCyB rate (%) at end-2020	Difference (percentage points)
Austria	0	0	0
Belgium	0.5	0	0.5
Bulgaria	1.5	0.5	1
Croatia	0	0	0
Cyprus	0	0	0
Czechia	2	0.5	1.5
Denmark	2	0	2
Estonia	0	0	0
Finland	0	0	0
France	0.5	0	0.5
Germany	0.25	0	0.25
Greece	0	0	0
Hungary	0	0	0
Iceland	2	0	2
Ireland	1	0	1
Italy	0	0	0
Latvia	0	0	0
Liechtenstein	0	0	0
Lithuania	1	0	1
Luxembourg	0.5	0.5	0
Malta	0	0	0
Netherlands	0	0	0
Norway	2.5	1	1.5
Poland	0	0	0
Portugal	0	0	0
Romania	0	0	0
Slovakia	2	1	1
Slovenia	0	0	0
Spain	0	0	0
Sweden	2.5	0	2.5
EEA average	**0.6**	**0.1**	**0.5**

reduction ≤0.5pp   reduction 1pp   reduction 1.5pp   reduction 2pp   reduction 2.5pp

Note: The CCyB rate planned to be implemented in 2020 refers to the level announced by Member States.

Source: ESRB

Chart 3.7. Credit-to-GDP ratio in EU Member States (2020 Q4)



Source: ECB

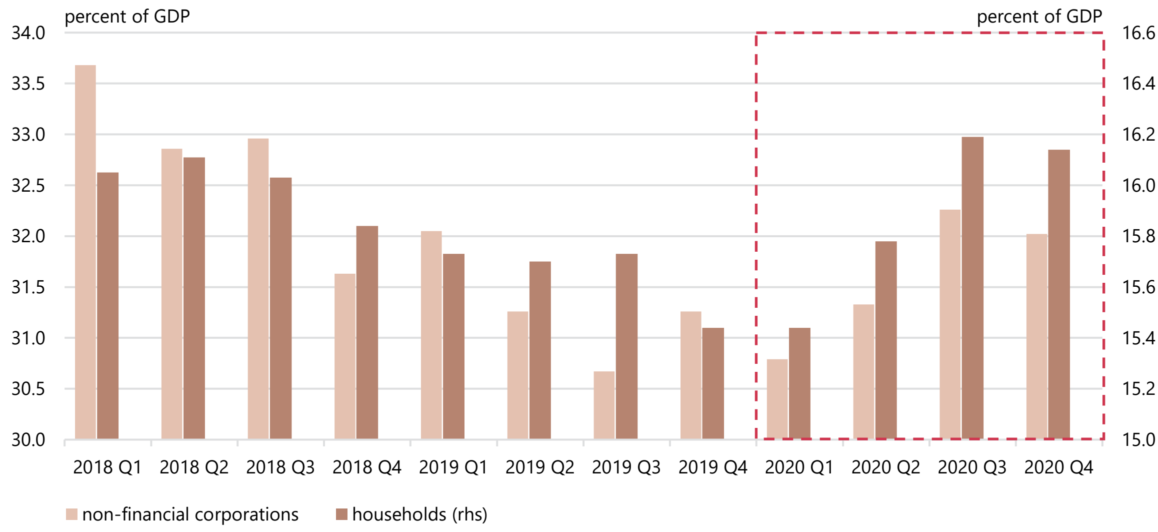
At end-2020, only five out of 30 EEA countries, i.e. Bulgaria, Czechia, Luxembourg, Norway and Slovakia, still had in place an active CCyB rate. The peak was reported by Norway and Slovakia, with both countries maintaining a 1 percent buffer rate, while Bulgaria, Luxembourg and Czechia kept a 0.5 percent level.

In line with Recommendation ESRB/2014/1 on guidance for setting countercyclical buffer rates, the indicator which should substantiate the decisions to change the countercyclical capital buffer is the deviation of the credit-to-GDP ratio from its long-term trend, also known as the Basel indicator. From a methodological perspective, in order to determine this indicator it is necessary to calculate the long-term trend of the credit-to-GDP ratio based on the Hodrick-Prescott filter, using a recursive (unilateral) method and a smoothing parameter reflecting the assumption of a long financial cycle. Apart from this standard indicator, the majority of European countries have been regularly monitoring a set of additional indicators for substantiating the decisions to recalibrate the buffer rate. A case in point is Norway, which considered mainly the following factors when updating the buffer rate: (i) financial imbalances are analysed to assess cyclical systemic risk that may trigger or amplify a downturn; (ii) access to credit is analysed to assess whether it is necessary to reduce the buffer rate for households and solvent non-financial corporations to have access to loans; (iii) banks' capacity to absorb losses, – the CCyB level is thus set so that banks have enough capital to cover losses during a downturn; (iv) effects of a change in capital requirements on banks and the real economy[31].

The additional indicators are different across countries, being adapted to the specificities of the national economy so that they can signal the potential events of excessive credit growth. Chart 3.7 provides a clear image of the lending level in Member States, while Chart 3.8 shows the dynamics of bank credit (as a share of GDP) in Romania.

31 "A framework for advice on the countercyclical capital buffer", *Norges Bank Papers,* No 4, Norges Bank, 2019, pp. 7-8.

Chart 3.8. Dynamics of bank credit (as a share of GDP) over the last 3 years in Romania



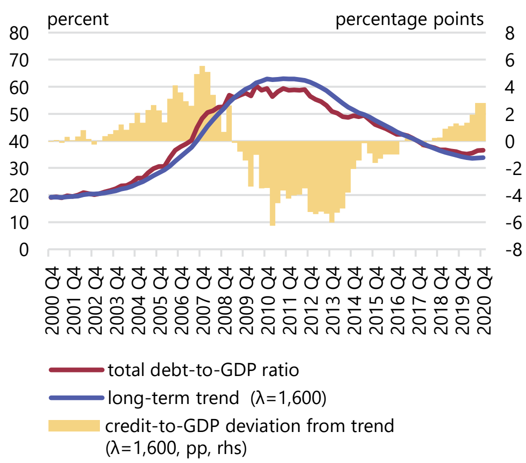
Source: ECB

During 2020, most of the decisions to reduce the CCyB rate were grounded on information and related analyses providing clearer signals than the Basel indicator on the amplitude of the financial cycle. This shows that, although the standard indicator provides relevant information on the recent credit market developments, in the event of strong economic turmoil, it is the additional indicators that help guide decisions.

Implementation of the countercyclical capital buffer in Romania

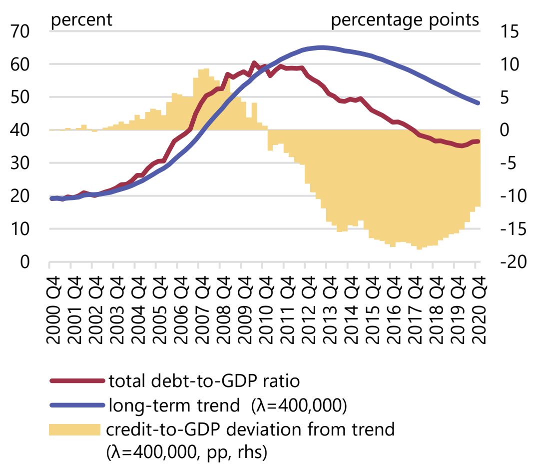
The analysis on the calibration of the countercyclical capital buffer is conducted on a quarterly basis, and the results are submitted for discussions during the meetings of the General Board of the National Committee for Macroprudential Oversight, in its capacity as macroprudential authority. During the meeting, the NCMO issues a recommendation to

Chart 3.9. Analysis of the countercyclical capital buffer in Romania, assuming a short financial cycle (alternative indicator)



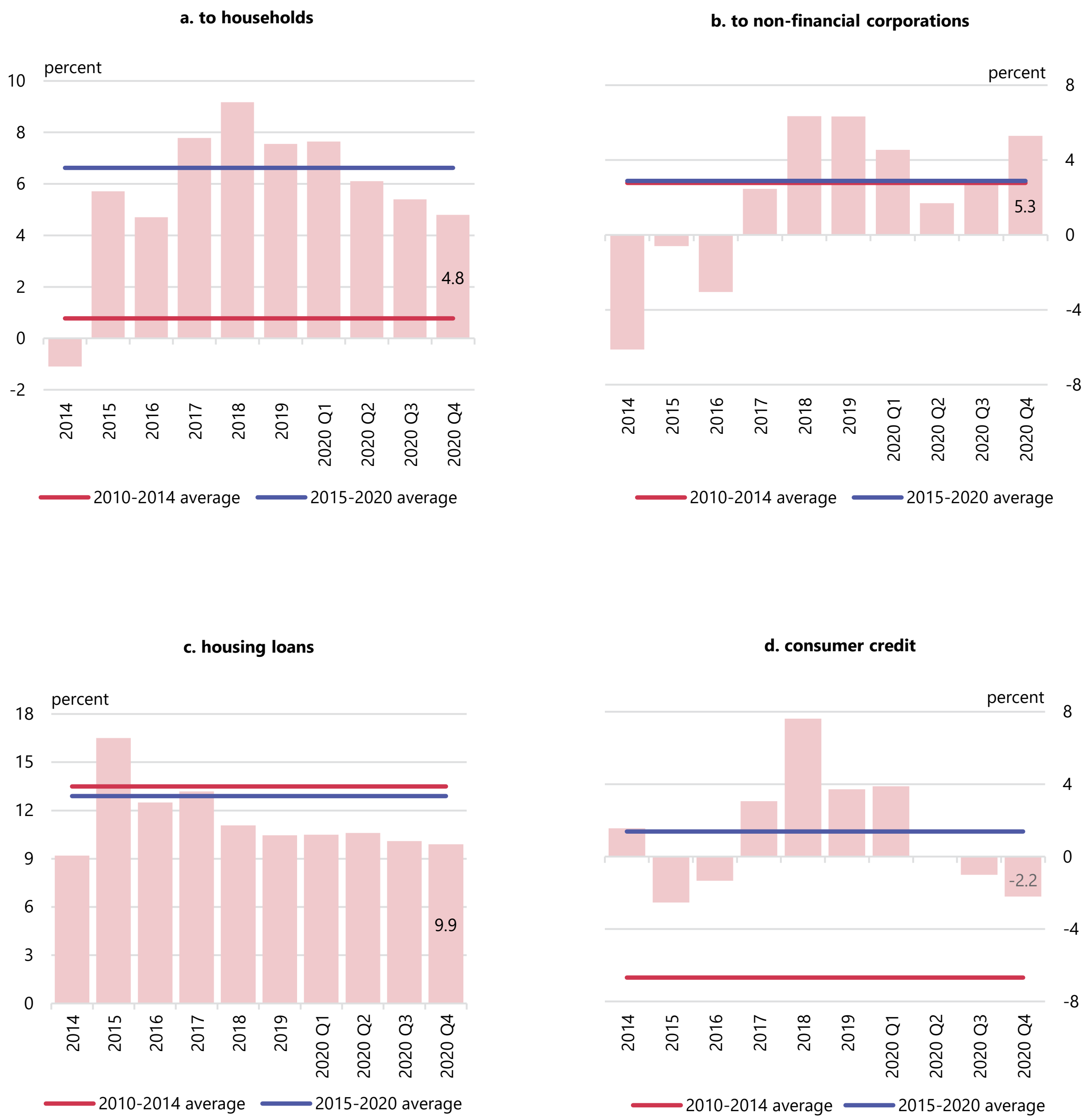
Source: NBR, NIS, NBR calculations

Chart 3.10. Analysis of the countercyclical capital buffer in Romania, assuming a long financial cycle (Basel indicator)



Source: NBR, NIS, NBR calculations

Chart 3.11. Nominal annual credit growth

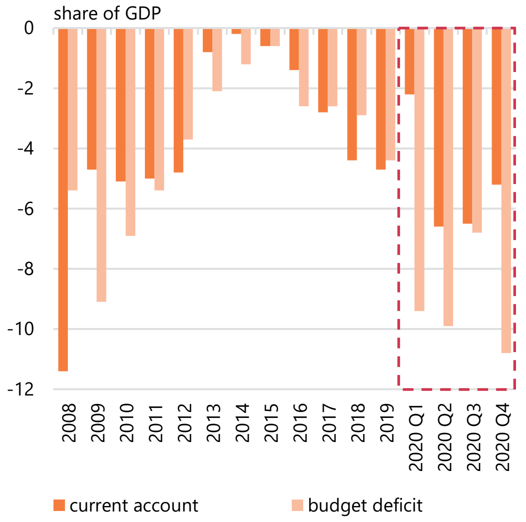


Source: NBR

the National Bank of Romania, setting the countercyclical capital buffer rate and the future actions to be taken by the NBR, in its capacity as competent authority responsible for the supervision of the banking sector.

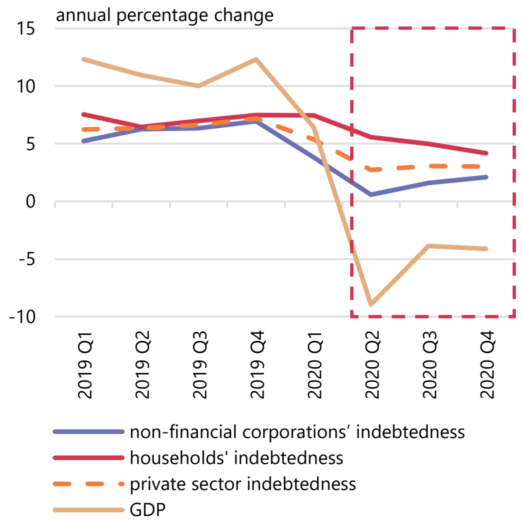
Underlying the decisions on the CCyB rate is a set of indicators recommended by the Basel Committee, adapted so as to reflect the specificities of the Romanian banking sector. Two of the most important indicators under the Basel framework are the standard indicator and the alternative indicator. The difference between the two indicators is given by the smoothing parameter (lambda) which in the first case is set at 400,000, corresponding to an advanced economy with long financial cycles, whereas the alternative indicator is set at 1,600, pointing to a significantly shorter financial cycle, specific to the domestic economy.

Chart 3.12. Evolution of twin deficits



Source: Eurostat

Chart 3.13. Annual dynamics of lending and GDP



Source: NIS, NBR

The results of the latest assessments on the countercyclical capital buffer, based on the data available at 31 December 2020 show that, in the event of a short financial cycle, the deviation of total indebtedness from its long-term trend stands at 2.79 percentage points (Chart 3.9). Conversely, by using the standard indicator based on a long financial cycle assumption, the deviation of total indebtedness is -11.65 percentage points (Chart 3.10). The credit cycle breakdown by component shows the deviation of the credit-to-GDP ratio from its long-term trend remaining in positive territory for loans to both households (0.76 percentage points), and companies (2.03 percentage points).

Apart from the indicators on the deviation of credit from its long-term trend, the decision is substantiated by a set of additional indicators, i.e. private sector indebtedness, households' total indebtedness, non-financial corporations' total indebtedness (Chart 3.11), as well as by a set of structural indicators, i.e. real estate market indicator, financial standing of the banking sector and lending standards, alongside the macroeconomic framework.

In 2020, each quarterly analysis on recalibration led to the conclusion that the CCyB rate should be maintained at 0 (zero) percent. This decision is largely substantiated by the significant uncertainty generated by the COVID-19 pandemic, and, on the other hand, by the fact that the Basel indicator was in negative territory throughout the year, showing no signals of an excessive rise in indebtedness. However, mention should be made that, during 2020, the additional Basel indicator remained in positive territory, owing mainly to the fact that credit dynamics were slower than those of gross domestic product, as a result of the economic effects of the COVID-19 pandemic (Chart 3.13).

The residential real estate market is yet another segment that could show signals of excessive credit growth. A significant increase in this sub-sector has a strong and fairly rapid impact on the credit market. Thus, mention should be made that the annual growth rate of housing prices remained on a positive path during the first three quarters of 2020.

The latest available data show this rate stood at 2.27 percent in September 2020 and at 6.55 percent during Q2, with both values running below the 10 percent signalling threshold recommended by the European Commission.

The calibration of the CCyB rate also takes into account the national macroeconomic framework. The uncertainty generated by the spread of the new coronavirus had a strong impact, especially via the twin deficits. Thus, at the end of 2020 Q4, the current account deficit had reached 5.2 percent, while budget deficit had come in at 10.8 percent, according to Eurostat data. Chart 3.12. shows the dynamics of the two indicators.

3.2.1.2. Buffer for other systemically important institutions

In order to limit the impact of potential negative externalities generated by large institutions and the higher risks they project on financial stability, for reasons related to their structure and role in the economic dynamics, the macroprudential policy regulatory framework sets forth the implementation of the capital buffer for other systemically important institutions (O-SII buffer) when referring to institutions with a prevailing impact at national level. As for the banks with significant size, coverage and cross-border operations and whose possible problems could propagate to the entire international financial system, they are subject to the global systemically important institutions buffer (G-SII buffer).

Year 2020 was particularly marked by the strong spread of the SARS-CoV-2 virus and the authorities' attempts to limit at maximum the rate of infection and the overcrowding of hospital facilities, *inter alia* by imposing restrictions on some economic activities, which had a significant impact on the evolution of gross domestic product, household income and the balance sheet of non-financial corporations.

While the O-SII buffer is designed to address risks other than those envisaged by the countercyclical capital buffer, some countries deemed it appropriate to release this buffer during the pandemic, given that no countercyclical capital buffer rate above zero was already in place – providing a short-term solution for supplying additional liquidity to the real economy. On the other hand, the ESRB points out that the release of O-SII or SyRB buffers can contribute to the increase in the structural risks they were designed to address.

The National Bank of Romania, in its capacity as sectoral supervisory authority, decided to allow banks to temporarily use the previously built capital buffers (including the O-SII buffer) (up to a date that will be subsequently communicated), while also keeping in place the legal requirements for such flexibilities. Adapting capital buffers to the new conditions helps banks preserve their support role for the real economy.

The implementation of an O-SII buffer has several objectives, such as: (i) increase the capacity of systemic institutions to absorb the potential losses arising from banking activity, (ii) lower the likelihood of financial difficulties for systemic banks, (iii) reduce the potential impact of stress episodes that large banks could face, (iv) build up capital buffers that can support and offset financial intermediation in periods when business and financial cycles are slower and (v) correct the inherent advantages associated with the quality of "too big to fail" financial institutions, ensuring a level playing field for credit institutions in the market.

The experience across the EU

Identifying systemically important institutions is based on an EU common methodology developed by the European Banking Authority (EBA), laid down in the Guidelines on the criteria to determine the conditions of application of Article 131(3) of Directive 2013/36/EU (CRD) in relation to the assessment of other systemically important institutions[32].

The EBA methodology ensures the harmonisation of comparability and transparency requirements for the assessment of systemically important institutions in every Member State with the aim to capture the specificities of the national financial systems, providing Member States with the opportunity to additionally identify eligible financial institutions based on a set of optional indicators, so as to capture a fair image of the links between financial system elements and the real economy. All EU Member States submit the annual assessment results to the ESRB.

Chart 3.14. Maximum O-SII buffer rate in EEA countries

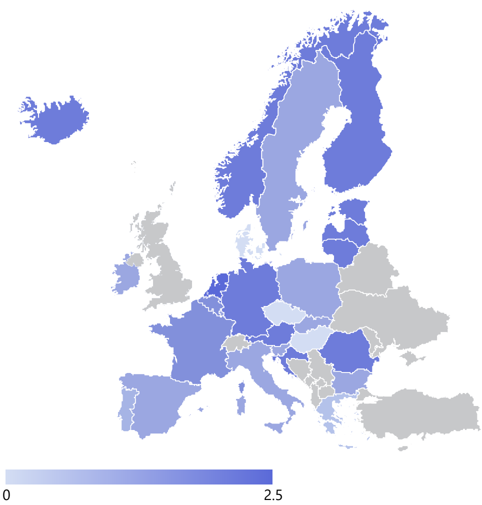
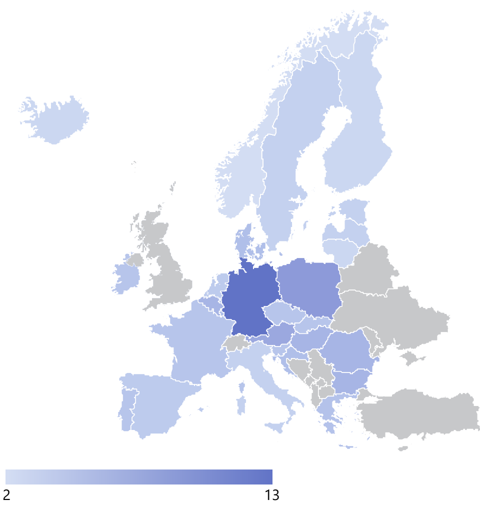


Chart 3.15. Number of O-SIIs in EEA countries



Source: ESRB

[32] The Romanian version of the EBA Guidelines on the criteria to determine the conditions of application of Article 131(3) of Directive 2013/36/EU (CRD) in relation to the assessment of other systemically important institutions (O-SIIs) is published on the National Bank of Romania's website: https://www.eba.europa.eu/sites/default/documents/files/documents/10180/1045622/6db72da6-f8e7-4ab7-9cc4-38e49f4bfd2d/EBA-GL-2014-10_RO_GL%20on%20O-siis.pdf?retry=1

In Romania, systemic banks are identified based on a nationally developed methodology[33], harmonised with the EBA methodology and applied by the NBR, in its capacity as sectoral supervisory authority.

A number of 196 institutions were classified as O-SIIs in EU Member States and the United Kingdom. In 2020, changes in the number of institutions were reported by Germany and France, two countries that each identified a new O-SII. Conversely, the number of O-SII banks in Luxembourg and Romania dropped by one in each of the two countries.

15 Member States amended the O-SII buffer rates (Chart 3.14). One third of these countries, i.e. Cyprus, Ireland, Malta, the Netherlands and Slovenia, increased the O-SII buffer requirement, whilst the remaining ten countries saw a decrease in the level of their buffers. The number of O-SIIs ranges from a minimum of two in Norway to 15 in the United Kingdom (Chart 3.15), depending on the concentration of national banking sectors.

Implementation in Romania

In accordance with Art. 21 para. (1) and Art. 23^2 para. (6) of NCMO Regulation No. 2/2017 on the methodology and procedure used for setting capital buffers and the scope of these instruments[34], as subsequently amended and supplemented[35], the National Committee for Macroprudential Oversight revises the scores of systemically important institutions in the Romanian banking sector at least annually to identify the systemically important entities with a view to setting the additional capital requirements that should be applied to them.

The methodology applied by the NBR, in its capacity as competent authority, is harmonised with the recommendations included in EBA Guidelines on the criteria to determine the conditions of application of Article 131(3) of Directive 2013/36/EU (CRD) in relation to the assessment of other systemically important institutions (O-SIIs).

In 2020, the central bank implemented NBR Order No. 10/2019 on the buffer for credit institutions authorised in Romania and identified by the National Bank of Romania as other systemically important institutions (O-SIIs)[36], which sets forth that nine banks are required to maintain, on an individual or consolidated basis, as appropriate, an O-SII buffer as follows: (i) 2 percent for Banca Comercială Română S.A. (consolidated level), Raiffeisen Bank S.A. (consolidated level), OTP Bank România S.A. (consolidated level), Banca Transilvania S.A. (consolidated level), CEC Bank S.A. (individual level) and (ii) 1 percent for

33 An overview of the methodology used to identify systemic banks is published on the National Bank of Romania's website: http://www.bnr.ro/Methodology-for-identifying-systemic-credit-institutions-15316.aspx

34 NCMO Regulation No. 2/2017 on the methodology and procedure used for setting capital buffers and the scope of these instruments is published on the NCMO website: http://www.cnsmro.ro/content/reg-2-2017-en.pdf

35 Via NCMO Regulation No. 1/2020 amending and supplementing NCMO Regulation No. 2/2017 on the methodology and procedures used for setting capital buffers and the scope of these instruments. NCMO Regulation No. 1/2020 is published on the NCMO website: http://www.cnsmro.ro/res/ups/Regulament-CNSM-1_2020_EN.pdf

36 NBR Order No. 10/2019 on the buffer for credit institutions authorised in Romania and identified by the National Bank of Romania as other systemically important institutions (O-SIIs) was published in *Monitorul Oficial al României*, Part I, No. 933 of 20 November 2019.

UniCredit Bank S.A. (consolidated level), BRD – Groupe Société Générale S.A. (consolidated level), Alpha Bank România S.A. (individual level) and Garanti Bank S.A. (individual level). NBR Order No. 10/2019 was issued for the purpose of enforcing the provisions of NCMO Recommendation No. R/4/2019 on the capital buffer for other systemically important institutions in Romania[37]. The assessment of systemic banks was made based on the data reported as at 31 December 2018.

In 2020, a new assessment was made to identify systemically important banks based on the available information related to the financial year ended 31 December 2019, with NCMO Recommendation No. R/8/2020 on the capital buffer for other systemically important institutions in Romania also setting the additional capital requirements consisting in the capital buffer for other systemically important institutions in Romania (O-SII buffer) applicable as of 1 January 2021. Eight credit institutions, Romanian legal entities, recorded a score above 275 basis points, which is higher than the threshold set for the entities automatically designated as O-SIIs, as follows: Banca Transilvania, UniCredit Bank, BCR, BRD, Raiffeisen Bank, Alpha Bank, CEC Bank and OTP Bank. The composition of the group of credit institutions identfied as having a systemic nature was different from the year before only due to the exit of Garanti Bank from the category of O-SIIs. The assessment was made at the highest consolidation level, in compliance with EBA Guidelines.

Starting with 1 January 2021, the O-SII buffer is applied as follows: (i) 2 percent for Banca Comercială Română (consolidated level), Banca Transilvania (consolidated level), Raiffeisen Bank (consolidated level) and CEC Bank (individual level) and (ii) 1 percent for UniCredit Bank (consolidated level), BRD – Groupe Société Générale (consolidated level), OTP Bank (consolidated level) and Alpha Bank (individual level).

The results of the latest assessment are shown in Table 3.4.

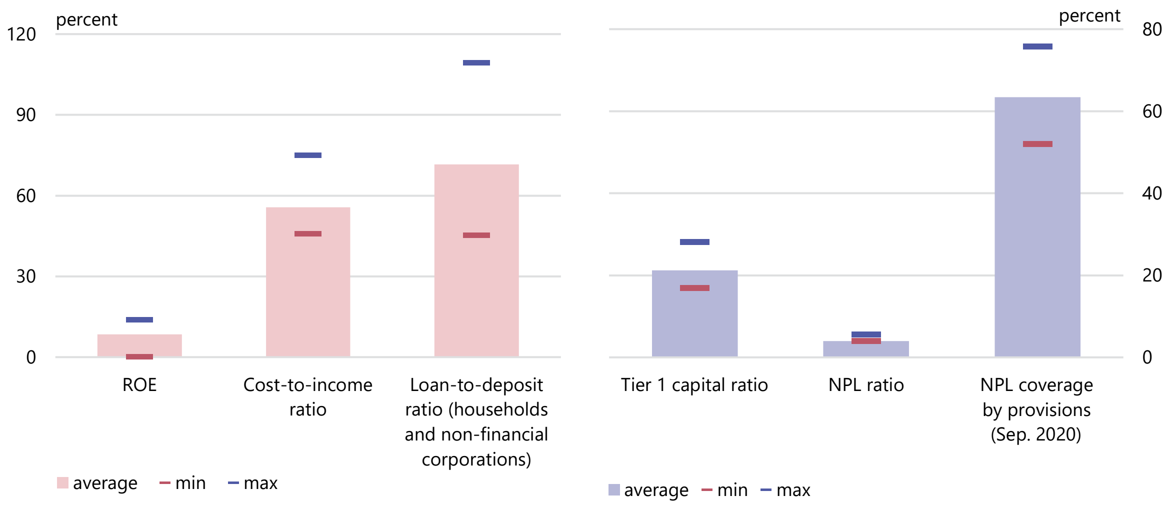
Table 3.4. O-SIIs identified in 2021

Credit institution	Score based on mandatory indicators (EBA Guidelines)	O-SII requirement (% of the total risk exposure amount)	Applicability of O-SII buffer
UniCredit Bank S.A.	1,672	1	consolidated basis
Banca Transilvania S.A.	1,586	2	consolidated basis
Banca Comercială Română S.A.	1,251	2	consolidated basis
BRD – Groupe Société Générale S.A.	1,087	1	consolidated basis
Raiffeisen Bank S.A.	757	2	consolidated basis
Alpha Bank România S.A.	569	1	individual basis
OTP Bank Romania S.A.	411	1	consolidated basis
CEC Bank S.A.	325	2	individual basis

Source: NCMO

[37] Recommendation No. R/4/2019 on the capital buffer for other systemically important institutions in Romania is published on the NCMO website: http://www.cnsmro.ro/en/politica-macroprudentiala/lista-recomandarilor/

Chart 3.16. Prudential and efficiency indicators of systemically important institutions (2020 Q4)



Source: NBR

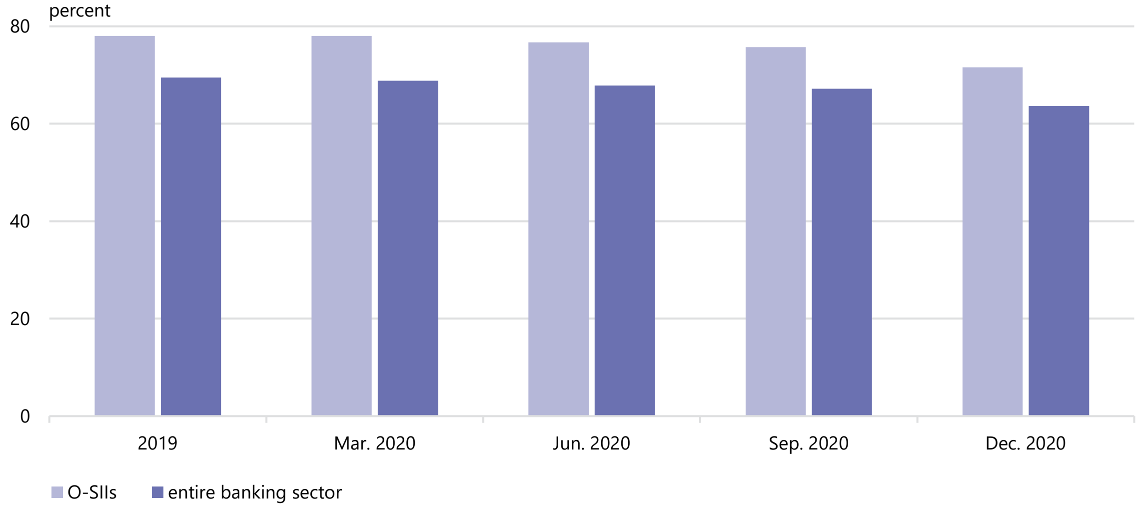
The 2020 assessment revealed that the O-SIIs play a decisive role in the Romanian banking sector, in terms of all the assessment criteria recommended by the European Banking Authority, as follows: (i) they held 75.3 percent of bank assets as at 31 December 2019, (ii) they provide a significant part of financial services to the real economy, i.e. 74.6 percent of loans in stock, 76.2 percent of deposits taken, and 55.1 percent of payments made, (iii) in terms of complexity, they conduct 90.3 percent of transactions in OTC derivatives, they place 86.1 percent of cross-border assets and raise 78.4 percent of foreign liabilities, while (iv) in terms of interconnectedness with the other undertakings conducting financial activities, they provide 60.8 percent of intra-financial assets, they use 72.9 percent of intra-financial liabilities and hold 98.8 percent of bonds issued.

From a prudential perspective, O-SIIs are well capitalised, with an average Tier 1 capital ratio of over 21 percent (September 2020), have a good asset quality (as reflected by the NPL ratio of 3.9 percent) and high profitability (ROE of 8.5 percent), Chart 3.16.

The return on equity was lower than in 2019 (8.5 percent versus 12 percent in December 2019), but the solvency improved – the Tier 1 capital ratio increased by 3 percentage points, while the NPL ratio fell below 4 percent, being also influenced by the moratoria that gave time to borrowers in distress due to the pandemic context.

As a result of the more prudent approach, given the uncertainty associated with the epidemiological situation, the appetite for consumption moderated somewhat. This behaviour of companies also reflected in the loan-to-deposit ratio, which reached 71 percent (two of the eight credit institutions reported an LTD ratio above one, with a structural character, which has however seen significant corrections recently) as compared to nearly 80 percent in the year before, which shows that deposits rose significantly faster than lending activity. In 2020, the growth rate of deposits was swifter than that of loans in

Chart 3.17. Loan-to-deposit ratio of O-SII banks and across the entire banking sector



Source: NBR

the case of O-SII banks, the differential between the two in terms of the LTD ratio standing at 8.5 points at the beginning of the previous year, as against 7.9 in December 2020 (Chart 3.17).

Six out of the eight banks identified as having systemic importance are subsidiaries of foreign banks in other Member States, each of them having systemic importance in their home country, namely France (BRD), Italy (UniCredit), Hungary (OTP Bank), Greece (Alpha Bank), and Austria (BCR, Raiffeisen Bank). Where an O-SII is a subsidiary of either a G-SII or an O-SII which is an EU parent institution and subject to an O-SII buffer on a consolidated basis, the O-SII buffer rate that applies on an individual or sub-consolidated basis to the subsidiary in Romania, in compliance with the European regulatory framework (which was implemented at national level via NCMO Regulation No. 2/2017 on the methodology and procedure used for setting capital buffers and the scope of these instruments) shall not exceed the higher of: (i) 1 percent of the total risk exposure amount and (ii) the G-SII or O-SII buffer rate applicable to the group at consolidated level. Two of the eight systemic banks identified at national level have Romanian capital, i.e. CEC Bank (state-owned capital) and Banca Transilvania (majority Romanian capital). The National Bank of Romania is the competent authority for these institutions.

In this context, when setting the capital buffer for other systemically important institutions for the subsidiaries in Romania of EU institutions, Recommendation NCMO No. R/8/2020 on the capital buffer for other systemically important institutions in Romania took into consideration the level of the global systemically important institutions buffer (G-SII buffer) or the level of the other systemically important institutions buffer applicable to parent undertakings, in accordance with the provisions of Art. 23 para (3) of NCMO Regulation No. 2/2017 on the methodology and procedures used for setting capital buffers and the scope of these instruments.

The vulnerabilities arising from the pandemic context and the higher magnitude of systemic risks[38] call for the implementation of the O-SII buffer at the maximum level allowed by the applicable regulatory framework, especially that this approach did not require new capital contributions from the shareholders of credit institutions, the banks already having voluntary capital reserves. The NCMO Secretariat notified the European Commission, the ESRB, the EBA, the ECB, as well as the credit institutions concerned of the requirement to maintain the O-SII buffer applicable in 2021, in compliance with the CRD IV/CRR regulatory framework.

After the NCMO issued Recommendation No. R/4/2018 on implementing macroprudential instruments for achieving the intermediate objectives included in the Overall Macroprudential Strategy Framework of the National Committee for Macroprudential Oversight, the NBR assumed the implementation of the macroprudential instrument, namely the buffer for other systemically important institutions (O-SII), to achieve the intermediate objective limiting the systemic impact of misaligned incentives with a view to reducing moral hazard. In this context, the NBR implemented NCMO Recommendation No. R/8/2020 on the capital buffer for other systemically important institutions in Romania by issuing Order No. 5/2020 on the buffer for credit institutions authorised in Romania and identified by the National Bank of Romania as other systemically important institutions (O-SIIs)[39].

Changes to the provisions of the regulatory framework at EU level with regard to the implementation of the O-SII buffer

The provisions of the CRD IV regulatory framework[40] regarding the level of the O-SII buffer that may be imposed by competent authorities in EU countries have been amended by Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures (CRD V), to be transposed into national law by 28 December 2020 (pursuant to the provisions of Article 2 in the said Directive).

Specifically, the O-SII buffer rate was raised to 3 percent of the total risk exposure amount (for this decision, the national competent authorities shall only notify the ERSB in advance). The O-SII buffer rate may be higher than 3 percent, subject to the European Commission

[38] The assessment to identify risks to financial stability is presented in the June 2020 *Financial Stability Report* published on the NBR's website. Specifically, the assessment signals two severe risks, namely (i) a rise in global uncertainty and fast deterioration of investor sentiment towards emerging economies and (ii) the worsening of domestic macroeconomic equilibria, also in terms of the structure and financing cost of the budget deficit. There is a third factor with an impact on financial stability that stands at a high level: the risk of an uncertain and unpredictable legislative framework in the financial and banking sector. Two other risks are moderate and refer to: (i) the default risk for loans to the private sector and (ii) the access to finance of the real economy. All five systemic risks mentioned above are seen rising in the period ahead.

[39] NBR Order No. 5/2020 on the buffer for credit institutions authorised in Romania and identified by the National Bank of Romania as other systemically important institutions (O-SIIs) was published in *Monitorul Oficial al României*, Part I, No. 1222 of 14 December 2020.

[40] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

authorisation and the favourable opinion of the ESRB and EBA. Moreover, the O-SII buffer rate that competent authorities in the host country may impose on subsidiaries of foreign credit institutions was also raised. Thus, where a systemically important bank is a subsidiary of either a G-SII or an O-SII which is either an institution or a group headed by an EU parent institution, and subject to an O-SII buffer on a consolidated basis, the buffer that applies on an individual or sub-consolidated basis for the O-SII shall not exceed the lower of:

(a) the sum of the higher of the G-SII or the O-SII buffer rate applicable to the group on a consolidated basis and 1 percent of the total risk exposure amount calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013, and

(b) 3 percent of the total risk exposure amount calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013, or the rate the Commission has authorised to be applied to the group on a consolidated basis in accordance with paragraph 5a of Article 131 in the Directive.

The change was necessary in the context in which competent or designated authorities in host countries should be able to determine the level or levels of application of the other systemically important institutions (O-SIIs) buffer, on the basis of the nature and distribution of the risks embedded in the structure of the banking group. Thus, there are cases when the systemic importance of subsidiaries operating in host countries is higher than that of the group in the home country. Against this background, the competent authorities in the home country and in the host country need to have the required flexibility to set an appropriate O-SII buffer rate for the entity under their supervisory scope.

The provisions of the new regulatory framework have to be implemented initially in the primary legislation, requiring the amendment of the legal framework in place, consisting in Government Emergency Ordinance No. 99/2006 on credit institutions and capital adequacy, as approved, amended and supplemented by Law No. 227/2007, as subsequently amended and supplemented. The NBR and the FSA prepared the draft law amending and supplementing GEO No. 99/2006, which was submitted to the Ministry of Finance, for carrying out the procedure for public consultation and inter-institutional endorsement; afterwards, it will be discussed and adopted by Parliament. Subsequently, the technical provisions of the CRD V need to be implemented in the secondary regulatory framework, by amending NBR Regulation No. 5/2013 on prudential requirements for credit institutions, as subsequently amended and supplemented.

The provisions of the CRD V regulatory framework on setting and calculating capital buffers by the authority designated for macroprudential purposes were implemented through NCMO Regulation No. 1 of 18 December 2020 amending and supplementing NCMO Regulation No. 2/2017 on the methodology and procedures used for setting capital buffers and the scope of these instruments, which was approved by the NCMO General Board in its meeting of 18 December 2020 (held by written procedure) and was published both in *Monitorul Oficial al României*[41] (as required by Article 3 para. 3 of Law No. 12/2017) and on the NCMO website[42] (in line with Article 10 para. (4) of Law No. 12/2017 on the macroprudential oversight of the national financial system).

3.2.1.3. The systemic risk buffer (SyRB)

Implementation framework of the macroprudential instrument

The systemic risk buffer (SyRB) is the main instrument available to EU macroprudential authorities in order to mitigate structural risks to financial system stability. Along with the buffer for other systemically important institutions (O-SII), which addresses the risk specific to institutions of significant sizes, it makes up the structural buffer, a natural complement to the countercyclical capital buffer (CCyB) dedicated to risks of varying intensity depending on the business and financial cycle positions. Introduced in 2013 through the CRD IV[43], the SyRB is currently subject to changes required by the transposition into national law of the CRD V/CRR II legislative package[44]. The legislative framework has been amended as follows: (i) the SyRB may no longer be used to address risks stemming from the systemic importance of institutions, specific to the O-SII buffer, (ii) the SyRB application to sectoral exposures has been clarified, (iii) the possibility to implement multiple buffers at different rates has been introduced, (iv) the requirements regarding the residual nature of the identified systemic risk have been removed, and (v) changes have been made to notification procedures.

The experience accumulated in the EU since the introduction of the macroprudential instrument has demonstrated the need to revise the regulatory framework in order to turn the SyRB from a residual instrument into a flexible one, both through the granularity of exposures to which it may be applied and via the multiple possibilities of application (at sectoral level, by group of institutions, differentiated at individual level, etc.).

The separate use of the two buffers regarding structural systemic risks, i.e. SyRB and O-SII, aims at doing away de facto with the practice of covering O-SII risks via the SyRB, which was possible under the CRD IV legislation. Against this backdrop, credit institutions used to set up the capital requirement by applying the maximum value of the two structural buffers (if the SyRB applied at the level of total exposures). According to the new regulations (CRD V), the capital requirement needs to be calculated exclusively by adding the rates of the two structural buffers. This change seeks to consolidate the flexible nature of the SyRB and avoid the use of several instruments to mitigate a single risk, which could dent the effectiveness of the implementation framework of macroprudential policy.

41 *Monitorul Oficial al României*, Part I, No. 1277 of 22 December 2020.

42 http://www.cnsmro.ro/res/ups/Regulament-CNSM-1_2020_EN.pdf

43 Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD).

44 Directive (EU) 2019/878 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures.

As regards the notification procedure of the new level set by the authorities for the SyRB, according to the CRD IV, irrespective of the rate applied, the relevant (competent or designated) authority had to submit a notification to the European Commission, the ESRB, the EBA and the competent or designated authorities of Member States. This procedure was amended once the CRD V came into force, so that at present, when a systemic risk buffer rate lower than 3 percent is applied, the competent or designated authority shall submit the notification to the ESRB alone[45]. The changes to the regulatory framework entrust the ESRB with the role of coordinating and centralising the notifications made by the Member States' competent and designated authorities. The EBA issued specific guidelines setting the methodology for sectoral application of the systemic risk buffer at European level and clarifying several aspects, such as the manner of implementation, the underlying principles, and the types of eligible exposures (see Box C for further details).

Another novelty consists in introducing the possibility of multiple application of the SyRB to several types of exposures or at the level of total exposures, the value of the buffer being determined as the sum of individual requirements (Article 133(2) of the CRD V):

$$B_{SR} = r_T \cdot E_T + \sum_i r_i \cdot E_i$$

where B_{SR} is the combined buffer requirement applicable to an institution, $r_T \cdot E_T$ is the requirement applied at the level of total exposures (calculated as the product of the buffer rate and the total exposure amount), while $r_i \cdot E_i$ is the requirement applied at the level of a subset of exposures i (calculated similarly to the requirement for total exposures). Through this change, macroprudential authorities can address multiple systemic risks occurring across several layers of the financial system.

Box C. EBA Guidelines on the appropriate subsets of sectoral exposures in the application of the systemic risk buffer

Under Article 133 of Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD IV) each Member State may introduce a systemic risk buffer (SyRB) of Common Equity Tier 1 capital calculated based on total risk exposures or a subset of sectoral exposures. In order to identify the most appropriate subsets of exposures to which competent authorities may apply a systemic risk buffer in accordance with paragraph (6), EBA issued on 30 September 2020 the Guidelines on the appropriate subsets of sectoral exposures to which the competent authority or the designated authority may apply a systemic risk buffer in accordance with Article 133 (5) (f) of Directive 2013/36/EU - EBA/GL/2020/13, whereby relevant guidelines are provided.

The objective of the guidelines is to set a common framework to harmonise the design of the appropriate subsets of sectoral exposures to the application of an SyRB, facilitating a

45 Depending on the exposures to which the SyRB rate applies, a notification needs to be submitted also to competent authorities in other Member States or third countries.

common approach throughout the EU. The guidelines recommend a common framework in which relevant authorities can define subsets specific to their needs. This is done by employing three dimensions: type of debtor or counterparty sector, type of exposure and type of collateral. In addition, if deemed appropriate, the relevant authorities may supplement these dimensions with three sub-dimensions: economic activity, risk profile and geographical area (Figure C.1).

Figure C.1. The dimensions and subdimensions of a subset of sectoral exposures

Counterparty sector	Exposure	Collateralised/secured
• Natural persons • Legal persons (including companies and the public sector)	• All exposures • Retail exposures • Other	• Secured by mortgages either on commercial immovable property or on residential property • Unsecured
+	+	+
Economic activity	**Risk profile**	**Geographical area**
• Economic sectors according to the statistical definition (NACE Rev. 2)	• NPL • Risk weight • LTV/DSTI	• Member State • Region • Subregion/City

Source: EBA

Figure C.2. Criteria for assessing the systemic relevance of the risks stemming from the subsets of sectoral exposures

Size	Riskiness	Interconnectedness
• the size of the targeted subset of sectoral exposures can give rise to a serious risk to the financial system and the real economy in a specific Member State • the relative size of the subset of sectoral exposures to the total assets of the domestic banking system, to the total capital of the domestic banking system, and to the GDP of the domestic economy	• the credit, market and liquidity risk of the targeted subset of exposures is correlated with the magnitude of losses stemming from this subset • historical loss/impairment rates, PD/LGD developments, value adjustments and market developments (forward-looking indicators may also be considered, given the pre-emptive nature of macroprudential buffers)	• direct or indirect dependency on the targeted subset of sectoral exposures • the materialisation of risk in the targeted subset leading to negative direct and/or indirect material spillover effects to other exposures or to financial market actors

Source: EBA

A pre-condition when defining a subset of sectoral exposures in the application of a sectoral SyRB is the systemic relevance of the risks stemming from the subset of sectoral exposures according to a qualitative and quantitative assessment conducted by the relevant authority. The guidelines recommend three criteria to be used in such assessment: size, riskiness and interconnectedness (Figure C.2).

The approach taken in these guidelines when defining the subsets of exposures for the application of a sectoral SyRB leans on the following three principles: (i) systemic relevance, (ii) flexibility and (iii) consistency between jurisdictions.

Systemic relevance: the risk to which the chosen subset of exposures is subject must be of a systemic nature in the country of activation. Flexibility: it is necessary to target the appropriate subset of exposures, considering the heterogeneity of the real estate markets, banking sectors and other economic sectors across the European Union. Consistency between jurisdictions: SyRB application should be consistent across the EU, so a degree of harmonisation is needed, especially for reciprocation by other Member States.

As described in Section 3.2.1.2., the O-SII buffer is applied based on specific criteria pertaining to the systemic importance of credit institutions, as laid down in the EBA Guidelines on the criteria to determine the conditions of application of Article 131(3) of Directive 2013/36/EU (CRD IV) in relation to the assessment of other systemically important institutions (O-SIIs). In the case of the SyRB, the European legislation does not specify standard criteria based on which the instrument can be activated, as this can be done following a specific assessment by each Member State. In order to support national analyses, the ESRB recommends the use of adequate indicators for calibrating the SyRB, their list being included in a relevant ESRB handbook[46] (Figure 3.2).

Figure 3.2. ESRB-recommended indicators to be used for SyRB calibration

Indicators reflecting structural characteristics of the banking sector	Indicators of propagation and amplification of shocks within the financial system	Indicators of risks to the banking sector stemming from the real economy
(i) contribution to the financing of the economy and concentration of the domestic banking sector (ii) foreign ownership (iii) levels of NPLs or significant exposures to level 2 and level 3 assets	(i) exposure concentration and asset commonality (ii) financial interconnections and contagion (iii) commonality in bank business models	(i) economic openness (ii) sectoral risks from the private non-financial sector, households and the public sector

Source: *The ESRB handbook on operationalising macroprudential policy in the banking sector*

[46] *The ESRB handbook on operationalising macroprudential policy in the banking sector.*

Indicators in the first category reflect the structural characteristics of the banking sector, which – in an unfavourable context – would carry the potential to extend the shock transmission channels. The indicators of propagation and amplification of shocks within the financial system enable the highlighting of the contagion effect and of the spiral effect that may lead to significant losses across the entire sector. The key signals that may be conveyed by this type of indicators relate to exposure concentration and asset commonality, financial interconnections and contagion, as well as to commonality in bank business models. Risks to the banking sector stemming from the real economy are analysed by means of a set of indicators, such as economic openness or sectoral risks from the private non-financial sector, households and the public sector. The non-exhaustive list recommended by the ESRB may also be complemented with other relevant indicators, specific to each country depending on the national context, since it is known that any strong shock from the real economy can significantly impair the functioning of the financial sector.

The experience across the EU

In the context of the COVID-19 pandemic, the same as for the other buffers, the year 2020 brought about significant cuts in the applied rates, some of the Member States even resorting to a full release of the SyRB. Data published by the ESRB show that, by end-2020, the SyRB was in place in 15 states, but in four of them the rate was set at 0 percent. Compared to the previous year, no other country embarked on implementing this macroprudential instrument in 2020, the reason being the uncertainties generated by the COVID-19 pandemic, a context in which it is recommended to release capital requirements or render them more flexible with a view to supporting the real economy. For a clearer picture of developments in the SyRB rate, Charts 3.18 and 3.19 indicate a snapshot prior to the outbreak of the COVID-19 pandemic and for end-2020 respectively.

Chart 3.18. Maximum SyRB rate in EEA countries before the outbreak of the COVID-19 pandemic

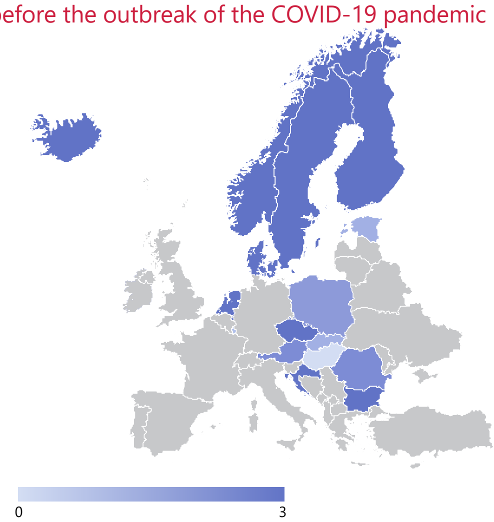
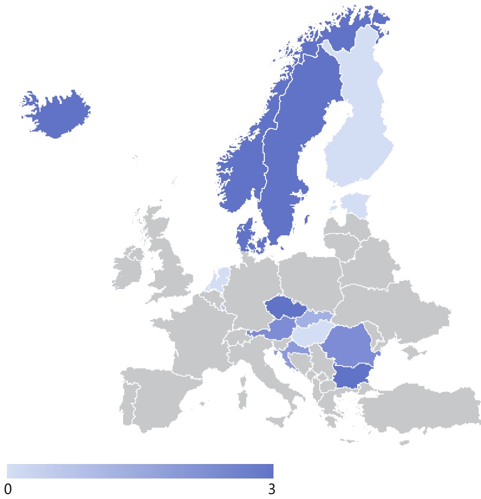


Chart 3.19. Maximum SyRB rate in EEA countries at end-2020



Note: The maximum SyRB rate before the COVID-19 pandemic refers to the level notified by Member States.
Source: ESRB

During 2020, the following countries resorted to downward adjustments in the level of the systemic risk buffer: Poland, Estonia, Finland and the Netherlands. The first three of them fully released the buffer (deactivation/recalibration at 0 percent), whereas the Netherlands lowered its rate only partially in the first phase, while during the CRD V transposition process it was fully released. As indicated in Table 3.5 as well, the maximum level of the SyRB rate applied by countries that implemented this instrument is 3 percent. One of the underlying reasons is the higher complexity of the notification and authorisation procedures for values above 3 percent.

Table 3.5. SyRB arrangements in EEA countries

Member State applying the SyRB	Rate (%)	Exposures to which the SyRB applies	Buffer reduction
Austria	0.5-2	All exposures	
Bulgaria	3	Domestic exposures	
Croatia*	1.5	All exposures	
Czechia	1-3	All exposures	
Denmark	1-3	All exposures	
	3	Domestic exposures (Faroe Islands)	
Estonia	0	Domestic exposures	1 pp
Finland	0	All exposures	1 - 3 pp
Hungary**	0	Domestic exposures	
Iceland	3	Domestic exposures	
Liechtenstein	1-2	All exposures	
Netherlands	0	All exposures	3 pp
Norway	3	All exposures	
Romania	0-2	All exposures	
Slovakia	1	Domestic exposures	
Sweden	3	All exposures	

reduction full release

*) The methodology was amended for the purpose of the CRD V transposition into the national legislation, by establishing a single rate of SyRB buffer (1.5 percent).

**) The recalibration of SyRB was suspended in 2020 due to COVID-19 pandemic, therefore the buffer will remain at 0 percent until the 2021 recalibration.

Source: ESRB

Most countries apply the SyRB rate to all exposures (nine of the 15 states that introduced this buffer), while five of them apply it to domestic exposures. Denmark is the only country that applies the SyRB in a differentiated manner by exposure: within the autonomous region of the Faroe Islands, it applies a SyRB level of 3 percent (domestic exposures), while in the rest of the country the rates range between 1 percent and 3 percent (all exposures).

Distinctly from the CCyB and O-SII buffers, one of the particular features of the systemic risk buffer is that its application does not require standard criteria to be met by national macroprudential authorities, but rather each country takes the steps to implement the buffer in view of a series of indicators determined based on its own assessment. Hence an elevated degree of heterogeneity in terms of both the rates applied and the methodology for setting them.

Implementation in Romania

On the domestic front, the National Committee for Macroprudential Oversight issued – in its meeting of 18 December 2017 – NCMO Recommendation No. 9/2017 on the systemic risk buffer in Romania, whereby the NBR is recommended to implement a systemic risk buffer applicable to all exposures, starting 30 June 2018, with the aim of supporting the adequate management of credit risk and enhancing banking sector resilience to unanticipated shocks, amid unfavourable structural circumstances. It should be mentioned that the recommendation was made in the context of structural vulnerabilities identified, carrying the potential to lead to a larger stock of non-performing loans.

The National Bank of Romania implemented this recommendation and shortly issued NBR Order No. 4/2018 on the systemic risk buffer, according to which – starting 30 June 2018 – credit institutions, Romanian legal entities, under the NBR's supervisory scope on a consolidated or individual basis should maintain, at a consolidated or individual level respectively, a systemic risk buffer applicable to all exposures. To supplement the domestic legislative framework for implementing the SyRB, the NBR issued Order No. 8/2018 on the systemic risk buffer and Order No. 2/2019 amending and supplementing NBR Order No. 8/2018 on the systemic risk buffer, comprising further methodological elements for calculating this buffer.

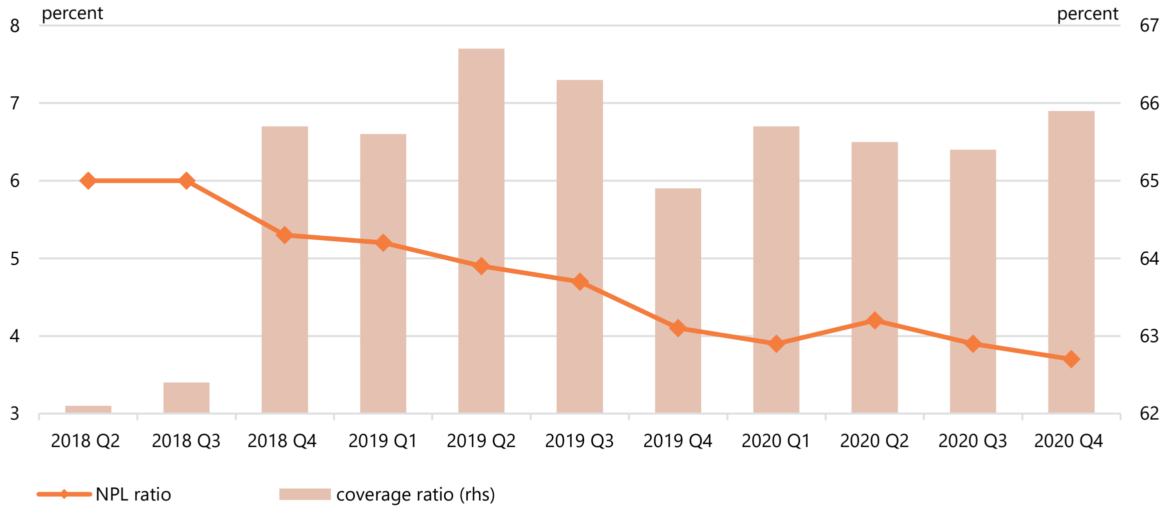
From a methodological perspective, credit institutions determine the level of the systemic risk buffer taking into consideration the non-performing loan ratio and the coverage ratio. Depending on the average recorded by the two indicators over a 12-month period prior to application, the SyRB rate may be set at 0 percent, 1 percent or 2 percent, in relation to the reference thresholds illustrated in Table 3.6.

Table 3.6. Calculation methodology of the systemic risk buffer

NPL ratio	NPL coverage by provisions	SyRB level (% of all exposures)
< 5%	> 55%	0
> 5%	> 55%	1
< 5%	< 55%	1
> 5%	< 55%	2

Source: NBR

Chart 3.20. Developments in the NPL ratio and the coverage ratio after applying the SyRB in Romania



Source: EBA

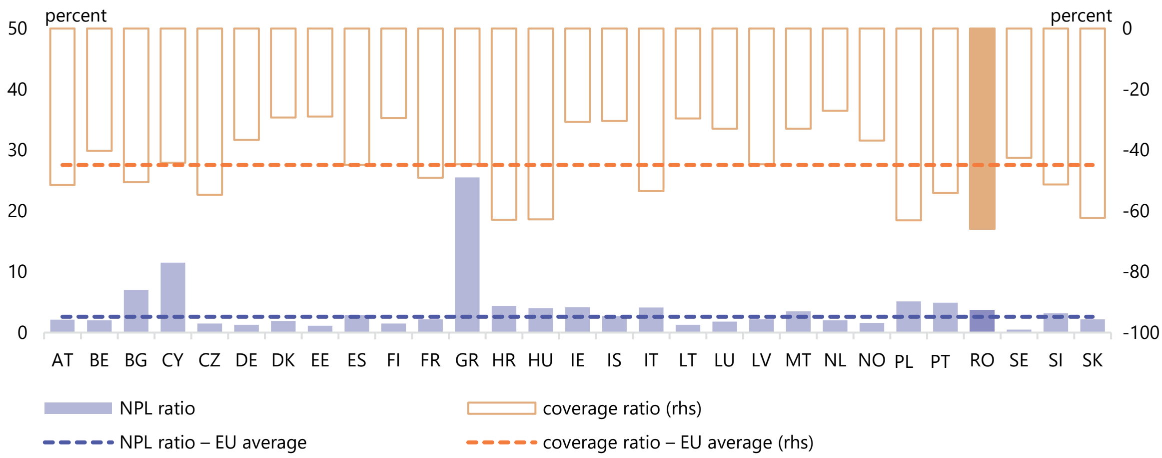
SyRB rates are applied to all exposures of the credit institution, taking into consideration the highest consolidation level. Another important aspect is that, for maintaining the capital buffer in the period from 1 July to 31 December of each calendar year, the average values of the two indicators are determined based on the reference data representing the end of each calendar month in the January-December period of the previous year. At the same time, for the level applied 1 January through 30 June year (N), the data at the end of each calendar month in the period from July (N-2) to June (N-1) are taken into account. The methodology for setting and calibrating the buffer is detailed in NBR Order No. 2/2019 amending and supplementing NBR Order No. 8/2018 on the systemic risk buffer. The level of the two indicators used for buffer calibration is assessed half-yearly to enable the real-time monitoring of their evolution.

The effects of using the SyRB macroprudential instrument soon became apparent. Specifically, around two years after its implementation, the non-performing loan ratio in the banking sector shed 30 percent (December 2020 versus December 2018), starting from 5.3 percent and reaching 3.7 percent. This positive trend illustrates both credit institutions' sustained efforts in the balance sheet clean-up process and the effectiveness of this macroprudential instrument, alongside the NBR's involvement as a supervisory authority in this process. The coverage ratio went up significantly during this period, from 62.1 percent at the end of 2018 Q2 to 65.9 percent at end-2020 (Chart 3.20).

Recent developments generated by the SyRB application have placed Romania among the best performing EU Member States in terms of NPL coverage by provisions (Chart 3.21). At end-2020, Romania ranked topmost in the EU by the level of this indicator.

As regards the other indicator, in spite of all credit institutions' sustained efforts to curb the non-performing loan ratio, Romania still stands above the EU average. At end-2020, the NPL ratio stood at 3.7 percent in Romania, around 1.1 percentage points above the average reported by EEA countries.

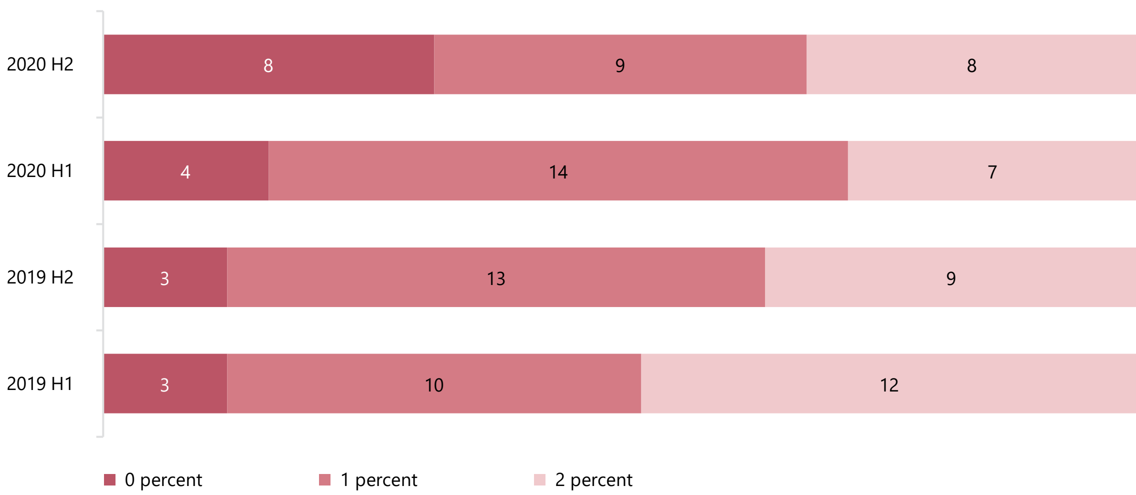
Chart 3.21. NPL ratio and coverage ratio across EU countries (December 2020)



Note: Data based on the EBA's technical standards on supervisory reporting requirements, set in accordance with Regulation (EU) No. 680/2014, as subsequently amended.

Source: EBA

Chart 3.22. Breakdown of credit institutions by SyRB rate



Source: NBR

The breakdown of credit institutions by SyRB rate is also indicative of an improvement during 2020, pointing to their migration towards categories with lower buffer rates (Chart 3.22). However, mention should be made that, although developments across the entire banking sector are positive in terms of curbing the NPL ratio and increasing the coverage ratio, additional efforts are still required at an individual level in the credit institutions' balance sheet clean-up process. The short- and medium-term prospects are surrounded by significant uncertainties related to the impact of the COVID-19 pandemic, while expectations of a pick-up in the NPL ratio may lead to changes in the breakdown of credit institutions in the sense of tighter requirements for the systemic risk buffer.

3.2.2. Other instruments with an impact on financial stability

3.2.2.1. Implementation through voluntary reciprocity of macroprudential policy measures taken by other Member States

By means of Recommendation ESRB/2015/2 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures, the ESRB recommends the relevant national authorities to recognise the macroprudential policy measures taken by other Member States. To this end, Member States adopting a macroprudential policy measure may opt for submitting a reciprocation request to the ESRB, which may issue a recommendation to the other Member States to recognise the said measure. When applying a particular reciprocating macroprudential policy measure, the national authorities may exempt financial service providers that have non-material exposures to the identified macroprudential risk (*de minimis* principle).

The economic shock triggered by the COVID-19 pandemic in 2020 prompted Member States to resort primarily to the easing of macroprudential policy measures, thus acting in a countercyclical manner and enabling financial institutions to continue lending to the economy. During 2020, there were no newly-issued ESRB recommendations on reciprocation at the request of a Member State. Moreover, Estonia decided to release the systemic risk buffer and therefore the Estonian measure was excluded from the list of macroprudential policy measures which are recommended to be reciprocated[47].

The NCMO analyses reciprocation recommendations on a case-by-case basis and decides accordingly. Up to now, there have been no instances where the measures taken by other countries had a material impact on the banking sector in Romania, as the relevant exposures in the context of the said measures stood below the materiality threshold suggested in the recommendations. Consequently, the NCMO decided on the non-reciprocation and on monitoring these exposures.

Considering the NCMO's previous decisions on the reciprocation of measures, as well as the continued low level of non-domestic exposures in the banking sector (see the next section for details), no further action by the national macroprudential authority was necessary during 2020. At the end of last year, the list of measures recommended to be reciprocated (Table 3.7) was as follows:

47 Recommendation ESRB/2020/9 amending Recommendation ESRB/2015/2 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures.

Table 3.7. Measures recommended for reciprocation in Recommendation ESRB/2015/2

Country	Measure	Materiality threshold
Finland	A minimum level of 15 percent for the average risk-weight on loans secured by a mortgage on housing units in Finland applicable to credit institutions using the Internal Ratings Based (IRB) Approach for credit risk.	• EUR 1 billion, at credit institution level
Belgium	A risk-weight add-on for retail exposures secured by residential immovable property located in Belgium, applied to credit institutions using the IRB Approach for calculating regulatory capital requirements. It is composed of (i) a flat risk-weight add-on of 5 percentage points; and (ii) a proportionate risk-weight add-on consisting of 33 percent of the exposure-weighted average of the risk-weights applied to the portfolio of retail exposures secured by residential immovable property located in Belgium.	• EUR 2 billion, at credit institution level
France	A tightening of the large exposure limit applicable to exposures to highly-indebted large non-financial corporations having their registered office in France to 5 percent of eligible capital, applied to global systemically important institutions (G-SIIs) and other systemically important institutions (O-SIIs) at the highest level of consolidation of their banking prudential perimeter.	• EUR 2 billion for the total original exposures of domestically authorised G-SIIs and O-SIIs • EUR 300 million applicable to G-SIIs and O-SIIs, for exposures meeting certain requirements • A threshold of 5 percent of the G-SII's or O-SII's eligible capital at the highest level of consolidation, for exposures identified in the measure
Sweden	A 25 percent floor for the exposure-weighted average of the risk weights applied to the portfolio of retail exposures to obligors residing in Sweden secured by immovable property.	• SEK 5 billion, at credit institution level

Source: ESRB

3.2.2.2. Assessment of materiality of third countries for the Romanian banking sector in relation to the recognition and setting of countercyclical buffer rates

In 2015, the European Systemic Risk Board adopted Recommendation ESRB/2015/1 on recognising and setting countercyclical buffer rates for exposures to third countries. This Recommendation puts into practice and harmonises the identification of material third countries for the European Economic Area and the setting of countercyclical buffer rates for those third countries that have an economic situation characterised by a risk that might spread across the European financial system. Article 139 of Directive 2013/36/EU (CRD IV) allows designated authorities to set a countercyclical buffer rate for exposures to a third country that domestically authorised institutions have to apply to calculate their institution-specific countercyclical capital buffer. A designated authority can act in situations where a countercyclical buffer rate has not been set and published by the relevant third-country authority for that third country, or if it considers that the countercyclical buffer rate set by the relevant third-country authority for that third country is not sufficient to protect the Member States' domestic banking sectors from potential losses associated with excessive credit growth in the third country in question. Moreover, pursuant to Article 138 of the aforementioned Directive, the ESRB may issue a recommendation on the appropriate countercyclical buffer rate for exposures to third countries. Thus, apart from the assessments carried out by each Member State, the ESRB identifies, on an annual basis, material third countries for the banking sector of the European Union and monitors exposures to those countries.

In order to implement Recommendation ESRB/2015/1 at a national level, the National Committee for Macroprudential Oversight adopted NCMO Recommendation No. 2 of 14 June 2017 by means of which the National Bank of Romania is recommended to assess on a regular basis material third countries for the banking sector in Romania in terms of recognising and setting countercyclical buffer rates and to propose the necessary measures should these exposures become material.

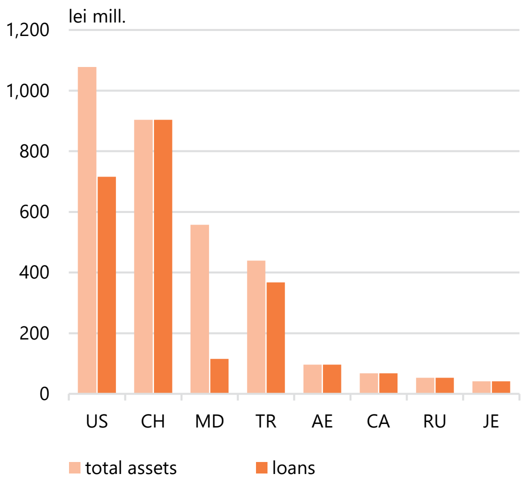
The methodology employed by the ESRB to identify the countries to which the European Union's banking sector has material exposures is based on three exposure metrics: (1) risk-weighted-assets, (2) original exposure, and (3) defaulted exposures. According to the Europe-wide harmonised methodology, these metrics are calculated by using COREP reporting templates. A third country shall be identified as material when meeting one of the following two criteria: (i) the exposures in each of the two quarters preceding the reference date were at least 1 percent for at least one of the metrics listed above and (ii) the arithmetic mean of exposures to the third country in the eight quarters preceding the reference date was at least 1 percent for at least one of the three metrics.

For 2020, the list of material third countries for the European banking sector identified by the ESRB comprised eight countries: the United States of America, Hong Kong, Singapore, Switzerland, China, Turkey, Brazil and Russia. The list remained unchanged as compared with 2019.

The ESRB methodology has the disadvantage that credit institutions must fill out the COREP templates on the geographical distribution of exposures by country only where the ratio of non-domestic original exposures to total original exposures (both domestic and non-domestic) is equal to or higher than 10 percent. Given that the Romanian banking sector has a high concentration of exposures to the domestic market, the analysis made for Romania based on this methodology yielded inconclusive results.

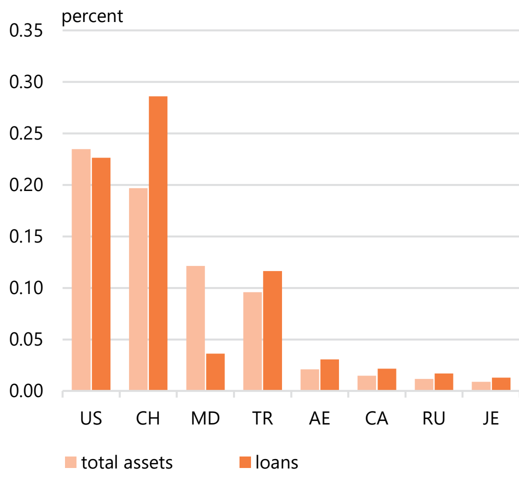
In this context, the analysis at the national level also included a series of additional indicators. According to monetary balance sheets at individual level, Romanian debtors account for 99.5 percent of loans to households and corporations, while EU residents hold the remaining 0.5 percent. Broadening the scope of debtors to also include financial institutions shows that

Chart 3.23. Total exposures and credit exposures to third countries (value)



Source: NBR

Chart 3.24. Total exposures and credit exposures to third countries (percent)



Source: NBR

total exposures to the USA amount to lei 1.1 billion, taking 0.23 percent of the total assets held by banks, Romanian legal entities. Other countries with exposures over 0.1 percent of total exposures are Switzerland, the Republic of Moldova and Turkey. Detailed information is set out in Charts 3.23 and 3.24.

The analysis also included data sets in COREP reports, other than those recommended by the ESRB methodology. The ratio of original exposures, other than domestic exposures, to total original exposures was 7.3 percent at end-2019. Total exposures to third countries generate a low capital requirement at consolidated level (0.14 percent) and credit risk exposures in compliance with the standardised approach place the Republic of Moldova, ahead of Turkey, Switzerland and the United States of America, among the third countries to which the Romanian banking groups and credit institutions are the most exposed, yet at a level that does not point to their materiality. An analysis of the loans granted to the real sector in accordance with the FINREP reports at solo level shows that the largest exposures to third countries are those to Turkey (lei 317 million, 0.18 percent of total), ahead of those to Switzerland and the Republic of Moldova, which are however significantly low.

In this light, the NCMO General Board issued NCMO Decision No. D/3/2020 on identifying material third countries for the Romanian banking sector in terms of recognising and setting countercyclical buffer rates, stating that no material third countries for the Romanian banking sector were identified in 2020.

In addition, following the NCMO meeting of 18 December 2020, a report was submitted to the ESRB concerning the implementation at a national level of certain measures included in Recommendation ESRB/2015/1, in accordance with the calendar set by the European authority, together with a number of proposals aimed at improving the analysis and reporting framework for the identification of cross-border exposures.

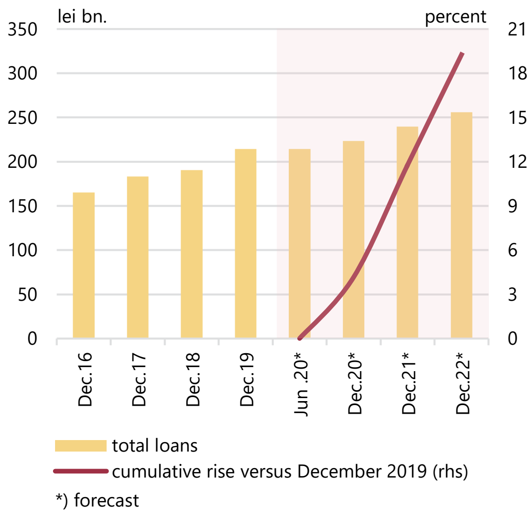
3.2.2.3. Assessment of the impact of credit institutions' funding plans on the flow of credit to the real economy

In the context of subrecommendation A3 of Recommendation ESRB/2012/2 on funding of credit institutions[48], the NCMO General Board was informed of the regular assessment conducted by the NBR of the impact of credit institutions' funding plans on the flow of credit to the real economy.

The reporting of credit institutions' funding plans is carried out in compliance with the EBA Guidelines on harmonised definitions and templates for funding plans of credit institutions under Recommendation A4 of ESRB/2012/2, which the National Bank of Romania included in the national regulatory framework. The obligation to submit regular reports on funding plans lies with the eight largest banks in the Romanian banking sector, i.e. Banca Transilvania, Banca Comercială Română, BRD, Raiffeisen, Unicredit, CEC Bank, Alpha Bank and OTP Bank. These institutions jointly account for approximately 75 percent of total assets and loans to the private sector, which ensures a good representativeness of the sample for the Romanian banking sector.

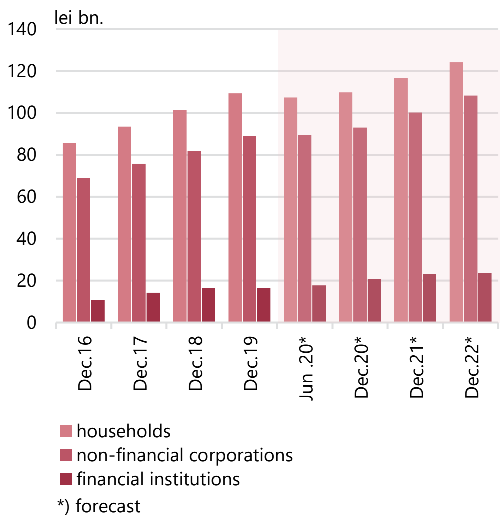
The annual reporting of credit institutions' funding plans takes place in the first quarter of the year and includes reports over a three-year horizon. Consequently, the eight banks listed above submitted their forecasts at a time when the uncertainty surrounding the COVID-19 pandemic had just emerged and its impact on the economy was difficult to estimate. In addition, mention should be made that, at the time of the reporting, government measures to mitigate the negative effects on the economy were at an early stage and yet to be implemented.

Chart 3.25. Lending activity



Source: NBR, credit institutions' reports on funding plans

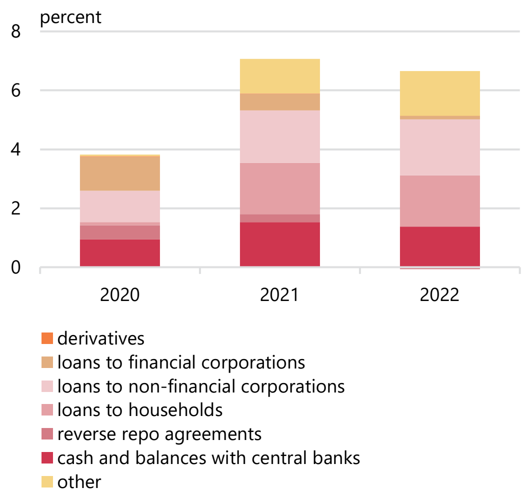
Chart 3.26. Breakdown of credit by component



Source: NBR, credit institutions' reports on funding plans

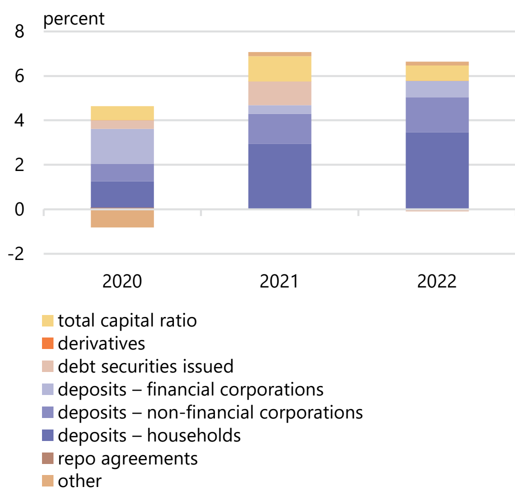
48 The ESRB Recommendation was enacted in Romania through NCMO Recommendation No. 10/2017 on the impact of credit institutions' funding plans on the flow of credit to the real economy.

Chart 3.27. Contribution of assets to the annual increase (forecast)



Source: NBR, credit institutions' reports on funding plans

Chart 3.28. Contribution of liabilities to the annual increase (forecast)



Source: NBR, credit institutions' reports on funding plans

Most banks expected a scenario in which lending would witness a weak performance in 2020 H1, an improvement in the latter half of the year and a strong recovery in 2021 and 2022 (Chart 3.25). According to their estimates, loans will see a 19.3 percent cumulative increase in 2022 versus end-2019, owing to the robust expansion in the years assumed to come in the aftermath of the pandemic. This development will be mainly accounted for by lending to financial institutions (up 44.2 percent, 3-year cumulative rise), whereas the growth rate of lending to the real sector will stand at 17.2 percent (cumulative evolution over three years), with increases being expected in loans to both households (up 13.5 percent) and non-financial corporations (up 21.7 percent) (Chart 3.26). It should be noted that the faster dynamics of lending to non-financial corporations might result in a narrower gap between loans to households and those to non-financial corporations in the balance sheets of banks under review, from lei 20.4 billion in 2019 to lei 15.8 billion in 2022. Housing loans to residents will further play an important part in banks' lending policy (up 14.7 percent). No material changes in banks' strategy for lending to non-financial corporations are expected over the next three years, the share of loans to SMEs remaining unchanged at approximately 55 percent of total loans to non-financial corporations.

Although the accuracy of forecasts was influenced by the unpredictability of the time when they were made, banks' funding plans have the merit of highlighting the behaviour of Romanian credit institutions facing a period of heightened uncertainty. Unlike reports in the previous years, mention should be made of banks' shift towards elements that have other financial entities as counterpart on both the asset and the liability sides, particularly in 2020. This advance can also be the result of a stronger relationship with the parent banks of institutions belonging to major European financial groups. Cash and balances with central banks make a significant contribution to the rise in assets as well, which can signify banks' flight to safety because of the uncertain economic environment, corroborated with a lack of possibilities to invest in high-yielding assets.

Loans to financial and non-financial corporations, cash and reverse repo agreements play an important part in the increase in assets (Chart 3.27) in the first year of the pandemic. The normalisation of the epidemiological situation expected in 2021 and 2022 leads to a major contribution of loans to the real sector during these years. The pick-up in financial activities can also be observed on the liabilities side (Chart 3.28), as deposits of financial corporations are anticipated to make the largest contribution to the annual rise in 2020, to the detriment of deposits of non-financial corporations or households. The tendency of an enhanced contribution of the real sector in 2021 and 2022 is noticeable on the liability side too. Moreover, a substantial contribution to the increase in issued securities in 2021 can be noticed at well. As a result of the rises in all the years under review, the share of equity in total liabilities will widen, which is indicative of banks' concern for ensuring good resilience. Loans to the real sector will further cover more than 50 percent of bank assets, while deposits of the real sector will continue to ensure over 70 percent of their funding needs.

4. Implementation of macroprudential policy

In order to implement at a national level the measures needed for preventing or mitigating systemic risks, in accordance with the provisions of Art. 4 para. (1) letters a) and b) of Law No. 12/2017, the National Committee for Macroprudential Oversight (NCMO) is empowered to (a) issue recommendations and warnings to the National Bank of Romania and the Financial Supervisory Authority, in their capacity of national financial supervisory authorities at a sectoral level and (b) issue recommendations to the Government for the purpose of safeguarding financial stability.

The NCMO was established as an interinstitutional cooperation structure without legal personality and, in this context, the recommendations issued by its General Board are implemented by member authorities (the National Bank of Romania, the Financial Supervisory Authority, the Government), which are the addressees of the NCMO recommendations. In accordance with the provisions of Art. 4 para. (2) of Law No. 12/2017, the addressees of the NCMO's recommendations or warnings may adopt the appropriate measures, including the issuance of regulations in order to observe the recommendations or, as applicable, they may take action in order to mitigate the risks they were warned about. The addressees shall inform the NCMO of the measures adopted or, in cases where the addressees have not taken such measures, they should provide adequate justification for any inaction. If the NCMO finds that its recommendation has not been followed up or that the addressees have not adequately justified their inaction, it shall inform the addressees under strict confidentiality (Art. 4 para. (3) of Law No. 12/2017 on the macroprudential oversight of the national financial system).

Pursuant to Regulation No. 1 of 9 October 2017 on the organisation and functioning of the National Committee for Macroprudential Oversight (the updated version according to NCMO Decisions No. D/1/2018 and No. D/1/2020), the General Board has the power to monitor the measures taken by the addressees following the warnings and recommendations adopted by the two Technical Committees (Art. 30 para. (1) of the NCMO's Rules of procedure). The Technical Committees assess the adopted measures and/or the justifications for not adopting the measures that were previously communicated by the addressees of recommendations, and inform the General Board thereof. In this context, it is required to make regular analyses on the manner of implementation of the recommendations issued by the NCMO.

In the period from January to December 2020, the NCMO issued nine recommendations, as follows:

- in its meeting of 8 May 2020 – NCMO Recommendation No. R/1/2020 on the countercyclical capital buffer in Romania; NCMO Recommendation No. R/2/2020 amending the strategy regarding the implementation of the International Financial Reporting Standards (IFRS) by non-bank financial institutions (NBFIs) as a basis of accounting and for preparing individual financial statements;

- in its meeting of 15 July 2020 – NCMO Recommendation No. R/3/2020 on the countercyclical capital buffer in Romania; NCMO Recommendation No. R/4/2020 on the implementation of Recommendation ESRB/2020/8 on monitoring the financial stability implications of debt moratoria, and public guarantee schemes and other measures of a fiscal nature taken to protect the real economy in response to the COVID-19 pandemic; NCMO Recommendation No. R/5/2020 concerning the implementation of Recommendation ESRB/2020/7 on restriction of distributions during the COVID-19 pandemic; NCMO Recommendation No. R/6/2020 on addressing vulnerabilities from the widening of the agri-food trade deficit;

- in its meeting of 14 October 2020 – NCMO Recommendation No. R/7/2020 on the countercyclical capital buffer in Romania; NCMO Recommendation No. R/8/2020 on the capital buffer for other systemically important institutions in Romania; NCMO Decision No. D/4/2020 concerning the set-up of a working group for supporting green finance;

- in its meeting of 18 December 2020 – NCMO Recommendation No. R/9/2020 on the countercyclical capital buffer in Romania.

In order to assess the manner of fulfilling the requirement set forth in Art. 4 para. (2) of Law No. 12/2017 on the macroprudential oversight of the national financial system , the Technical Committee on systemic risk carried out an analysis on how the recommendations issued by the National Committee for Macroprudential Oversight between January and December 2020 were implemented, based on the information received from the addressees.

The stages of implementation by the addressees of the recommendations issued by the NCMO from January to December 2020, as well as of the recommendations issued in the previous period, which were not completed or which are applicable on a permanent basis, are as follows:

(i) seven recommendations were implemented by the addressee authorities;

(ii) three recommendations are currently being implemented, respectively:

a) NCMO Recommendation No. 3 of 14 June 2017 on enhancing statistical information required for the analyses on the real estate market – the ESRB issued the Recommendation of 21 March 2019 amending Recommendation ESRB/2016/14 on closing real estate data gaps (ESRB/2019/3), which sets forth new deadlines for submitting to the ESRB the reports on the data availability of indicators. Thus, the national macroprudential authorities are requested to deliver their final reports regarding subrecommendations C and D by 31 December 2020 and 31 December 2025 respectively (if the information referred to in point (a) of recommendation D (2) is not available by 31 December 2021);

b) NCMO Recommendation No. R/4/2020 on the implementation of Recommendation ESRB/2020/8 on monitoring the financial stability implications of debt moratoria, and public guarantee schemes and other measures of a fiscal nature taken to protect the real economy in response to the COVID-19 pandemic – concerning part B of NCMO Recommendation No. R/4/2020, the national authorities are required to report the information needed for filling in the templates sent to ESRB on a quarterly basis, at least until January 2022;

c) NCMO Recommendation No. R/6/2020 on addressing vulnerabilities from the widening of the agri-food trade deficit – the largest part of the measures which are the Government's responsibility, respectively those dedicated to implementing the strategy in the field of agriculture have the implementation period of 1-3 years, whereas the measure regarding the implementation of an industrial policy for the food sector that should lead to an improved fulfilment of the government's role in underpinning the agri-food sector has the implementation period of 3-5 years. Moreover, the NBR is recommended to review, at least once every two years, the methodology for identifying the firms that could be viewed as potential national champions in the agri-food sector and to disseminate additional statistical data in order to improve the agri-food firms' access to finance. These responsibilities have a regular implementation period, starting December 2020;

(iii) three recommendations are applicable on a permanent basis, requiring addressees to carry out regular analyses. The addressees implemented all three recommendations in 2017, 2018, 2019 and 2020.

The result of the analysis concerning the developments in the implementation by the addressees of the recommendations issued by the National Committee for Macroprudential Oversight from January to December 2020, as well as of the recommendations issued in the previous period, which were not completed or which are applicable on a permanent basis is summarized in the Annex.

Annex

The stages of implementation of the recommendations issued by the NCMO from January to December 2020, as well as of the recommendations issued in the previous period, which were not completed or which are applicable on a permanent basis

NCMO recommendation	Addressee	Stage of implementation
NCMO Recommendation No. 2 of 14 June 2017 on material third countries for the Romanian banking sector in terms of recognising and setting countercyclical buffer rates (permanent basis)	NBR	The NCMO recommendation was implemented by regular assessments made by the NBR, which were reviewed and decided upon by the NCMO General Board, resulting in the adoption of the following: (i) NCMO Decision No. D/8/2018 on identifying material third countries for the Romanian banking sector in terms of recognising and setting countercyclical buffer rates; (ii) NCMO Decision No. D/2/2019 on identifying material third countries for the Romanian banking sector in terms of recognising and setting countercyclical buffer rates; (iii) NCMO Decision No. D/3/2020 on the assessment of materiality of third countries for the Romanian banking sector in relation to the recognition and setting of countercyclical buffer rates. According to the above-mentioned decisions, for 2018, 2019 and 2020, no material third countries were identified for the banking sector in Romania in terms of recognising and setting countercyclical buffer rates.
NCMO Recommendation No. 3 of 14 June 2017 on enhancing statistical information required for the analyses on the real estate market	NBR, FSA	The NBR and the FSA implemented the recommendation by developing and conducting a survey on real estate and commercial real estate markets in Romania, which was sent to: (1) credit institutions in Romania playing an important role in the real estate sector, (2) non-financial corporations participating directly or indirectly in the Romanian real estate market (77 companies), (3) insurance companies, pension funds and investment funds. The results of the survey were published in the June and December 2018 *Financial Stability Reports* (published on the NBR website http://www.bnr.ro/Regular-publications-2504.aspx). Considering all the difficulties encountered by Member States when collecting information, primarily that on the commercial real estate market, the European Systemic Risk Board issued Recommendation of 21 March 2019 amending Recommendation ESRB/2016/14 on closing real estate data gaps (ESRB/2019/3), which sets forth new deadlines for submitting to the ESRB the reports on the data availability for a number of indicators. According to the ESRB's preliminary assessment of the interim report submitted on 31 December 2019, Romania was assessed as fully compliant. During the NCMO meeting of 18 December 2020, NCMO Note No. 38/2020 on reporting to the ESRB on the availability of information on residential real estate loans was approved, whereby the NCMO General Board was informed that the National Bank of Romania will submit to the ESRB, by 31 December 2020, the template for the follow-up regarding the availability of indicators mentioned by subrecommendations A and B, according to the requirements in Recommendation ESRB/2016/14 (implemented at national level via NCMO Recommendation No. 3 of 14 June 2017 on enhancing statistical information required for the analyses on the real estate market), supplemented and amended by Recommendation ESRB/2019/3.

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NCMO recommendation	Addressee	Stage of implementation
		The template for the follow-up of Recommendation ESRB/2016/14 for deadline 31.12.2020 was submitted to the ESRB on 24 December 2020.
NCMO Recommendation No. 10 of 18 December 2017 on the impact of credit institutions' funding plans on the flow of credit to the real economy (permanent basis)	NBR	The recommendation was implemented through the assessments for 2018 (based on the reports with the reference date of 31 December 2017), for 2019 (based on the reports with the reference date of 31 December 2018) and for 2020 (based on the reports with the reference date of 31 December 2019) on the impact of credit institutions' funding plans on the flow of credit to the real sector, also in terms of macroprudential policy, which were submitted to the NCMO General Board. The analyses showed the projected developments in credit to the real sector (for both non-financial corporations and households) and the level of financial intermediation, the total debt-to-GDP ratio, the dynamics of the funding and liquidity profile of credit institutions, and the impact of credit institutions' funding plans on solvency and profitability ratios.
NCMO Recommendation No. R/4/2018 on implementing macroprudential instruments for achieving the intermediate objectives included in the Overall Macroprudential Strategy Framework of the National Committee for Macroprudential Oversight (permanent basis)	NBR, FSA	The NBR makes regular assessments of the risks and vulnerabilities in the financial system and the real economy, as well as of the appropriateness of implementing/recalibrating/deactivating macroprudential instruments, which are presented to the NCMO General Board for review and decision. To date, the NBR has implemented the following macroprudential instruments: the capital conservation buffer; the countercyclical capital buffer (CCyB); the buffer for other systemically important institutions (O- SII buffer); the systemic risk buffer (SyRB); requirements for the loan-to-value ratio (LTV); requirements for the debt service-to-income ratio (DSTI). The FSA makes regular assessments of the risks and vulnerabilities identified in the three non-bank financial markets under its supervision, as well as of the appropriateness of implementing the existing macroprudential instruments. To date, the following macroprudential policy measures have been implemented: (i) at the level of firms for financial investment services (FFIIs): the capital conservation buffer (which was implemented in four annual increments of 0.625 percent of the total risk-weighted exposure from 1 January 2016 to 1 January 2019); (ii) in the case of insurance companies: the liquidity index of insurance undertakings; the recovery plan; (iii) in the case of the private pension market: limits on significant exposures; (iv) in the case of administrators of private pension funds: limiting the exposure to an issuer to 5 percent of net assets; the exposure to a group of issuers and their affiliates may not exceed 10 percent of the private pension fund's assets; and (v) for all entities under its supervision, the FSA applies requirements on IT system security.
NCMO Recommendation No. R/1/2020 on the countercyclical capital buffer in Romania	NBR	The NBR implemented the NCMO recommendation on maintaining the countercyclical capital buffer rate at 0 (zero) percent as set forth in NBR Order No. 12/24 December 2015 on the capital conservation buffer and the countercyclical capital buffer (published in *Monitorul Oficial al României*, Part I, No. 980 of 30 December 2015), which establishes the following in Art. 2:

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NCMO recommendation	Addressee	Stage of implementation
		Art. 2 - Starting with 1 January 2016, the countercyclical capital buffer rate for credit institutions with credit exposures in Romania is 0 percent of the total risk exposure amount calculated in accordance with Article 92(3) of Regulation (EU) No. 575/2013. NBR Order No. 12/24 December 2015 on the capital conservation buffer and the countercyclical capital buffer was issued for the purpose of enforcing the National Committee for Financial Stability’s Recommendation No. 1/2015 on the implementation of capital buffers in Romania. The analyses aimed at assessing the opportunity to use the capital countercyclical buffer from the perspective of lending developments are carried out on a quarterly basis.
NCMO Recommendation No. R/2/2020 amending the strategy regarding the implementation of the International Financial Reporting Standards (IFRS) by non-bank financial institutions (NBFIs) as a basis of accounting and for preparing individual financial statements	NBR	The NBR implemented the NCMO recommendation by issuing NBR Order No. 3 of 11 June 2020 amending and supplementing NBR Order No. 8/2019 on the application of International Financial Reporting Standards by non-bank financial institutions, which was published in *Monitorul Oficial al României*, Part I, No. 537 of 23 June 2020 (entry into force: 23 June 2020). In addition, NBR Regulation No. 4/2020 amending NBR Regulation No. 20/2009 on non-bank financial institutions was adopted, so as to ensure compliance with the NCMO decision on the 6-month postponement of the programme for applying the transitory regime by using off-balance sheet accounting to affect the own funds that should be held by the non-bank financial institutions enlisted in the Special Register, effective 1 January 2021 and not 1 July 2020 (which was the date set out in the previous version of the Regulation).
NCMO Recommendation No. R/3/2020 on the countercyclical capital buffer in Romania	NBR	The NBR implemented the NCMO recommendation on maintaining the countercyclical capital buffer rate at 0 (zero) percent as set forth in NBR Order No. 12/24 December 2015 on the capital conservation buffer and the countercyclical capital buffer (published in *Monitorul Oficial al României*, Part I, No. 980 of 30 December 2015).
NCMO Recommendation No. R/4/2020 on the implementation of Recommendation ESRB/2020/8 on monitoring the financial stability implications of debt moratoria, and public guarantee schemes and other measures of a fiscal nature taken to protect the real economy in response to the COVID-19 pandemic	NBR, FSA, Government	Regarding part A of NCMO Recommendation No. R/4/2020, the NBR had a proactive role in assessing the impact of debt moratoria on financial stability, focusing on the banking sector and NBFIs (by conducting stress tests of solvency and liquidity, monitoring relevant prudential indicators and the flow of new loans). Along with the public moratorium (introduced by GEO No. 37/2020), other legislative initiatives were proposed in order to protect borrowers and defer payments, the NBR conducting the related impact assessments. At the same time, the NBR introduced a special weekly report, whereby banks should submit information on the number and volume of accepted requests for deferred payments, while also including additional requests for information in the monthly reports of banks and NBFIs to the Central Credit Register (CCR) with a view to monitoring their credit portfolios and the changes in risk indicators. Another significant data source consists of the new bank reports specific to fiscal measures, set up following the EBA recommendations. Moreover, the NBR conducts regular analyses on the situation of non-financial corporations, based on semi-annual financial data, as well as on the household sector, while also monitoring the developments in the labour market and the real estate market.

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NCMO recommendation	Addressee	Stage of implementation
		The Financial Supervisory Authority adopted a series of microprudential measures in response to the COVID-19 pandemic, which are not of a fiscal nature and are not subject to NCMO Recommendation R/4/2020. These measures mainly refer to: extending report deadlines for the insurance market; recommendations regarding the transparency of issuers; using electronic means of communication; cutting 25 percent of all taxes charged by the FSA during the state of emergency; introducing the possibility of activating exceptional tools for investment fund participants; issuing cyber risk alerts; temporary derogation from the ceiling on investment in government securities for private pension funds. As regards part B of NCMO Recommendation No. R/4/2020, the national authorities submitted the data needed for filling in the templates submitted to the ESRB. The NCMO Secretariat aggregated the contributions of member authorities, submitting the templates to the ESRB within the established deadlines (July and October 2020). Reporting will take place on a quarterly basis and is required at least until January 2022.
NCMO Recommendation No. R/5/2020 concerning the implementation of Recommendation ESRB/2020/7 on restriction of distributions during the COVID-19 pandemic	NBR, FSA	Ever since the beginning of the pandemic, the NBR took measures to ensure compliance with Recommendation ESRB/2020/7 on restriction of distributions during the COVID-19 pandemic, targeting both the banking sector and non-bank financial institutions (NBFIs). Regarding the measures applicable to the banking sector, the NBR sent to credit institutions, Romanian legal entities, Letters No. FG/161/19 March 2020 and No. FG/189/3 April 2020, recommending the adoption of necessary measures to ensure an adequate level of own funds in order to allow a sound management of risks, *inter alia* to refrain from dividend distribution under the balance sheet at 31 December 2019, from buying back ordinary shares and from creating an obligation to pay variable remuneration for a longer period. Moreover, the NBR sent Letter No. FG/229/28 April 2020 to banks, informing them that they will not benefit from the flexibility enhancement of capital requirements imposed from a macroprudential perspective (the combined capital buffer) nor from liquidity (complying with a liquidity coverage ratio – LCR above one) if they make a dividend distribution during 2020 (including in the form of share buy-backs). As for non-bank financial institutions (NBFIs), there was a need to increase their absorption capacity of potential losses. Under these circumstances, the NBR sent to the NBFIs enlisted in the Special Register Letter No. FG/252/19 May 2020, informing them that the NBFIs that decide to distribute dividends or buy back shares would not benefit from the measures enhancing the flexibility of own funds requirements. Following the transposition of Recommendation ESRB/2020/7 at national level via NCMO Recommendation No. R/5/2020, the NBR sent letters to banks, Romanian legal entities (Letter No. FG/443/12 August 2020), and to non-bank financial institutions (Letter No. FG/444/12 August 2020), fully incorporating their provisions.

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NCMO recommendation	Addressee	Stage of implementation
		The Financial Supervisory Authority issued a set of recommendations for the insurance and reinsurance companies regarding the measures for minimising the effects of the COVID-19 crisis, in view of: the need to maintain a sufficiently high level of own funds in order to mitigate systemic risk and contribute to economic recovery; the negative impact that the COVID-19 crisis might have on the companies' solvency through a decrease in subscriptions and a rise in liabilities, as a result of persistently low interest rates and of low returns on assets. Out of a total of 26 insurance/reinsurance companies, approximately 83 percent complied with the recommendations issued by the FSA, whereas 15 percent expressed their intention to comply. Financial Investment Companies (FIC) had a level of own funds well above the minimum capital requirement in their category of services. Regarding the recommendations to refrain from buying back ordinary shares or paying variable remuneration, these measures do not have a significant impact on investment companies in Romania. The FSA will apply the recommendation on an individual basis if there are indications that the investment firms do not comply with or will not meet capital requirements.
NCMO Recommendation No. R/6/2020 on addressing vulnerabilities from the widening of the agri-food trade deficit	Government, NBR	The contributions set forth by NCMO Recommendation No. R/6/2020, which fell under the NBR's responsibility during 2020, were implemented via the publishing on the NCMO website, in August 2020, of the following information: i) the methodology for identifying the firms with development potential in the food sector; ii) statistical data on lending to agri-food firms by credit institutions and NBFIs, based on the NACE code, updated in March 2020. An overview of the measures adopted by the Government in view of the tasks assigned by the NCMO recommendation is presented below: **According to point 1:** In order to implement the Common Agricultural Policy (CAP) for the 2021-2027 programming period and the Farm to Fork Strategy, the Government organised a consultation process of the partnership structures with regard to the National Strategic Plan (NSP) 2021-2027. The working groups carried out a SWOT analysis, based on socio-economic, agricultural and environmental assessments, which was submitted to the European Commission and the external assessor. On 1 July 2020, the SWOT analysis was published on the Ministry of Agriculture and Rural Development website for public consultation and it was forwarded to the members of the Thematic Advisory Committee (TAC). In July 2020, online meetings of the working groups and the TAC were organised to discuss the SWOT analysis, the first draft of the Needs Analysis being also prepared, both documents benefiting, *inter alia*, from the recommendations made by the European Commission on the development of strategic plans. **According to point 2:** Under the CAP 2021-2027 framework, digitalisation in rural areas and agriculture is a significant objective, which is addressed within the cross-cutting approach "Fostering and sharing of knowledge, innovation and digitalisation in agriculture".

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NCMO recommendation	Addressee	Stage of implementation
		According to point 3: Once with the Government's approval of the legal act on the implementation of the "IMM Agro Invest" sub-programme, the legislative framework was created for farmers to access the financial resources provided by the Ministry of Finance under this programme, which consisted in state guarantees and mechanisms for subsidising interest rates on loans; these support measures were implemented in accordance with the temporary framework for granting state subsidies during the COVID-19 pandemic, a document whose application period was extended by the EC until 30 June 2021. **According to point 4:** The current legislation stipulates regulatory measures for establishing a guarantee scheme for funds granted by credit institutions and/or non-bank financial institutions based on certificates of deposit, as well as for the set-up of the Warehouse Receipt Compensation Fund. These mechanisms aimed to ensure the farmers' access to financing granted by banks/non-bank financial institutions, based on the certificates of deposit issued on account of the stored harvest. The Guarantee Funds' participation procedure in the operationalisation of the certificate-of-deposit system for consumer seeds is currently under review. **According to point 5:** The Government has taken specific steps to improve the legislation on certifying and promoting high value-added agri-food products, with new legal acts on quality schemes being prepared and notified to the European Commission, as follows: • Draft order on the attestation of agri-food products marked as "Premium Quality"; • Draft order on the registration of "established recipes" and the attestation of food products prepared by following "established recipes"; • Draft order on the registration of technical quality specifications related to the general scheme "Quality Guaranteed". Romania has also introduced, under the National Rural Development Programme, special promotion and development measures, namely: support for the first-time participation in quality schemes; support for information and promotion activities carried out by groups of producers on the domestic market; support for horizontal and vertical cooperation between supply-chain actors, in order to establish and develop short supply chains and local markets, as well as to perform related promotion activities in the local context; investments in tangible assets; investments in agricultural holdings, where family farms, small and medium-sized farms were financed as a priority, with a special emphasis on creating new forms of farmers' associations via the established Local Action Groups; these measures should remain in place when the new National Strategic Plan is prepared. Among the measures aiming to consolidate the short agri-food chain are: • sustainable local partnerships – between local action groups, local consortia, local and regional clusters, etc., which could contribute to the development of local trade: ASTA (associations supportive of traditional agriculture), flying markets and stores with Romanian products;

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NCMO recommendation	Addressee	Stage of implementation
		• events organised to promote Romanian agri-food products; • innovative partnerships for selling agri-food products in European and third countries where Romanian communities hold a significant share and have representative local organisations. **According to point 6:** During 2020, the Government took actions to promote registered/attested/certified agri-food products based on various quality schemes, the main objective of which is to better recognise the additional effort of farmers and economic agents to obtain agri-food products of a higher quality. Thus, through the legal acts initiated by the Government with regard to the national and European quality schemes, local products were attested at national level and recognized at European level, thus securing the right to make use of a specific logo inscribed on the label of these products, making them visible and thus easily identified by consumers. The products attested/certified that make use of such logos are the following: • "traditional product", according to MARD Order No. 724/2013 on the attestation of traditional products, as subsequently amended and completed, registered in the National Register of Traditional Products; • "food product prepared by following established Romanian recipes", according to MARD Order No. 394/2014 on the attestation of food products prepared based on established Romanian recipes, registered in the National Register of Established Recipes; • product that was awarded the optional quality term of "mountain product" according to MARD Order No. 52/2017 on the approval of the Procedure for verifying the compliance of the data included in the tender specifications in order to grant the right to use the optional quality term of "mountain product" and to verify the compliance with European and national legislation of the economic agents who gained the right to use that mention, registered in the National Register of Mountain Products. The Catalogue of Certified Food Products mobile application is used to promote these categories of products. There is also information available in a separate section on the www.madr.ro website. **According to point 7:** The National Strategic Plan will aim to (i) promote the establishment and development of short supply chains and local markets, (ii) support investment in agriculture and the food industry in order to narrow the agri-food trade deficit, (iii) digitalise agriculture and the rural areas, (iv) promote innovation in the agricultural sector and operations leading to a low environmental impact of the agriculture and food industry, and (v) increase the agricultural areas with certified organic crops and enhance trade in organic agri-food products.

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NCMO recommendation	Addressee	Stage of implementation
NCMO Recommendation No. R/7/2020 on the countercyclical capital buffer in Romania	NBR	The NBR implemented the NCMO recommendation on maintaining the countercyclical capital buffer rate at 0 (zero) percent as set forth in NBR Order No. 12/24 December 2015 on the capital conservation buffer and the countercyclical capital buffer (published in *Monitorul Oficial al României*, Part I, No. 980 of 30 December 2015).
NCMO Recommendation No. R/8/2020 on the capital buffer for other systemically important institutions in Romania	NBR	The NBR implemented the NCMO recommendation by issuing NBR Order No. 5 of 4 December 2020 on the buffer for credit institutions authorised in Romania and identified as other systemically important institutions (O-SIIs), published in *Monitorul Oficial al României*, Part I, No. 1222 of 14 December 2020 (entry into force: 14 December 2020).
NCMO Recommendation No. R/9/2020 on the countercyclical capital buffer in Romania	NBR	The NBR implemented the NCMO recommendation on maintaining the countercyclical capital buffer rate at 0 (zero) percent as set forth in NBR Order No. 12/24 December 2015 on the capital conservation buffer and the countercyclical capital buffer (published in *Monitorul Oficial al României*, Part I, No. 980 of 30 December 2015).

Abbreviations

BSE	Bucharest Stock Exchange
CAP	Common agricultural policy
CARES	Coronavirus Aid, Relief, and Economic Security
CCoB	Capital Conservation Buffer
CCR	Central Credit Register
CCyB	Contercyclical Capital Buffer
CLIFS	Country-Level Index of Financial Stress
COREP	Common Reporting Framework
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
DSTI	Debt service to income
DTI	Debt to income
EAGF	European Agricultural Guarantee Fund
EBA	European Banking Authority
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECB	European Central Bank
ECDC	European Centre for Disease Prevention and Control
EDP	Excessive Deficit Procedure
EEA	European Economic Area
EIB	European Investment Bank
EIOPA	European Insurance and Occupational Pensions Authority
ESA	European System of Accounts
ESAs	European Supervisory Authorities
ESIF	European structural and investment funds
ESRB	European Systemic Risk Board
EU	European Union
Eurostat	Statistical Office of the European Communities
FDI	Foreign direct investment
FEAD	Fund for European Aid to the Most Deprived
FINREP	Financial Reporting
FIC	Financial Investment Companies
FSA	Financial Supervisory Authority
GDP	Gross domestic product
GEO	Government Emergency Ordinance
G-SII/O-SII	Global/Other Systemically Important Institutions

IFRS	International Financial Reporting Standards
ILO	International Labour Organization
IMF	International Monetary Fund
IRB	Internal Rating Based approach
LCR	Liquidity coverage ratio
LTV	Loan to value
MARD	Ministry of Agriculture and Rural Development
MF	Ministry of Finance
MTO	Medium-term objective
NBFI	Non-bank financial institution
NBR	National Bank of Romania
NCMO	National Committee for Macroprudential Oversight
NIS	National Institute of Statistics
NPL	non-performing loans
NSP	National Strategic Plan
OCR	overall capital ratio
PEPP	Pandemic Emergency Purchase Programme
ROA	Return on assets
ROBOR	Romanian Interbank Offered Rate
ROE	Return on equity
SEK	Swedish krona
SGP	Stability and Growth Pact
SMEs	Small and medium-sized enterprises
SURE	Support to mitigate Unemployment Risks in an Emergency
SyRB	Systemic Risk Buffer
TAC	Thematic Advisory Committee
TLTRO	Targeted longer-term refinancing operations
UCIs	Undertakings for collective investment
VIX	Chicago Board Options Exchange Volatility Index

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