The National Committee for Macroprudential Oversight

Annual Report

2021

Annual Report
of the National Committee
for Macroprudential Oversight
for the year 2021

N O T E

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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 multiple capacity as monetary, prudential, resolution and payment system oversight authority. Financial stability objectives are pursued both by way of its prudential, regulatory and resolution 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 international macro-financial environment was marked by the evolution of the COVID-19 pandemic during 2021 as well, with the authorities further taking measures to mitigate the identified vulnerabilities and address new challenges. The main risks to financial stability remained manageable, but major vulnerabilities continued to build up during this period, such as high indebtedness, particularly of the public sector, asset overvaluation in some financial market segments, as well as the exposure of the economy and the financial system to climate change risks. Short-term risks related to the health crisis have abated, whereas other risks have gained prominence: the geopolitical risk and the risk generated by costlier fossil fuels. In this uncertainty-ridden context, macroprudential policy was one of the key elements in the mix of measures taken at European and national level to ensure financial sector resilience and the supply of finance in order to prop up the post-pandemic economic recovery. After the outbreak of the pandemic had prompted the launch of numerous measures fostering the real economy, especially by recalibrating the instruments so as to support financing, the year 2021 saw the entering into a new paradigm, i.e. the normalisation of macroprudential policy, amid overcoming the initial shock and with a view to preventing the build-up of systemic risks. Specifically, eight EEA countries decided to raise the countercyclical buffer (CCyB) rate in 2021, with most of measures applying as of 2022 and 2023, given the 12-month lag set forth in the legislative framework between the decision and the actual implementation thereof. Moreover, several Member States recalibrated the structural buffer rates (the buffer for systemically important institutions and the systemic risk buffer), mainly as a result of the new European regulatory framework (CRD V) becoming effective.

On the domestic front, the prudent stance of macroprudential policy materialised in an increase of countercyclical capital requirements, given the high levels of liquidity and profitability indicators of the banking sector, which allow capital conservation, without creating lending constraints and hindering eligible borrowers' access to credit. Furthermore, the National Committee for Macroprudential Oversight (NCMO) approved the use of a new methodology to calibrate the capital buffer for other systemically important institutions (O-SII buffer), which directly reflects the connection between the scores calculated based on EBA-recommended indicators and the level of applied requirements. In order to address the new challenges and vulnerabilities to financial stability, an interinstitutional working group was set up and a recommendation was issued to support green finance. The purpose was to underline the major role of climate change effects for the Romanian economy and the banking sector, in terms of both opportunities and costs associated with the transition to a green economy. During 2021, the NCMO analysed the macroprudential policy stance on a regular basis and issued five recommendations on capital buffers (four regarding the CCyB and one regarding the O-SII buffer):

- the countercyclical capital buffer (CCyB) was raised to 0.5 percent starting 17 October 2022, amid the fast increase in lending during 2021, the tensions surrounding macroeconomic equilibria, the high levels of voluntary capital reserves, and the normalisation trend of macroprudential policy at European level (NCMO Recommendation No. R/7/2021);
- looking at the buffer for other systemically important institutions (O-SII), nine systemically important institutions were identified; they are applied a differentiated buffer ranging between 0.5 and 2 percent, in equal increments of 0.5 percentage points, according to the new calibration methodology by score buckets (NCMO Recommendation No. R/8/2021);
- regarding the systemic risk buffer (SyRB), NCMO Recommendation No. R/9/2017 (as subsequently amended by NCMO Recommendation No. R/7/2018) was further operative, whereby credit institutions are required to apply a buffer level of 0 percent, 1 percent or 2 percent depending on the values of the non-performing loan ratio and the coverage ratio. SyRB requirements posted downward dynamics in 2021, given the improvement in the aforementioned prudential indicators across the banking sector in Romania.

During the four meetings of the NCMO General Board in 2021, nine recommendations were issued, of which four on other topical issues pertaining to macroprudential policy in Romania:

- extension of the period to refrain from dividend distribution until 30 September 2021 (Recommendation No. R/2/2021);
- compliance with the provisions of EBA Guidelines on the specification and disclosure of systemic importance indicators – EBA/GL/2020/14 (Recommendation No. R/3/2021);
- implementation of Recommendation ESRB/2020/12 on identifying legal entities (Recommendation No. R/5/2021);
- analysis of the working group on supporting green finance (Recommendation No. R/6/2021).

The sustainable increase in financial intermediation is one of the intermediate objectives of macroprudential policy laid down in the *Overall Macroprudential Strategy Framework of the National Committee for Macroprudential Oversight*. Given that Romania records the lowest level of financial intermediation in the European Union, the NCMO General Board decided, in its meeting of 15 December 2021, to set up an interinstitutional working group tasked with identifying possible measures to foster the sustainable rise in financial intermediation in Romania.

In line with its mandate and complying with the principle of transparency and institutional accountability, the NCMO continued its communication with the public in 2021, by posting on its website, in Romanian and English, press releases after each General Board meeting, the issued recommendations, as well as the 2020 *Annual Report* of the National Committee for Macroprudential Oversight.

1. The National Committee for Macroprudential Oversight's activity in 2021

1.1. Macroprudential policy framework in Romania and the European Union

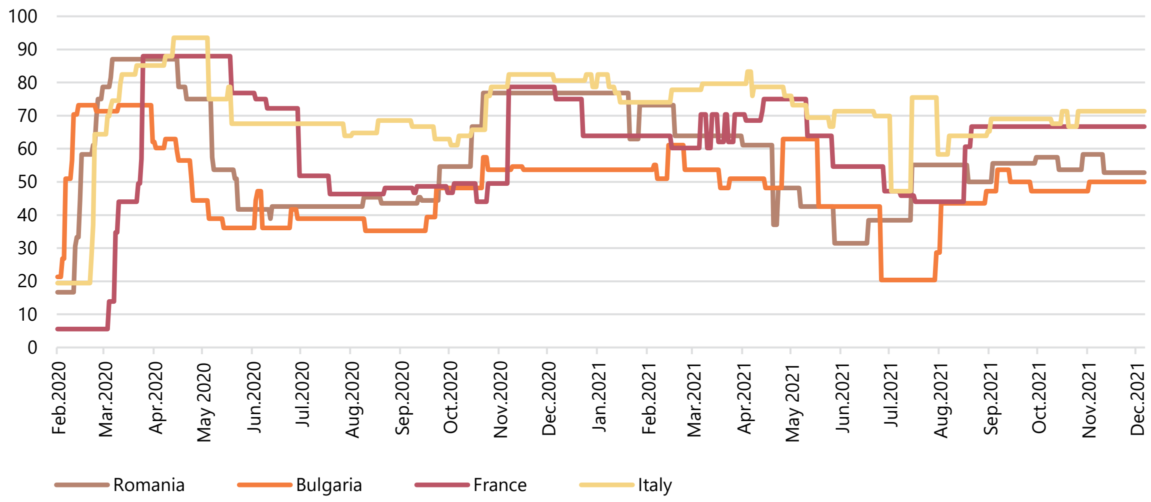
After the record economic contraction worldwide in 2020 that owed mainly to containment measures, 2021 marked the entry into a new stage, namely that of economic recovery and fast-paced lending. The stimulus and early intervention measures taken after the outbreak of the pandemic acted as a stabiliser and contributed to the economic rebound. Nevertheless, in order to avert the negative externalities that may arise throughout this process and implicitly the build-up of vulnerabilities that could pose a systemic risk, the macroprudential instruments need to be adapted to the new environment and thus seek to strike a balance between economic recovery and preventing the emergence of risks to financial stability.

In 2021, the pandemic showed a sinusoidal curve globally. The possibility of mass vaccination allowed for the resumption of certain pre-pandemic consumer habits, but the emergence of new strains or variants of the virus led to a resurgence of new infections. Hence, renewed mobility restrictions were imposed, but their economic impact was lower than that of the containment measures implemented in 2020 H1, when their stringency and coverage were much higher.

Western and Eastern countries took on different approaches to imposing restrictions, with those in Central and Eastern Europe taking a more lenient view, as their concern was to favour the maximisation of economic recovery over mobility restrictions. Thus, the pace of economic recovery was different for Member States in Western and Eastern Europe. One of the significant factors that have contributed to the faster rebound in the east than in the west is this preference for prioritizing economic revival over the health situation.

The stringency index, calculated based on nine metrics (e.g. school closures and travel bans), with values from 0 to 100 (100=strictest), shows that, in spite of recording low vaccination rates, countries like Romania and Bulgaria kept the stringency of restrictions at a lower level than other states such as Italy or France, where the vaccination rates exceeded 70 percent (Chart 1.1).

Chart 1.1. Developments in the stringency index from the outbreak of the pandemic until end-2021



Source: Mathieu, E., Ritchie, H., Ortiz-Ospina, E. et al. "A global database of COVID-19 vaccinations", Nature Human Behaviour (2021)

On the other hand, a number of substantial changes in the global economic environment pose risks to economic recovery at domestic and European level, which cannot be overlooked.

According to the IMF's *World Economic Outlook* of October 2021, global economy was projected to grow by 5.9 percent in 2021 and 4.9 percent in 2022, 0.1 percentage points lower than in the July 2021 report. The expectations were updated amid the worsening of supply disruptions in advanced economies and the concerns about the impact of the pandemic.

As regards monetary policy, inflationary pressures compel central banks to identify the optimal measures for keeping prices under control, without jeopardising however the economic rebound. Geostrategic tensions in the region add to the energy market problems and their pass-through to the price index. Therefore, the uncertainty from both health and economic perspectives is further high.

The price of the international benchmark Brent crude oil per barrel rose by over 55 percent in 2021, nearing a seven-year high.

Energy market developments have an immediate impact on price dynamics. Thus, a robust pick-up in price growth can be noted after a long period of low inflation rates. At end-2021, the inflation rate in Romania stood at 8.19 percent, in line with the substantial rises in the region: Poland (8.6 percent), Hungary (7.4 percent) or Czechia (6.6 percent).

The euro area inflation rate reached 5 percent in December 2021. The highest inflation rates among the 19 euro area Member States were recorded in the Baltic states, namely Estonia (12 percent), Lithuania (10.7 percent) and Latvia (7.7 percent).

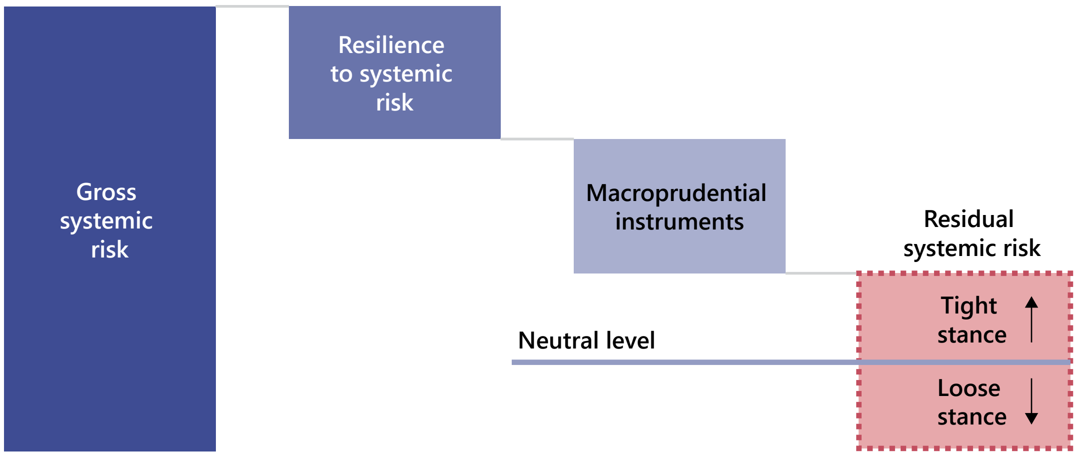
Following these developments, the bottlenecks in the production and supply chains may worsen, with direct implications for economic recovery.

At the same time, 2021 was also marked by the change in the European regulatory framework for macroprudential instruments via the shift to the new CRR II[1] and CRD V[2] legislative package. Most amendments to the legislative framework refer to structural buffers, i.e. the buffer for other systemically important institutions (O-SII) and the systemic risk buffer (SyRB). Those changes were chiefly meant to avoid the situations of excessive capital requirements or the overlapping of areas of risk coverage related to buffers.

Box A. The conceptual framework for monitoring the macroprudential stance

At EU level, the European Systemic Risk Board (ESRB) addressed the issue of rigorously defining the macroprudential policy stance in a report laying the theoretical groundwork, which was published in April 2019[3]. The key concept introduced by the ESRB is that of a risk-resilience framework, whose schematic representation is shown in Figure A. The conceptual framework covers the assessment of gross systemic risk, taking into account the available resilience in the economy and the financial system, as well as the extent to which macroprudential instruments counter systemic risks or provide additional resilience.

Figure A. Risk-resilience framework



Source: ESRB, *Features of a macroprudential stance: initial considerations*, April 2019

1 Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012.

2 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.

3 ESRB, *Features of a macroprudential stance: initial considerations*, April 2019.

Gross systemic risk, the first component of the framework, is endogenously generated, given the externalities that may arise from strategic complementarities, fire sales or contagion effects, and should be the main focus of macroprudential policy. The size of the systemic risk may vary over time, but its assessment from the perspective of the macroprudential stance takes place at a given point in time.

Resilience, the second component of the conceptual framework, depicts the ability of the financial system and the economy to absorb the fallout when shocks and systemic risks materialise. In the context of the macroprudential stance assessment, resilience is divided into aspects that are covered by other policy areas, including microprudential provisions, regulatory aspects or public safety tools (i.e. deposit insurance schemes, resolution funds, etc.). As such, resilience to gross systemic risk includes institution-specific loss-absorption capacities also for systemic events and available safety nets, and can account for specific institutional features that provide contingent resilience to specific risk materialisations.

The third component of the risk-resilience framework is the contribution of macroprudential policy instruments used to mitigate the gross systemic risk and to raise resilience. Macroprudential measures can build resilience, primarily in the form of capital or liquidity buffers, or can mitigate risks by restricting exposures or lending conditions, including by guiding expectations.

The difference between gross systemic risk and the resilience available within the system, taking also into account the implemented macroprudential policies, gives an indication of the level of the endogenous residual systemic risk. A larger amount of the residual systemic risk indicates that the gross systemic risk exceeds the available resilience and the implemented policies to a greater extent. Instead, if the residual systemic risk is small, it indicates that the system provides abundant resilience beyond those levels generally considered adequate.

In this conceptual framework, the macroprudential stance is defined as the difference between the observed level of residual systemic risk and a benchmark level of risk, i.e. the neutral level. If there is a positive difference, the policy stance is considered loose, whereas, in an opposite scenario, the stance is considered tight. In the event of a loose stance, it may be necessary to implement additional macroprudential measures in order to adequately cover risks, while a tight stance may affect the ability of the financial system to finance the real economy. Therefore, one of the key roles of the macroprudential authority is to strike a balance between adequately covering systemic risks and ensuring the proper capacity of the financial system to sustainably finance the real economy.

The neutral level of residual systemic risk can incorporate a broad range of aspects of the financial system and also includes an assessment of the risks to be covered. The neutral level takes into account the level of residual systemic risk that policymakers have deemed acceptable in the long run and with which the financial system usually operates. As a result, this indicator is little likely to vary significantly over time or throughout the financial or business cycle.

1.2. Topics discussed during the NCMO meetings

During 2021, the Chairman of the NCMO convened, pursuant to the legislation in force, four meetings of the National Committee for Macroprudential Oversight, which were held by written procedure on 30 March, 3 June, 14 October and 15 December, following the measures imposed by the Romanian authorities in the context of the COVID-19 pandemic.

On the agenda of the first meeting held in 2021 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 2020; and (iii) the extension of the period to refrain from dividend distribution following the publication of Recommendation ESRB/2020/15 amending Recommendation ESRB/2020/7 on restriction of distributions during the COVID-19 pandemic. In addition, during the meeting, the NCMO General Board was informed of: (i) the systemic risks identified across the domestic financial system; (ii) the actions taken by the addressees in order to implement the recommendations issued by the NCMO in 2020, as well as those which have not been completed and those that are applicable on a permanent basis; (iii) the manner of implementation of NCMO Recommendation No. R/6/2020 on addressing vulnerabilities from the widening of the agri-food trade deficit; and (iv) 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. The following macroprudential policy measures were approved:

- NCMO Recommendation No. R/1/2021 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 and to closely monitor developments in structural imbalances and indebtedness at aggregate and sectoral levels;

- 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, whereby the national competent authorities, namely the National Bank of Romania and the Financial Supervisory Authority, are recommended to extend until 30 September 2021 the restrictions on dividend distribution by credit institutions, investment firms or insurance and reinsurance companies;

- NCMO Recommendation No. R/3/2021 on compliance with the provisions of EBA Guidelines on the specification and disclosure of systemic importance indicators – EBA/GL/2020/14, whereby the National Bank of Romania and the Financial Supervisory Authority, in their capacity as sectoral financial supervisory authorities, are recommended to comply with the provisions of EBA/GL/2020/14 from the date when there is a relevant institution (G-SII) within their jurisdiction and to ensure their enforceability against the relevant credit institutions;

- NCMO Decision No. D/1/2021 on the *Annual Report of the National Committee for Macroprudential Oversight for 2020*;

- NCMO Decision No. D/2/2021 approving the NCMO intention to comply with the provisions of the Guidelines of the European Banking Authority on the specification and disclosure of systemic importance indicators – EBA/GL/2020/14;

- NCMO Decision No. D/3/2021 to comply with the provisions of EBA Guidelines on the appropriate subsets of sectoral exposures to which competent or designated authorities may apply a systemic risk buffer in accordance with Article 133(5)(f) of Directive 2013/36/EU – EBA/GL/2020/13.

The second meeting focused on the following: (i) the regular analysis on the recalibration of the countercyclical capital buffer; (ii) the manner of implementation of Recommendation ESRB/2020/12 on identifying legal entities; as well as (iii) the analysis of the NCMO Working Group on supporting green finance. In addition, the NCMO General Board was informed of: (i) the systemic risks identified across the domestic financial system; (ii) the results of the regular analysis on the systemic risk buffer; and (iii) 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. The NCMO meeting ended with the approval of the macroprudential policy measures below:

- NCMO Recommendation No. R/4/2021 on the countercyclical capital buffer whereby the National Bank of Romania is recommended to maintain the countercyclical buffer rate at 0 (zero) percent and to closely monitor developments in structural imbalances and indebtedness at aggregate and sectoral levels;

- NCMO Recommendation No. R/5/2021 on implementing Recommendation ESRB/2020/12 on identifying legal entities whereby the competent authorities, namely the National Bank of Romania and the Financial Supervisory Authority, are recommended to require, to the extent permitted by law, all legal entities involved in financial transactions under their supervisory remit to have a legal entity identifier (LEI). Moreover, competent authorities are recommended to include or continue to include the LEIs in financial reporting obligations and public disclosure. The LEI is a 20-character reference code to uniquely identify legally distinct entities that engage in financial transactions and associated reference data and which is based on the ISO standard 17442 developed by the International Organization for Standardization;

- NCMO Recommendation No. R/6/2021 on the analysis of the Working Group on supporting green finance whereby 16 proposals for recommendations were adopted, addressed to the National Bank of Romania, the Financial Supervisory Authority and the Government, under three categories of measures, namely: (i) the sustainable increase in the financing of green projects, (ii) supporting structural changes in the economy towards generating higher value added, and (iii) enhancing transparency and raising awareness on the impact of climate change in the economy and the financial system;

- NCMO Decision No. D/4/2021 on not applying through voluntary reciprocity the macroprudential policy measures adopted by Luxembourg and Norway;

- NCMO Decision No. D/5/2021 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 Decision No. D/6/2021 on the draft of NCMO Procedure No. 1/2021 regarding the transposition at national level of the provisions of the guidelines issued by the European Banking Authority addressed to the National Committee for Macroprudential Oversight;

The agenda of the meeting of 14 October 2021 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 implementation of structural buffers applicable to credit institutions as of 1 January 2022. Furthermore, the NCMO General Board decided not to extend the period of implementation of 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. In addition, the NCMO General Board was informed of: (i) the withdrawal of the authorisation of City Insurance S.A.; (ii) the systemic risks identified across the domestic financial system; (iii) the impact of credit institutions' funding plans on the flow of loans to the real economy; and (iv) 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. During the meeting, the following measures were approved:

- NCMO Recommendation No. R/7/2021 on the countercyclical capital buffer, whereby the National Bank of Romania is recommended to raise the countercyclical buffer rate to 0.5 percent from 0 (zero) percent as of 17 October 2022;

- NCMO Recommendation No. R/8/2021 on the capital buffer for other systemically important institutions in Romania whereby the National Bank of Romania is recommended to impose, starting 1 January 2022, 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 30 June 2021. The recommendation proposes a new calibration methodology for the O-SII buffer, which considers the scores obtained by systemic banks in the first assessment stage that determines the mandatory indicators recommended by the European Banking Authority (EBA), using six equal 500-basis point buckets (the bucketing approach).

During the last meeting of 2021, 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 up-to-date assessment of macroprudential instruments since their implementation in the national legislation; (ii) the impact of interest rate risk on the banking sector's government securities portfolio and interest rate-sensitive bank assets and liabilities; (iii) the systemic risks identified across the domestic financial system; (iv) 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; and (v) the implementation of the ESRB Recommendation amending ESRB Recommendation/2016/14 on closing real estate data gaps (ESRB/2019/3). On that occasion, the Board approved the following measures:

- Recommendation NCMO No. R/9/2021 on the countercyclical capital buffer whereby the National Bank of Romania is recommended to keep in place the measure to raise the countercyclical buffer rate to 0.5 percent, as of 17 October 2022, and to further monitor developments in the economy and lending, in a context marked by uncertainties;

- The setting-up of a working group mandated to support financial intermediation.

In line with its mandate and complying with the principle of transparency and institutional accountability, the NCMO continued its communication with the public in 2021, 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 on supporting green finance

With a view to addressing the possible effects of climate risk on the financial system and real economy, the NCMO decided, in its meeting of 14 October 2020, to set up a working group on green finance. It consisted of representatives appointed by the Presidential Administration, line ministries, other public authorities (NBR, FSA), as well as representatives of credit institutions, of the private sector and international donors (EBRD, EIB, World Bank). The working group carried out its activity in the period from November 2020 to May 2021. The ensuing Report identified several solutions, in line with the objectives set at national and European level, for sustainably enhancing access to finance for projects on the climate change agenda, supporting the structural change of the economy towards a higher value added one, as well as enhancing transparency and raising awareness on the impact of the fallout from related risks to the financial system[4]. Moreover, the Report highlighted the need for competent authorities to carry out substantial structural adjustments, considering that the climate change agenda entails opportunities and costs alike.

Based on this outcome and on the proposals set forth, the NCMO General Board issued Recommendation No. R/6/2021 on supporting green finance addressed to the NBR, FSA and the Government. For details on the working group's activity and proposals, which were

[4] See also the summary of the *NCMO Report on supporting green finance*: http://www.cnsmro.ro/res/ups/Summary-Report-NCMO-green-finance.pdf

subsequently taken on board in the adopted recommendation, see Section 1.3.1. The Report prepared by the working group was presented to the public in a press conference on 8 June 2021.

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

The COVID-19 pandemic crisis called for the adoption of sizeable fiscal measures in order to counter the negative effects on Romania's economy and financial stability. These measures included loan payment moratoria, public guarantee schemes on loans, grants and financing for the companies impacted by the crisis, exemptions from and deferrals of tax payments, furlough benefits, etc. The pandemic crisis reached its peak in economic terms during 2020, but the authorities decided to extend a large part of these measures in the course of 2021 as well. Specifically, the aim was to avoid the potential cliff effects whereby the sudden stop in granting aids would have aggravated the problems faced by the real sector, thus providing additional time for firms to adjust their activity accordingly. Moreover, the activity of certain economic sectors, particularly accommodation and food service activities, was further limited, due to the measures adopted to contain the community spread of SARS-COV-2.

The most important fiscal measures adopted by the Government of Romania in the pandemic context are presented below.

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

In accordance with the European Commission's temporary framework scheme for State aid to support the economy during the COVID-19 pandemic, 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:

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.

The government support scheme is valid until 30 June 2022, as set forth by the amended EU temporary framework. As at 31 December 2021, the granted guarantees amounted to lei 2.8 billion, while the loans with subsidised interest rates totalled lei 472 million. Additionally, in 2022, it is envisaged to grant de minimis products, namely the relief of interest on outstanding loans, subsidised interest rates on new loans and de minimis guarantee ceilings for working capital loans granted by commercial banks. EximBank will complete the de minimis schemes and will consequently initiate legal proceedings.

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 and the Romanian Rural Credit Guarantee Fund under the "Agro IMM Invest" sub-programme, 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 2022 and the grant payment until 30 June 2023. To this end, the change in the State aid scheme was notified to the European Commission, which gave its approval. 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.

For 2022, GEO No. 142/2021 set a ceiling on the issuance of guarantees under this programme in amount of lei 10 billion, of which lei 5 billion were earmarked for the "Agro IMM Invest" sub-programme.

Since the start of the "IMM Invest Romania" programme and until 31 December 2021, 43,492 guarantees in amount of lei 23.80 billion were issued, out of which 41,128 guarantees (totalling lei 21.80 billion) were granted under this programme and 2,364 guarantees (amounting to lei 1.99 billion) were issued under the "Agro IMM Invest" sub-programme.

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.

For 2021, a ceiling was approved for the issuance of guarantees under this programme tantamount to lei 2 billion.

Since the programme was implemented, i.e. in October 2020, until 31 December 2021, 24 guarantees in amount of lei 8.85 million were granted. In 2021, 22 guarantees totalling lei 8.68 million and a financing value of lei 14.47 million 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.

The guarantee ceiling approved for this programme was lei 1 billion 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 severe 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 2021, 48 letters of guarantee in amount of lei 499.38 million were issued.

NCMO Recommendation on identifying legal entities

On 24 September 2020, the European Systemic Risk Board (ESRB) adopted Recommendation ESRB/2020/12 on identifying legal entities. In order to implement the ESRB recommendation, in its meeting of 3 June 2021, the NCMO General Board approved NCMO Recommendation No. R/5/2021 on implementing Recommendation ESRB/2020/12 on identifying legal entities, whereby it recommended the competent authorities, namely the Financial Supervisory Authority and the National Bank of Romania, to require, to the extent permitted by law, all legal entities involved in financial transactions under their supervisory remit to have a legal entity identifier (LEI). Moreover, competent authorities were recommended to include or continue to include the LEIs in financial reporting obligations and public disclosure.

The rationale behind the recommendations is that technological progress and financial innovations have led to an increasing interconnectedness of economic agents. The global economy is based on a complex network of financial transactions, which includes not only financial institutions, but also entities that interact with each other and with financial markets. As shown in the preamble to the Recommendation, the breakage of any single crucial node has the potential to cause sudden and severe consequences throughout the network, requiring early monitoring and intervention mechanisms. In an attempt to reduce contagion and especially its effects, the authorities need to draw a reliable map of the global economic and financial landscape.

Therefore, the ESRB highlights that, in order to ensure financial stability, enabling the correct identification of non-financial entities is as important as the correct identification of financial entities.

Although it has been adopted by over one million entities across more than 200 countries since its establishment in 2012 by the G20 group, the LEI system[5] still faces a set of challenges. According to the Financial Stability Board (FSB), the low rate of adoption of the LEI by entities outside the securities and over-the-counter (OTC) derivatives markets, as well as the insufficient level of voluntary adoption of the LEI or the limited adoption of the LEI by non-financial entities, are obstacles to achieving the objectives for which the LEI system has been designed.

One of the characteristics of the LEIs that sets them apart from other national identifiers is related to their ability to provide information on the ultimate parent entity, thus upgrading the old "who is who" formula to "who owns whom"[6]. Specifically, aside from playing the major role in monitoring systemic risk and contagion phenomena, LEIs may be significantly useful in supervising, preventing and combating money laundering, as well as in integrating existing databases or developing new ones. However, not only public authorities can benefit from the advantages of adopting the LEI. Agents, such as credit institutions, non-financial corporations or universities can benefit from such new data sources that will allow a more accurate capture of the connection and interdependence relations between the entities with which they have direct contractual relations or which they intend to evaluate for this purpose.

The purpose of Recommendation ESRB/2020/12 is to contribute to the prevention and mitigation of systemic risks to financial stability in the EU through the establishment of systematic use of the LEI by entities engaged in financial transactions. Until the adoption of such a regulatory framework across the EU, the ESRB recommends that national authorities pursue and systematise their efforts to promote the adoption and use of the LEI, making use for this purpose of the various regulatory or supervisory powers which they have been granted by national or Union law. For the above-mentioned reasons, the Recommendation consists of two parts, the first one addressed to the European Commission and the second one to the relevant national authorities.

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5 LEI stands for legal entity identifier and is a 20-character reference code to uniquely identify legally distinct entities that engage in financial transactions and associated reference data and which is based on the ISO standard 17442 developed by the International Organization for Standardization.

6 Laurent *et al.*, "The benefits of the Legal Entity Identifier for monitoring systemic risk", *ESRB Occasional Paper Series*, 2021.

1.3. The activity of working groups within the NCMO

1.3.1. Working group on identifying solutions to support green finance

The Working Group on identifying solutions to support green finance completed its activity in 2021 by issuing a number of recommendations and publishing the report entitled the *Analysis of the NCMO Working Group on supporting green finance*[7]. The proposed measures covered three important areas (Table 1.1): (i) sustainably enhancing access to finance for projects on the climate change agenda; (ii) supporting the structural change of the economy towards one with a higher value added; and (iii) enhancing transparency, improving reporting and the availability of climate change-related information and raising awareness on the impact of climate change in society and the financial system.

Table 1.1. Recommendations of the NCMO Working Group on supporting green finance

With a view to sustainably enhancing access to finance for projects on the climate change agenda	• Communication by national authorities to the entities in their area of competence of recommendations on a prudent approach to climate risk; • Submit to the international financial institutions (EBRD, EIB, WB, etc.), as part of the regular consultation process on their activity in Romania, the proposal to consider enhancing the financing of green projects for the 2021-2025 period; • Create an interministerial group tasked with compiling the Sovereign Green Bond Framework; • Conduct an analysis on the opportunity of easing the prudential requirements for green finance, in line with similar concerns at European level, with a view to stimulating this category of lending, without affecting financial stability; • Set up a support scheme for tendering new renewables capacities based on Contracts for Difference (CfD); • Amend Government Emergency Ordinance No. 74/2020 on amending and supplementing Law No. 123/2012 – The Electricity and Natural Gas Act to allow all producers of renewables to conclude bilateral power purchase agreements (PPA) outside the centralised market, negotiating freely and directly with suppliers or end-users of electricity, with the possibility to have them concluded before the start of the construction.
With a view to supporting the structural change of the economy towards one with a higher value added	• Develop an industrial policy focusing on the climate change agenda, phased in annually until 2025, in correlation with the European Commission's New Industrial Strategy for Europe; • Assign markedly higher scores, in any support scheme provided by the authorities (state aid, guarantees from credit guarantee funds, EU funds, promotion of investments, exports, etc.), to firms that make an important contribution to the climate change agenda; • Elaborate and publish a methodology for identifying companies with domestic capital that competitively produce goods and services related to green sectors. Prepare, regularly update and publish the list of companies identified using that methodology. Engage Romania's diplomatic and commercial representatives from abroad in promoting the companies on this list;

[7] http://www.cnsmro.ro/res/ups/Summary-Report-NCMO-green-finance.pdf

– continued –

	• Revise the Power Grid Development Plan in order to fulfil Romania's obligations to meet the renewable energy targets by 2030, as set forth in the 2021-2030 Integrated National Energy and Climate Plan (INECP) and the Energy Strategy of Romania; • Launch a support scheme for new high-efficiency cogeneration capacities whose beneficiaries will be selected on the basis of a competitive tender.
With a view to enhancing transparency, improving reporting and the availability of climate change-related information and raising awareness on the impact of climate change in society and the financial system	• Create a dashboard to monitor climate change risks to the banking sector, which should be regularly updated and disseminated. Conduct annual stress tests on climate risk-related issues and publish the results; • Introduce in the NBR's Central Credit Register information on green loans, starting from the European taxonomy; • Require large companies and recommend SMEs to publish data (the latter voluntarily), in digital format (online platform), according to uniform and transparent specifications and definitions; • Encourage non-financial reporting by SMEs via: (i) the publication of a simplified reporting model, (ii) the digitalisation of reporting and (iii) the allocation of funds to increase the reporting capacity of SMEs, including by compiling guidelines. Set up an automated framework for monitoring the reporting of non-financial statements; • Develop the climate change governance architecture (adaptation and mitigation), involving the relevant ministries, the Presidential Administration, the scientific environment, the private sector, the NBR, the FSA, credit institutions, international financial institutions, NGOs, etc.

Source: NCMO, *Analysis of the NCMO Working Group on supporting green finance*, 2021

According to the analysis of the Working Group, the acceleration of projects designed to support the transition towards a green and energy-efficient economy is likely to have significant beneficial effects on the Romanian economy. Specifically, the full absorption of funds for green economy under the Next Generation EU (NGEU) programme could contribute to economic growth by 1.9 to 2.3 percentage points in 2021-2026. Conversely, a delay in the implementation of EU-funded green projects could lead to a sharp decline in their positive impact on the economy, due to competitiveness losses, higher funding and production costs, etc. (a two-year delay is expected to reduce the positive effect by one third). Moreover, the development of environmentally friendly projects generates a sustainable borrowing potential that local banks could capitalise on. The financing of such projects by credit institutions in Romania is currently modest (approximately EUR 1 billion, March 2021), the estimates of the sustainable potential being around three times higher.

1.3.2. Working group on sustainable increase in financial intermediation

The sustainable increase in financial intermediation is one of the intermediate objectives of macroprudential policy set forth in the Overall Macroprudential Strategy Framework of the National Committee for Macroprudential Oversight, adopted in the NCMO General Board meeting of 21 May 2018.

Romania currently has the lowest financial intermediation in the European Union. When measured as a ratio of financial institutions' assets to GDP, the level of intermediation was 76.2 percent (June 2021), but when taking into account only bank assets, it stood at 54.6 percent (March 2021), well behind the readings reported by Poland and Bulgaria, with 99.7 percent and 107.2 percent, respectively. The indicators on loans from local financial institutions as a share of GDP also show a low level of financial intermediation. The total loans from banks and NBFIs as a share of GDP ran at 33 percent (June 2021), while the bank credit-to-GDP ratio stood at only 26 percent.

Prior to the pandemic outbreak, non-financial corporations boasted a significant borrowing potential, while credit institutions had sufficient liquidity and solvency to back a sustainable growth in lending to this sector. The analysis of firms' financial soundness showed a borrowing potential of lei 166 billion for this sector, which is equivalent to a more than doubling of the loan stock.

In view of the above, the NCMO General Board decided in its meeting of 15 December 2021 to set up a working group with a mandate to identify possible measures to foster the sustainable increase in financial intermediation in Romania, taking into account not only loans from credit institutions, but also financing via the NBFI sector (over 85 percent of the NBFI portfolio is intended for corporate lending). Moreover, the working group will examine how the FinTech sector (also at international level) contributes to financial intermediation and how it could affect financial stability in Romania.

The activity of the working group will focus on analysing the following issues identified as key elements for achieving the objective of a sustainable increase in financial intermediation, namely: (i) enhancing the role of the financial system in co-financing EU-funded projects, (ii) digitising financial services and developing the FinTech sector, (iii) increasing the financial system's contribution to corporate lending, (iv) improving the financial education of entrepreneurs, as well as the professional training of bank and NBFI employees, and (v) making structural changes towards a higher value-added economy, such as supporting the financing of innovative sectors, of green projects, etc. The NCMO working group will round off its activity by drafting a report comprising proposals on the possible measures identified in the form of recommendations to the Government, the Financial Supervisory Authority and the National Bank of Romania.

1.4. Collaboration of NCMO member authorities with the macroprudential authority at EU level

In the context of identifying and implementing macroprudential measures at national and EU level, the cooperation between the relevant national and international authorities becomes essential. It requires the involvement and participation of each NCMO member authority, both in working groups set up at national level, such as the NCMO working groups, and in those established by the European Systemic Risk Board (ESRB). Specifically, in 2021, representatives of the National Bank of Romania, the Financial Supervisory Authority and the Ministry of Finance participated in the meetings of the following ESRB working groups:

- 2022 Review of Macroprudential Framework: Set up under the ESRB's Instruments Working Group, it focused on assessing the European macroprudential policy framework. Based on the assessments made, *inter alia* with the contribution of an NBR expert representing Romania, a report was prepared, discussed within the European Systemic Risk Board structures, and ultimately submitted to the ESRB General Board for approval, before being published on the ESRB website[8].

- Working group set up to assess compliance with Recommendation ESRB/2020/08 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. The team put together at the ESRB level, also including NBR representatives, carried out its activities in 2020 and 2021, completing the assessment by publishing two compliance reports[9], one for each part of the above-mentioned Recommendation. According to this assessment, the NCMO was graded "fully compliant" for both parts of the Recommendation.

- Working group established to assess compliance with Recommendation ESRB/2015/1 on recognising and setting countercyclical buffer rates for exposures to third countries. The report that drew on the working group's assessments is to be submitted for approval to the Advisory Technical Committee of the ESRB. The evaluation team also included a representative of the National Bank of Romania.

- Task Force on Stress Testing – TFST. The resilience of financial institutions in Europe to adverse macroeconomic developments is assessed on a regular basis, under the coordination of the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) or the European Securities and Markets Authority (ESMA) and in cooperation with the ESRB. The task force brings together experts from national regulatory and supervisory authorities, including the NBR, with a view to developing a relevant macroeconomic environment and harmonised (baseline and adverse) scenarios at European level for possible developments in the macroeconomic framework and the financial market. In 2021, a number of scenarios[10] were prepared and submitted to the relevant authorities, being subsequently used at European level in the stress testing of banking and insurance sectors and of central counterparties. The NBR considered the ESRB scenarios in the solvency stress test

8 https://www.esrb.europa.eu/home/html/index.en.html

9 https://www.esrb.europa.eu/pub/pdf/recommendations/esrb.20208_compliance_assessment~1e171bd993.en.pdf?b04a4eec3452ec4167f2fd7c02c8ce94; https://www.esrb.europa.eu/pub/pdf/recommendations/esrb.202108.recommendation_of_the_european_systemic_risk_board_of_27_May_2020_on_monitoring_the_financial_stability_implications_of_debt_moratoria~0365cd6715.en.pdf?cf1d14ecb186250805a7f4e2bfb59d5e

10 https://www.esrb.europa.eu/mppa/stress/html/index.en.html

of the Romanian banking sector spanning the period from 2021 to 2023. In building the adverse scenario, the NBR took into account the main risks to financial stability: a macroeconomic framework affected by the COVID-19 pandemic, the impact on global confidence and strongly negative effects on non-financial corporations.

- Expert Group on Macroprudential Stance – Phase II (implementation). The task force further developed the conceptual framework by implementing empirical and structural approaches to assess the macroprudential policy stance across EU Member States. This materialised in a report published in December 2021[11], which devises a toolkit consisting of complementary approaches, such as (i) applying the empirical growth-at-risk (GaR) approach for the 27 Member States, (ii) using a semi-structural approach to produce counterfactual scenarios on the impact of recalibrating macroprudential tools in the euro area banking sector; and (iii) developing an initial framework for assessing sectoral instruments and measures, particularly those concerning the real estate sector and borrower-based macroprudential measures.

[11] https://www.esrb.europa.eu/pub/pdf/reports/esrb.report_of_the_Expert_Group_on_Macroprudential_Stance_Phase_II202112~e280322d28.en.pdf?2e9a9e43b97d86e7d933b71fc43efde8

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

2.1. Assessment of risks and vulnerabilities at global level

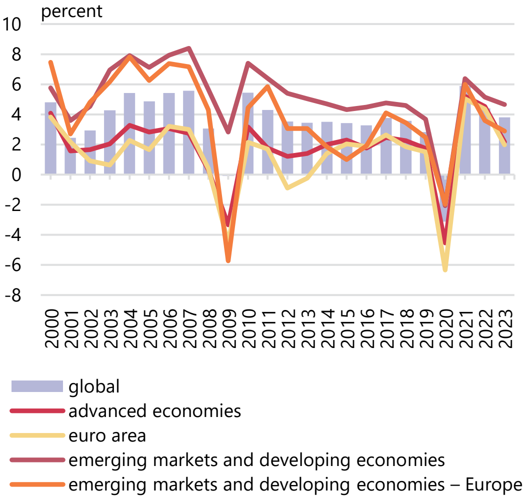
The COVID-19 pandemic continued to take its toll on economic and financial developments in 2021 as well. The main risks to financial stability remained manageable, but significant vulnerabilities build up further throughout the year (high indebtedness, particularly of the public sector, asset overvaluation in some financial market segments, as well as the exposure of the economy and the financial system to climate change risks). Short-term risks related to the health crisis have abated, whereas other risks such as geopolitical risk and the risk generated by costlier fossil fuels have gained prominence.

Global economic growth outpaced the pre-pandemic level (6.1 percent in 2021 versus the 2015-2019 average of 3.4 percent), yet the recovery was uneven across countries (Chart 2.1). Moreover, the swift spread of the new coronavirus variants maintained high uncertainty, entailed a relatively short-lived financial market turmoil and depressed the pace of economic recovery in 2021 Q4. The International Monetary Fund (IMF) cut down forecasts for 2022 for both global growth (from 4.9 percent to 3.6 percent; *World Economic Outlook Update*, April 2022) and international trade (from 6.7 percent to 5 percent), with figures being revised downwards after the outbreak of the military conflict in Ukraine. In the euro area, economic growth posted similar developments as in other advanced economies (5.3 percent compared to 5.2 percent, according to IMF forecast), but prospects for 2022 were substantially lowered because of the war in Ukraine (2.8 percent).

Global financial conditions remained favourable in 2021, also helped by the ongoing accommodative monetary policies pursued by the major central banks, yet the resumption of economic activity amid persistent disruptions in production chains unleashed stronger inflationary pressures and growing commodity prices, of fossil fuels in particular (Chart 2.2). The surge in fuel prices was also fuelled by greater geopolitical risk, especially in Europe. These developments hastened the decisions to normalise monetary policies in the major developed countries. The European Central Bank announced in March 2022 the discontinuation of the Pandemic Emergency Purchase Programme, which had been introduced at the onset of the pandemic. Stepping up efforts to support the transition of the economy towards a sustainable, environmentally friendly and energy-efficient growth pattern may mitigate the risks to the economy and the financial system caused by an oil or natural gas price shock.

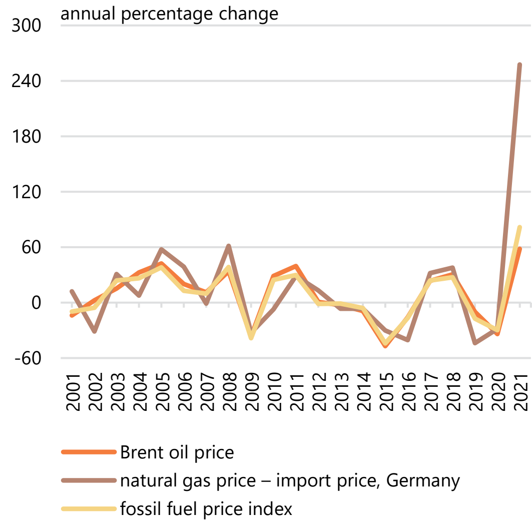
International financial markets saw mixed developments in the course of 2021. During the first part of the year, the start of vaccination campaigns and the easing of measures on containing mobility and economic activity during the summer supported noticeable positive

Chart 2.1. Global economic growth



Source: International Monetary Fund, *World Economic Outlook Update*, January 2022

Chart 2.2. Fossil fuel prices

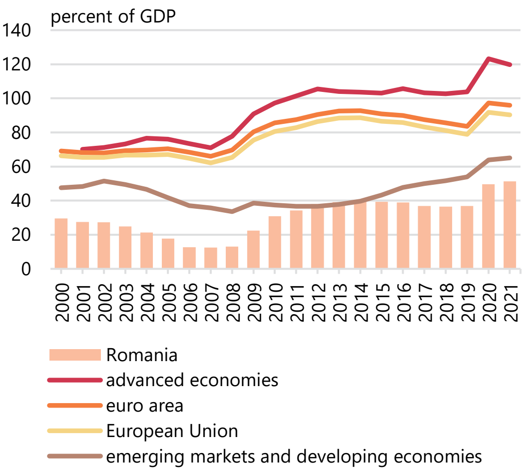


Source: *World Economic Outlook Database*, October 2021

developments, with technology being the most favoured sector. The emergence of new coronavirus variants and a renewed increase in the number of infections at the beginning of 2021 Q4, coupled with investors' concerns about debt sustainability as inflationary pressures went up, led to asset price adjustments and expanding risk premiums, especially in the emerging economies.

Real estate prices advanced at a swift pace in some countries, on the back of a hefty rebound in demand, but also of looser credit standards. Across the euro area, the upturn in residential property prices was the highest since the beginning of the previous financial cycle in 2005. These developments were also accompanied by a step-up in mortgage lending, which calls for a careful adjustment of the macroprudential framework governing loans to households.

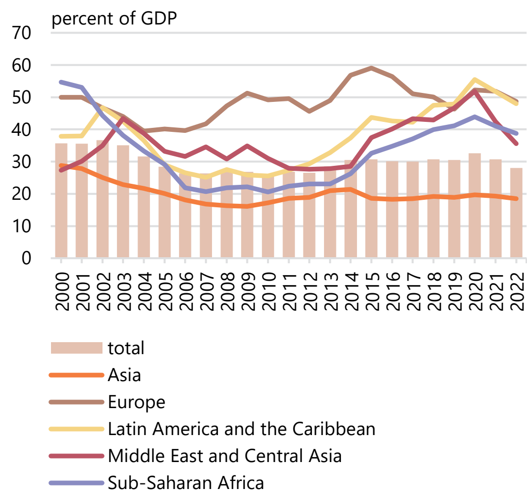
Chart 2.3. Public debt



Note: Data for Romania were taken from the Ministry of Finance's database.

Source: *World Economic Outlook Database*, April 2022

Chart 2.4. External debt in emerging markets and developing countries



Source: *World Economic Outlook Database*, April 2022

The sustained budgetary effort during the pandemic boosted public debt (Chart 2.3) as well as external debt in the case of emerging economies (Chart 2.4) to similar or even higher levels than those seen in the previous financial cycle (prior to the 2007-2008 global financial crisis). The emerging economies felt a more pressing need for funds and their borrowing cost was on the rise. For example, the spread of yields on 5-year government securities issued by Romania and its regional peers versus Germany's Bunds posted increases by, on average, 1.5 percentage points. The ongoing economic recovery and the implementation of reforms to support the growth pattern shifting towards a sustainable one may take off some high indebtedness pressures and help fiscal consolidation.

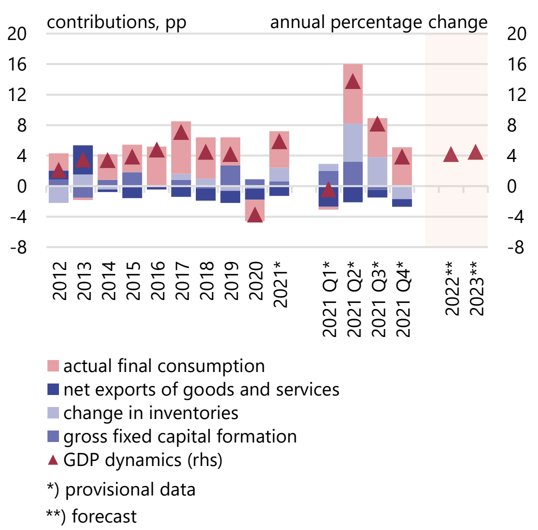
2.2. Main challenges at national level

On the domestic front, the protraction of the health crisis and the notable rise in commodity prices, of fossil fuels in particular, maintained the risk of tensions surrounding domestic macroeconomic equilibria at a severe level and took the risk of delay in implementing reforms and absorbing EU funds, especially via the National Recovery and Resilience Plan (NRRP), to a high level. Other systemic risks to financial stability were the ongoing global uncertainty amid the COVID-19 pandemic and the default risk for loans to the private sector.

Economic growth moderated throughout 2021 (Chart 2.5), after a sturdy recovery in 2020 H2. The 2021 performance was driven by the moderation of domestic demand due to elevated uncertainty stemming from the brisk spread of the new coronavirus variants, on the one hand, and the persistent supply chain disruptions, the rise in commodity prices and agricultural producer prices, on the other hand. In the first part of 2021, gross fixed capital formation made a positive contribution to GDP growth, propelled by investment in ICT equipment, particularly in 2021 Q2. Increased focus on the digitalisation of products and services and the start of important EU programmes to support the shift towards a sustainable economic growth pattern are most likely the main factors.

The National Recovery and Resilience Plan (NRRP) endorsed by the European Commission and subsequently by the Council of the European Union in the final quarter of 2021 provides for investment to support the transition to a green economy and digitalisation (41 percent and 21 percent respectively). Moreover, the structural and investment funds allotted to Romania under the Multiannual Financial Framework 2021-2027 amounted to EUR 38.3 billion. Nonetheless, Romania

Chart 2.5. GDP dynamics



Source: NIS, EC, *European Economic Forecast*, Winter 2022 recorded low EU funds absorption rates, below the average of the EU and its regional peers (61 percent, compared to 66.3 percent in the region, November 2021). Against this backdrop, developing the institutional capacity to absorb these funds should be a priority within the new macroeconomic context, especially as the delayed project implementation may reduce the efficiency of their outcome by up to one third[12].

The fiscal position improved over the previous year. The general government deficit stood at 6.7 percent of GDP in 2021 versus 9.6 percent of GDP in 2020, while public debt added 1.5 percentage points to reach 48.9 percent of GDP at end-2021. These developments were driven by the higher revenues, due mainly to the pick-up in economic activity (receipts from both corporate income tax and VAT rose significantly), while public spending increased at a much slower pace (8.3 percent against 17.7 percent for revenues). However, the future evolution of the fiscal position continues to fuel high uncertainty in particular with regard to the continuation of fiscal consolidation and the implementation of reforms committed to under the excessive deficit procedure and the EU-funded structural programmes. Moving from general measures to support the economy towards other measures aimed at stimulating the sectors with a major potential to underpin a sustainable growth pattern and enhancing the institutional capacity to absorb EU funds can abate some of the fiscal consolidation pressures.

The external balance continued the previously-reported deterioration trend, similarly to that observed prior to the 2007-2008 global financial crisis. The current account deficit widened to EUR 16.95 billion in the course of 2021, up 54 percent over the same year-earlier period, owing to a stronger pick-up in imports of goods once domestic demand rebounded in the first part of the year and the slowdown in exports due to persistent supply chain disruptions. The widening current account deficit reveals major structural issues of Romania's economy: heavy dependence of domestic production on imports, deficiencies in the agri-food sector and the large share of energy-intensive sectors (40 percent of the value added and 50 percent of the assets of non-financial corporations[13]). With a view to mitigating these risks, the NCMO issued a number of recommendations on addressing vulnerabilities from the widening of the agri-food trade deficit (NCMO Recommendation No. R/6/2020) and on supporting the shift of the economic growth pattern to an environmentally friendly one (NCMO Recommendation No. R/6/2021). These measures were implemented only to some extent, except for those addressing the National Bank of Romania.

External deficit financing was covered mainly by foreign direct investment flows, which rose both in terms of non-interest-creating flows (equity expanded by nearly 50 percent compared to a year before) and of debt instruments (inflows totalled 21 percent of the net flows of foreign direct investment in 2021).

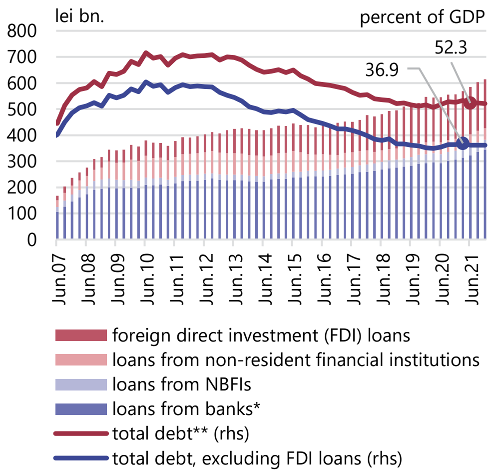
Private sector indebtedness stayed on the upward trend that started in 2016 H2 (Chart 2.6), with both components, namely domestic and foreign loans, posting positive developments.

12 http://www.cnsmro.ro/res/ups/Summary-Report-NCMO-green-finance.pdf

13 *Analysis of the NCMO Working Group on supporting green finance,* 2021

The elevated uncertainty amid the protracted health crisis, on the one hand, and the government financing support programmes for businesses in the form of guarantees, on the other hand, underpinned domestic lending, which rose at a swifter pace than that granted by non-residents. According to the Ministry of Finance, by end-2021, loans granted under the "IMM Invest Romania" programme came in at lei 12.7 billion, the programme being extended to June 2022.

Chart 2.6. Private sector indebtedness



*) including write-offs

**) including the external debt in the form of FDI

Source: NIS, NBR calculations

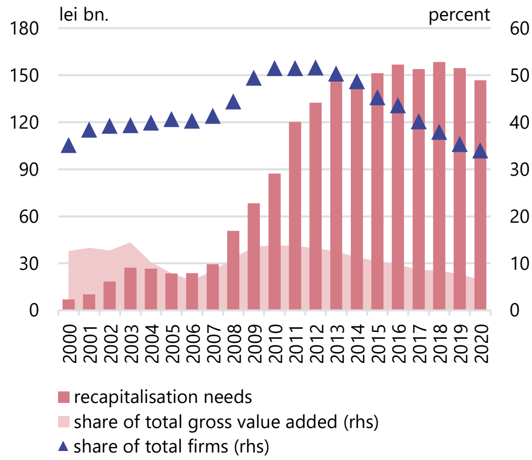
The loans granted by domestic financial institutions rose at a brisk pace throughout 2021, pointing to the start of a new credit cycle. The challenging domestic economic environment, characterised by the worsening external deficit and the narrow fiscal room, amid the protracted health and energy crises, calls for the close monitoring of risks and adequate calibration of the prudential framework to ensure that risks to financial stability remain manageable. Against this background, the NCMO issued a recommendation to the National Bank of Romania to raise the countercyclical buffer rate to 0.5 percent from 0 percent as of 17 October 2022 (NCMO Recommendation No. R/7/2021). The measure is in line with the normalisation trend of macroprudential policy across the EU.

The share of financing from non-resident financial institutions and companies is substantial, i.e. 38 percent of private-sector indebtedness, whereas the level of financial intermediation by domestic financial institutions remains the lowest across the European Union. This is likely to amplify risks to financial stability. On the one hand, the real sector is exposed to refinancing and home bias risks, via the direct financing channel, but also to third-country risks, via the common lender channel, especially in challenging economic and/or financial times. On the other hand, local financial institutions face stronger adverse selection, with top firms receiving funds from non-residents. Addressing the hindrances to the development of financial intermediation may contribute to companies' shift in preference to funds from Romanian financial institutions. In this vein, in December 2021, the NCMO General Board decided to set up a working group on sustainable increase in financial intermediation mandated to identify possible measures to foster the sustainable growth of financial intermediation (for further details, see Chapter 1 in this *Report*).

The NPL ratio of loans granted by credit institutions stayed on a downtrend throughout 2021. As far as households were concerned, it declined to 3.2 percent in December 2021 from 3.7 percent in December 2020, on the back of lower NPL ratio of housing loans, while it remained flat for unsecured consumer credit. As for the loans granted to non-financial corporations, the non-performing loan ratio slipped to 5.7 percent, from 6.6 percent, over the same period. Developments were also supported by the pre-pandemic macroprudential measures, particularly those aimed at recalibrating indebtedness (starting January 2019), which are likely to maintain a higher level of prudence in the case of household loans. Nevertheless, households' loan portfolio may worsen because of the borrowers with deferred loans, as a larger share of them have a level of indebtedness above 50 percent.

The non-financial corporations sector is further faced with sizeable vulnerabilities, such as a large share of severely undercapitalised firms, low corporate governance and loose payment discipline, with the health crisis aggravating these weaknesses. Thus, the number of companies with negative equity rose to 34 percent in 2020 (up by about 2 percentage points from 2019). These companies' minimum capitalisation requirements are substantial (lei 146.7 billion, Chart 2.7), most of them owing to microenterprises (72 percent) and enterprises in the services and real estate sectors (38 percent). These entities accounted for merely 6.5 percent of the sector's gross value added, yet they hired 13.7 percent of the number of employees and held 11 percent of the loans granted by credit institutions. In 2020, arrears to non-banks added 2.5 percent to lei 82.8 billion, with suppliers accounting for the bulk of outstanding payments (about lei 40 billion). Moreover, trade credit makes up the largest share of external corporate financing (approximately 18 percent), having a non-performing loan ratio of 13.5 percent in 2020. In addition, the receivables collection period expanded by 8.5 percent as against 2019 to 92 days. Facilitating the access to credit by financial institutions, improving the financial education of managers and entrepreneurs and enhancing the professional training of bank staff involved in lending and risk analysis count among the measures that may contribute to a better management of the sector's financing risks, with a positive impact on economic growth.

Chart 2.7. Developments in recapitalisation needs and the relevance of undercapitalised companies for the economy



Source: Eurostat, MF, NBR calculations

The real estate market saw mixed developments in 2021 on both segments, i.e. residential and commercial, but risks remained manageable. Activity in the residential real estate market picked up steam, yet this development was not reflected in the performance of the price index. Specifically, real estate prices trailed further behind the value hinting at additional risks to macroeconomic balances, according to the European Commission, and below the values observed in Romania's regional peers (2.1 percent in annual nominal terms). Both demand, including that financed by bank credit, and supply gathered momentum on this real estate market segment. Developments point to a brisk resumption of the financial cycle and greater cyclical risks. Against this backdrop, the NBR decided to act in a countercyclical manner on a sub-segment of the residential real estate market, namely that of loans granted for the purchase of residential property for non-residential purposes, by cutting 10 percentage points off the LTV caps, which is equivalent to a

10-percentage-point increase in the down payment when extending a loan. This measure had to be implemented due to the growing importance of this type of loans and the higher level of associated risk.

On the commercial real estate market segment, activity remained low, with investors choosing to postpone investments or extend the delivery of projects. The value of transactions reverted to pre-pandemic levels, amounting to lei 0.9 billion at end-2021. Moreover, the market is further concentrated (54 percent of the transactions concluded in 2021 were transactions of buildings in Bucharest) and foreign capital prevails (non-residents carried out 88 percent of transactions).

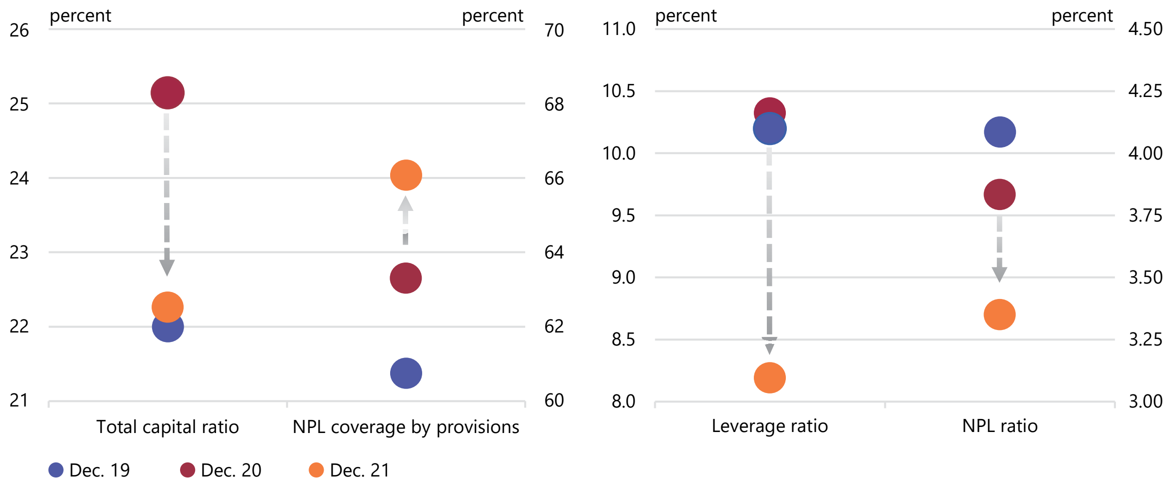
2.2.1. Banking sector

Following the notable negative adjustments to the macroeconomic framework in 2020, amid the COVID-19 pandemic, 2021 brought about a significant improvement, which was faster than that expected in most European countries. The uncertainty surrounding the onset of the pandemic diminished in 2021, and the burst of activity on international markets also had a positive influence on the local economy, which was supported by a series of measures taken by the general government. In this context, the banking sector generally saw positive developments in the main financial soundness indicators and contributed to economic recovery through the accelerated resumption of lending.

The key developments in the banking sector in 2021 show further good management of shocks from the real sector, given the protracted effects of the COVID-19 pandemic: (i) the solvency ratio remained high (22.3 percent in December 2021), ensuring the banking sector's capacity to support lending to the real sector and to absorb potential losses in case of unfavourable adjustments to the macroeconomic framework; (ii) liquidity ratios stood at comfortable levels, while the central bank reduced considerably its support for banks via bilateral repo operations, (iii) structural developments confirm a strengthening of the financing sources of the banking sector (especially on account of the pick-up in saving due to lockdown measures, which pushed consumption down), concurrently with a step-up in financing of the real sector and the government, (iv) asset quality improved, given the decline in the non-performing loan ratio (to 3.4 percent in December 2021 from 3.8 percent in the previous year) and the increase in NPL coverage by provisions (to 66.1 percent in December 2021, from 63.3 percent at end-2020), (v) profitability returned to similar pre-pandemic levels, with a net profit of lei 8.3 billion (equivalent to ROE and ROA levels of 13.4 percent and 1.4 percent, respectively), based on the upward trend of operating profit, concurrently with a decrease in provisioning costs (after their significant recognition in 2020).

Banks preserved substantial capital reserves in 2021, above the pre-pandemic levels, despite the expiry on 30 September 2021 of the ESRB and NCMO recommendations on restricting/limiting dividend distributions and other similar actions (for further details,

Chart 2.8. Developments in banking indicators – capital adequacy and asset quality



Note: Data at 31 December 2021 are preliminary (prior to submission of audited annual accounts)

Source: NBR

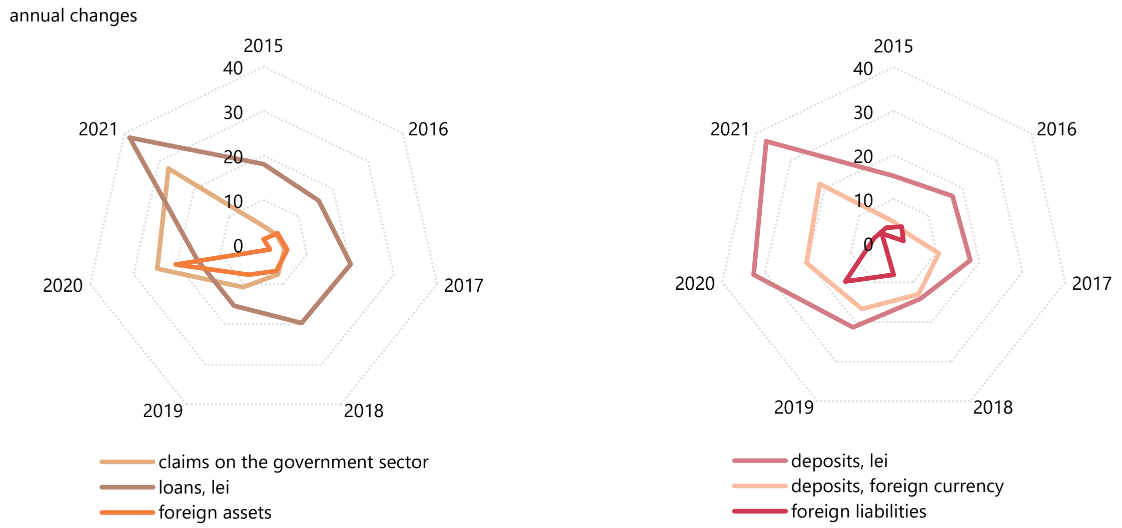
see Box C). The total capital ratio (22.3 percent, December 2021) contracted from its all-time high of 25.1 percent (December 2020, Chart 2.8), owing particularly to the resumption of lending (especially to non-financial corporations). The solvency of credit institutions in Romania remained around the 75th centile, specific to the distribution of European values (22.6 percent[14], September 2021). In line with overall solvency developments, the leverage ratio decreased to 8.2 percent.

Although adequate, the total capital ratio currently benefits from certain provisions of the CRR "quick fix" package (Regulation (EU) 2020/873), which was adopted in June 2020 in response to the pandemic crisis. The impact of this regulatory framework on the banking sector in Romania is focused around three measures: (i) introducing new transitional arrangements according to IFRS 9; (ii) reintroducing transitional arrangements for credit risk capital requirements for exposures to central governments and central banks where those exposures are denominated in the domestic currency of another Member State; (iii) advancing by one year the implementation of the revised SME supporting factor and an infrastructure supporting factor. The joint impact of these measures on the total capital ratio is significant (approximately 3 percentage points, according to September 2021 data). The provisions of the CRR "quick fix" package will largely dissipate in the following years, thus the total capital ratio will decline (under *ceteris paribus* conditions).

The results of the solvency stress test spanning 2021-2023 confirm the resilience of the Romanian banking sector in a challenging macroeconomic environment, marked by the substantial rise in risks, especially in credit and market risks. The overall good results of the solvency stress test are based on banks' capacity to generate operating profit even under unfavourable conditions (especially in the case of large banks) and on the initial adequate capital level (a historically high total capital ratio of 25.1 percent in December 2020), which leaves room for the absorption of the shocks taken into consideration.

[14] According to EBA Risk Dashboard, data as of Q3 2021.

Chart 2.9. Dynamics of main balance sheet items



Source: NBR

Liquidity remained adequate and the temporary liquidity deficits declined compared to those recorded in 2020. The liquidity coverage ratio (238.6 percent, December 2021) further stood significantly above the minimum requirement and around the 75th centile of the distribution at European level (268.9 percent, September 2021). Therefore, the banking sector has adequate stability to short-term (30 days) liquidity shocks, due to a large stock of liquid assets (consisting mainly of government securities and exposures to the central bank).

The results of the latest liquidity stress test at the level of credit institutions (June 2021) confirm an adequate liquidity level and do not indicate any significant risks, there being further polarisation of the results in that large credit institutions are more resilient to potential shocks associated with withdrawals of funding sources or decline in the liquidity of assets.

The aggregate balance sheet of the Romanian banking sector increased significantly for the second year in a row, i.e. to lei 694.1 billion at end-2021 (recording an annual growth of 14.4 percent from an average of 7.3 percent in 2018-2019, and 4.3 percent in 2016-2017).

On the liabilities side, domestic deposits strengthened considerably during the two years of the pandemic crisis (annual growth of 14.9 percent in December 2021, from a 10 percent average in 2016-2019), due to involuntary and precautionary savings. With a share of almost 70 percent in total liabilities, Romania is approximately 30 percentage points above the EU average (41 percent, December 2020) and compares with Lithuania, Bulgaria and Slovenia with regard to the traditional financing model. The high granularity given by the prevalence of deposits from households (equivalent to 41 percent of total liabilities) ensures a good stability of the Romanian banking sector from the perspective of funding sources.

On the assets side, financing flows to the real economy, in particular to non-financial corporations and to the government sector, witnessed a faster increase (Chart 2.9). In 2021, the annual dynamics of credit to the private sector (14.8 percent) almost tripled compared to the previous year, amid the contribution of government programmes and the removal of pandemic-specific restrictive measures. This development was driven by the leu component, both loans to households and non-financial corporations, and, to a smaller extent, by the return to positive territory of the annual dynamics of the foreign currency component. The share of leu-denominated credit in total loans reached 72.4 percent in December 2021. Loans to non-financial corporations rose at a faster pace, posting an annual growth rate of 19.8 percent in December 2021, compared to an average annual increase of 4.6 percent in 2018-2020. The annual dynamics of household loans stepped up starting with 2021 Q2, reaching 9.7 percent in December 2021.

The share of claims on the government further widened in 2021 as well, the stock increase (lei 27.4 billion) exceeding nearly four times the average annual growth rate recorded in 2017-2019. Their share in aggregate assets (24.2 percent, December 2021) is the highest in the EU. Looking at these claims, securities issued by the general government prevailed (21 percent of assets, December 2021), with loans to central and local government having a modest contribution (3 percent of assets, December 2021).

Asset quality remained adequate in 2021, the measures taken by government authorities to support borrowers (*inter alia* via legislative moratoria) leading to a lower-than-expected materialisation of credit risk. The NPL ratio fell to 3.4 percent from 3.8 percent in December 2020. However, there are still concerns surrounding asset quality amid a large number[15] of customers resorting to moratoria, loans with relatively high migration in more unfavourable stages of impairment (Stages 2 and 3 under IFRS 9).

In Romania, loans and advances for which suspension of payments was requested were taken primarily by non-financial corporations (amounting to approximately 51 percent in June 2020 – December 2021), ahead of those to households (approximately 45 percent). According to the conditions for the suspension of loan repayments, this option expired in December 2020 for a large part of the volume of loans under moratoria (around 93 percent of exposures). In December 2021, there were no exposures subject to active moratoria.

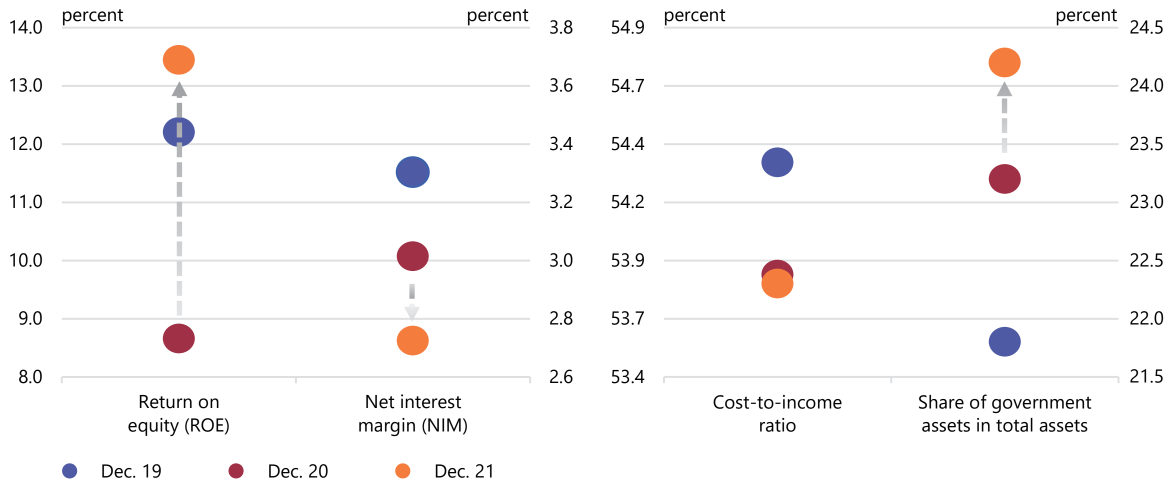
NPL coverage by provisions further improved throughout 2021, i.e. to 66.1 percent in December 2021. While positive, such positioning reflects an inclination towards exposures with lower collateral and a limited capacity of recovery and realisation of collateral compared to the EU.

The banking sector in Romania remained profitable during the pandemic crisis, recording a significant net financial result (lei 8.3 billion[16]) in 2021, amid the reduction in net expected credit losses and the operating profit growth. Net interest income, the main component of operating income (65.8 percent), posted positive dynamics of approximately 4 percent versus 2020 based on lending recovery and higher interest rates (which did not translate

[15] In Romania, approximately 10 percent of the volume of loans granted to the real sector were subject to moratoria (compared to the EU average of 5 percent).

[16] Data as at end-2021 are not audited.

Chart 2.10. Developments in banking indicators – profitability and share of government assets in total assets



Note: Data at 31 December 2021 are preliminary (prior to submission of audited annual accounts).

Source: NBR

to the same extent into the remuneration of deposits). Net annual expected credit losses (lei 1.3 billion) went down by 65.6 percent compared to the previous year[17], their dynamics being positively influenced by economic recovery.

Compared to 2020, the sector's net profit increased (by 64.6 percent), as did the profitability indicators: return on assets (ROA) – by 0.4 percentage points to 1.4 percent, and return on equity (ROE) – by 4.8 percentage points to 13.4 percent, Chart 2.10. The polarisation of profitability persisted, the positive aggregate financial result being concentrated among large banks[18] (87.1 percent). The market share of loss-making banks recorded a historical low (0.9 percent). The cost-to-income ratio did not change significantly (53.8 percent), remaining in the medium-risk bucket according to the EBA's prudential limits.

The risks and challenges generated, fuelled or exacerbated by the pandemic crisis were still visible in 2021, a series of vulnerabilities building up in this period. Specifically, current developments must be monitored by both credit institutions and the central bank, with a view to containing the possible negative effects in the event of the materialisation of the associated risks: (i) vulnerabilities related to asset quality, especially in terms of the portfolio subject to moratoria, (ii) significant rise in potential losses related to the materialisation of interest rate risk given the sizeable volume of government securities and higher interest rates, (iii) low operational efficiency (mainly that of small-sized banks), (iv) increased operational risk (*inter alia* in terms of cyber risk) amid the acceleration of digitalisation due to the pandemic crisis, as well as to competition from the FinTech/BigTech sector.

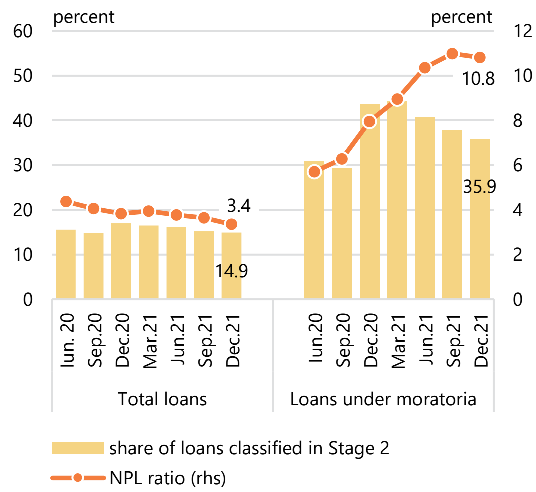
(i) The key asset quality indicators witnessed a positive evolution in 2021, but the high share of loans under moratoria and the increased credit risk of these exposures according to recent developments show certain vulnerabilities.

[17] Year 2020 was characterised by the fast recognition of credit risk provisions due to banks' proactive behaviour and as a result of some measures taken by the NBR as supervisory authority.

[18] Large banks have net assets of over 5 percent of total bank assets.

Compared to the total loan portfolio, developments in the portfolio of loans subject to moratoria indicate a lower quality in terms of credit risk. Specifically, the NPL ratio of loans subject to moratoria had a divergent trajectory compared to that of the entire portfolio, going up from 5.7 percent in June 2020 to 10.8 percent in December 2021 (Chart 2.11). After reaching a 44.2 percent high in March 2021, the share of loans under moratoria classified in Stage 2 contracted, in line with the optimistic prospects for the macroeconomic framework (down to 35.9 percent in December 2021), remaining well above that of the entire loan portfolio for the real sector (14.9 percent, December 2021). The coverage ratio by stage of impairment is similar to that seen at portfolio level. Hence, there is significant uncertainty about these borrowers maintaining their repayment capacity amid the protracted pandemic. Developments in the quality of the loan portfolio will hinge on the overall dynamics of the economy, with an impact on the financial standing of debtors that resorted to moratoria suspending their loan payment obligations.

Chart 2.11. Comparisons of asset quality – total loans and loans under moratoria



Source: NBR

(ii) The government securities portfolio helps improve the liquidity and solvency indicators (according to the prudential treatment), yet the large and increasing share of this class of exposures in total bank assets enhances the sovereign-bank nexus, the possible vulnerabilities in one of these sectors being likely to generate adverse externalities for the other sector. At the same time, interest rate risk materialises if their upward trend resumes. The impact of interest rate risk is monitored by the NBR on an ongoing basis and is assessed based on stress scenarios regarding the shift of the leu- or EUR-denominated yield curve and on mark-to market losses on government securities.

In addition, the pandemic context and some measures adopted at European level supported the concentration trend in government securities at EU level, which was also recorded by a number of local credit institutions. Due to the increase in countries' financing needs during the COVID-19 pandemic, the assessment on the timeliness of some macroprudential measures that may reduce these risks was postponed.

(iii) 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. The market share of banks with a cost-to-income ratio above 60 percent (15.1 percent) saw a slight change from 2020, dropping by 0.5 percentage points. Small-sized banks are characterised by low operational efficiency that can worsen significantly if the macroeconomic environment deteriorates.

(iv) The COVID-19 pandemic affected people's day-to-day activities life fundamentally and, in some cases, irreversibly. One of the sectors that had to adapt fast to the new challenges was the banking sector. In a very short period, credit institutions had to adopt teleworking for the employees who could perform their tasks at home, without being physically present at the workplace. Moreover, contact with the public was limited in branches, which were reorganised in order to meet the sanitary rules in effect. Banks' reaction speed and the extraordinary measures adopted allowed these institutions to continue their operation with minimal disruptions and to protect their employees and customers from the risk of infection. Although the measures taken at the time seemed to be temporary, some of them persisted and banks had to change their business strategy to adjust to customers' new needs and to market conditions influenced by the COVID-19 pandemic. These adaptation processes required important investments in the digitalisation of bank products and services. According to an NBR survey[19], digitalisation expenses in 2017-2020 amounted to approximately lei 2.44 billion, especially for technological innovation projects, almost three quarters of which focused on customer relations. The budgeted digitalisation expenses in 2021 accounted for almost half of total such expenses recorded in the past four years, showing the acceleration of the digitalisation process on the back of the pandemic crisis, as well as of the competition from the FinTech/BigTech sector.

Developments in digital transformation also raise some concerns about the way in which digitalisation can change future bank services, the risks associated with digital transformation (operational risk, especially in terms of cyber risk) evolving continuously. Specifically, banks will have to use significant resources to develop the necessary infrastructure to protect customer data, as well as sensitive information. These concerns are also manifest at European level, where the recent rise in major cyber incidents (however causing no critical damage to banks so far) is a relevant hint for the need to oversee the financial stability EU-wide from this perspective. To this end, the ESRB developed a strategy to mitigate systemic cyber risk and issued Recommendation ESRB/2021/17[20] on the pan-European coordination in the event of a large-scale cyber attack.

In spite of these changes regarding bank digitalisation, as well as taking into account that Romania has (i) a large disparity between urban and rural areas, (ii) a low level of financial education, (iii) an ageing trend of the population (people with low IT skills), and (iv) the lowest degree of digital society[21] development in the EU, banks will most likely maintain an adequate mix[22] of digital services and face-to-face advisory services in the territorial units, in order to best meet customer demand and expectations. Nevertheless, given that approximately 70 percent of the Romanian banking sector is held by European banks, the

[19] The survey was conducted in September 2020 among the top 15 credit institutions in Romania (cumulative market share of 93 percent in terms of asset value).

[20] https://www.esrb.europa.eu/pub/pdf/recommendations/esrb.recommendation220127_on_cyber_incident_coordination~0ebcbf5f69.en.pdf?f2ec57c21993067e9ac1d73ce93a0772

[21] According to the Digital Economy and Society Index (DESI) 2021, published on the European Commission's website, Romania ranks last among EU Member States as regards the level of digitalisation.

[22] This mix is currently maintained as confirmed by the limited reduction in the number of banks' territorial units (by 4 percent annually since the onset of the pandemic, lower than that recorded in 2019).

progress in digitalisation may be spurred through the EU parent banks' efforts to improve efficiency, adapted for the domestic market. Consequently, from this perspective, risks are considered to be lower in Romania than in other EU countries. In the coming period, the banking sector needs however to make sustained efforts for resilient digital development with regard to operational risk.

Box C. ESRB recommendations on restriction of distributions during the COVID-19 pandemic and their implications for the Romanian banking sector

The measures announced by the European Systemic Risk Board (ESRB) in response to the shock generated by the COVID-19 pandemic included Recommendation ESRB/2020/7 on restriction of distributions during the COVID-19 pandemic, which aimed at maintaining prudential capital levels by financial institutions, in order to mitigate systemic risk and support economic recovery in the EU. Given the high uncertainty surrounding the impact of the pandemic on the macroeconomic environment at end-2020, when this recommendation was to expire, the ESRB General Board deemed it appropriate to extend the measures on the restriction of profit distributions until 30 September 2021, as subsequently amended. Specifically, Recommendation ESRB/2020/15 advocated for the extremely prudent behaviour of financial institutions (banks, investment firms, insurers and reinsurers[23]) when making any form of profit distributions, and granted competent authorities increased flexibility in applying the Recommendation, by establishing a conservative threshold of distributions and engaging in bilateral dialogue with financial institutions before taking any decision to distribute dividends or any similar actions.

After the implementation of Recommendation ESRB/2020/15 at national level by issuing NCMO Recommendation No. R/2/2021, the National Bank of Romania required credit institutions to refrain from making any form of profit distribution at least until 30 September 2021. To this end, it was recommended that a possible distribution in 2021 should not exceed a conservative threshold (15 percent of the total profit for 2019 and 2020 or at most 20 basis points of the CET1 capital ratio, in line with the thresholds set by the European Central Bank). The measures taken at national level were communicated to the ESRB, within an ongoing dialogue to determine the level of compliance with the provisions of the recommendations, the efficiency of the national measures and the need to extend them.

The recommendations on restriction of distributions had a significant positive effect on the solvency of credit institutions in Romania in 2020 and 2021. Specifically, several banks that had shown their intention (on the agendas of the general assemblies of shareholders) to distribute dividends before or shortly after the outbreak of the COVID-19 pandemic, decided to no longer do that in 2020; the amount thus retained equalling approximately lei 2 billion. In addition, there were credit institutions that refrained from making dividend distributions, despite their history of doing so, while others adjusted their distribution intentions, the impact of this measure being, most likely, more important. Subsequently,

[23] The scope of Recommendation ESRB/2020/7 also covered central counterparties.

the banks that made distributions until 30 September 2021 generally fell within the conservative thresholds set by the NBR. The build-up of substantial capital buffers pushed the total capital ratio up to a historical high (25.1 percent) in December 2020; the indicator stood at 22.3 percent in December 2021, particularly after the resumption of lending, the excess capital remaining above pre-pandemic levels.

The measures aimed at restricting/limiting dividend distributions proved effective at European level as well. Specifically, according to studies conducted by the ECB and Banco de España, credit institutions that complied with Recommendation ESRB 2020/7 ensured increased financing support to the economy compared to banks whose profit distribution decisions had been taken before the recommendation. In addition, after amending the legal provisions by Recommendation ESRB/2020/15, banks under ECB supervision had a distribution ratio three times smaller than in the pre-pandemic period[24].

Due to the higher-than-expected economic rebound in European countries, in the first part of 2021, there was a considerably lower need that the ESRB and ECB should extend their recommendations after 30 September 2021. Specifically, the significant capital reserves built up in this period and the lower-than-expected deterioration in asset quality (based on support measures and economic recovery) prompted the ESRB and ECB to decide not to extend the recommendations on restriction of dividend distributions after 30 September 2021. The macroprudential authority in Romania (NCMO) took a similar decision.

The expiry of Recommendation ESRB/2020/15 contributes to financial markets return to their normal functioning, but calls for prudence in the coming period from supervisory authorities and banks in terms of credit risk, by promoting and applying adequate practices in a still uncertain economic environment.

2.2.2. Non-bank financial markets

Non-bank financial markets in Romania showed good resilience to the COVID-19 pandemic shocks, all the three sectors supervised by the Financial Supervisory Authority seeing overall favourable developments over the period under review, in terms of main indicators.

The market for collective investment undertakings adequately managed risks through diversification and compliance with investment policies. In addition, the liquidity stress test for investment funds in Romania conducted during 2021 showed the industry's good resilience to severe shocks. The persistence of a low level of development remains the most significant risk to the local stock exchange, on the whole, from the perspective of capitalisation, liquidity and diversification of issuers, which may exert a negative impact on other components of the financial market (e.g. insurers, pension funds, collective investment undertakings) and the economy as a whole (limited access to market financing,

[24] https://www.bankingsupervision.europa.eu/press/speeches/date/2021/html/ssm.sp210702~cf91f91b62.en.html

as an alternative to bank financing). The insurance market is further highly concentrated, which remains a vulnerability in terms of exposure by class of insurance and the market shares held by a small number of insurance companies. The private pension system has been resilient, posting positive developments overall. Private pension funds are institutional investors that chiefly support the domestic economy, while also acting as a balancing and stability factor for the financial market.

Interconnectedness of non-bank financial markets

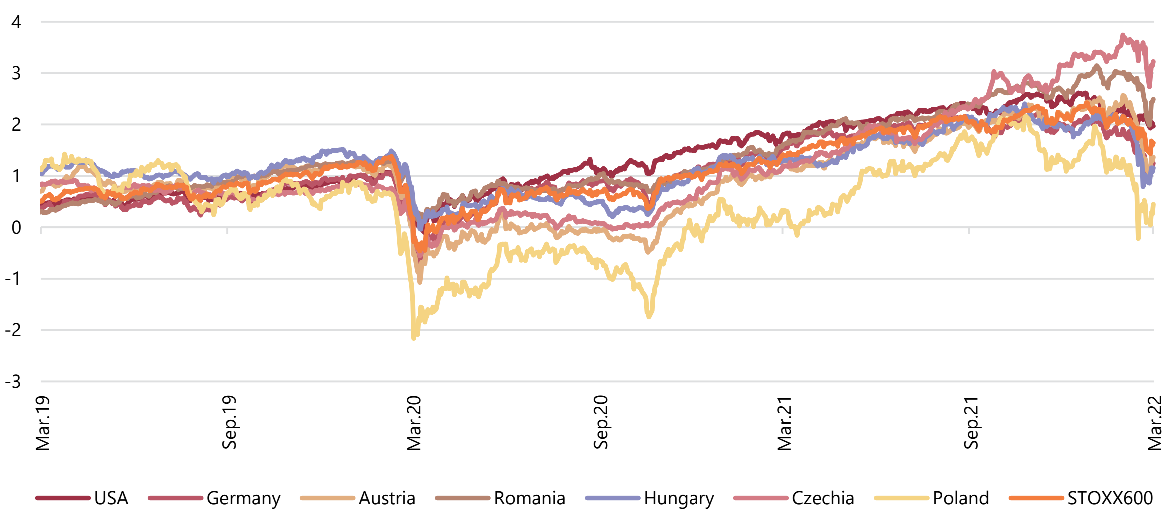
2021 was a year of uncertainty and anticipation, which highlighted both the difficulty to make investment decisions based on predictions about financial market developments and the sustainable benefits of diversification and flexibility.

All the European capital markets followed a swift growth trend in 2021 Q1, which continued in the next two quarters as well. A severe correction in these markets might lead to a steep increase in market risk, given that the economic growth expectations incorporated in long-term bonds would be lower.

One of the already traditional methods employed to monitor the level of market interconnectedness is the analysis of on-balance sheet exposures between sectors or individual entities. Specifically, 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.

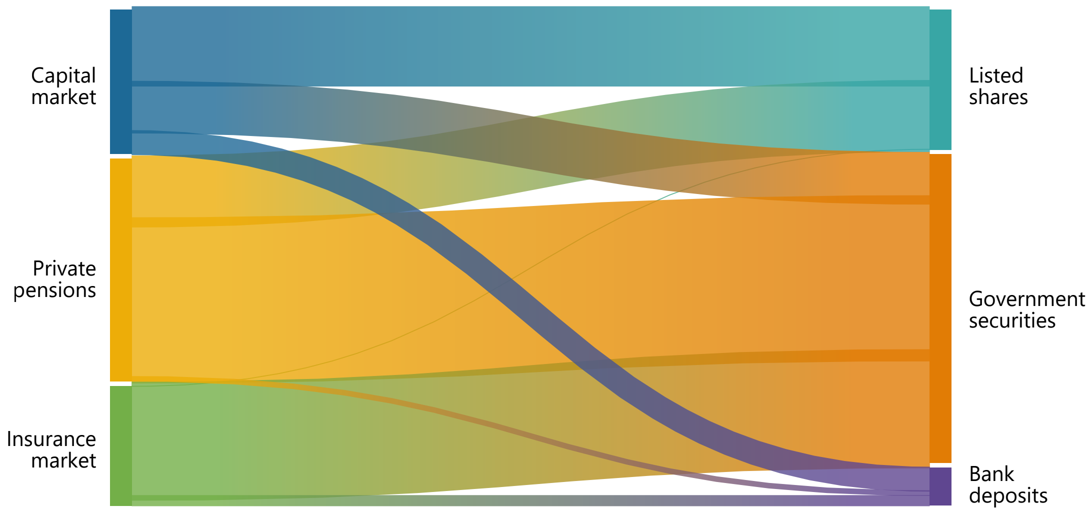
Open-end investment funds (OEIFs) and alternative investment funds (AIFs) held approximately 29 percent of listed shares as at 31 December 2021. At the same time, listed shares accounted for about 26 percent of the investment portfolio of private pension funds

Chart 2.12. Developments in short – term indices (standard deviation)



Source: Refinitiv, FSA calculations

Chart 2.13. Network of exposures of non-bank financial entities by asset class as at 31 December 2021



Source: FSA, FSA calculations

(private pension funds – Pillar II and voluntary pension funds – Pillar III). The insurance market, through the insurance companies operating as at 31 December 2021, invested 0.3 percent in listed shares. The interconnectedness of FSA-supervised entities with stock markets is deemed to be average to low.

Due to the specifics of the activity of insurers, investment funds and pension funds, the holdings of financial assets play an extremely important part in the capacity of these entities to meet the obligations 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 that sector.

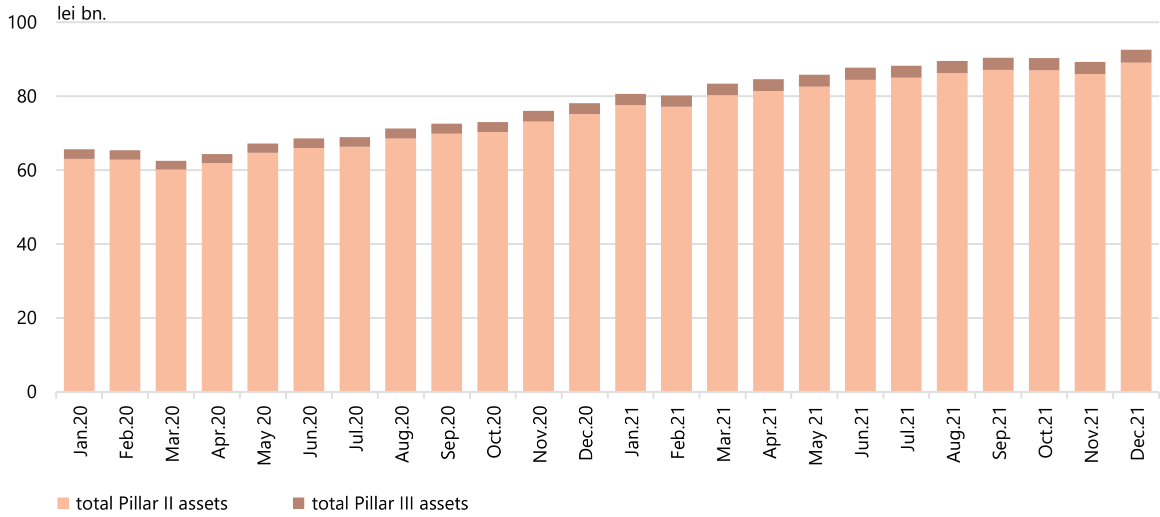
Collective investment undertakings have the largest exposure to the banking sector, accounting for 9 percent of bank deposits, whereas insurance companies hold around 4 percent and private pension funds 2 percent. The interconnectedness with the banking sector (in terms of bank assets) is considered 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 they hold in their portfolios. Specifically, government bonds account for approximately 19 percent of the investment portfolios of collective investment undertakings, 60 percent of the investment structure of private pension funds and 43 percent of the asset investments of insurance companies.

2.2.2.1. Private pension market

The total assets and number of participants in the private pension system have been growing steadily ever since its establishment. Specifically, at end-December 2021, the total assets of private pension funds (Pillar II and Pillar III) amounted to lei 92.52 billion, up by 19 percent from the same year-ago period, accounting for 7.84 percent of GDP.

Chart 2.14. Total assets of the private pension system



Source: FSA

As at end-2021, the investment policy of private pension funds further focused on the local capital market. The share of investments in fixed-income securities accounted for 69 percent of the total investment portfolio of private pension funds, whereas equity investments made up 26 percent.

The private pension system remained one of the least affected segments amid the uncertainty generated by the COVID-19 pandemic, given its long-term saving and investment characteristics. In the context of a prudent, balanced and diversified investment policy, pension funds have evolved favourably even in times of turmoil, by constantly adapting to the new financial market conditions.

In 2021, private pension funds were exposed to the following risks:

- Credit risk remains low, as private pension funds are only allowed to make investments in fixed-income securities that are investment grade. At 31 December 2021, 60 percent of total assets of the sector were invested in government securities issued in Romania, which is an investment grade country.

- Liquidity risk is low, as the private pension system is further in an accumulation stage, with very modest payments and outflows, due to the demographic structure of the population that has many years until 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: in order to cover the minimum guaranteed value, private pension fund managers are required to set up technical provisions from their own funds. The provisions are intended to cover the risks related to the minimum required investment guarantee established by Law No. 411/2004 and is used if the value of a participant's personal assets is lower than that of the their contributions paid throughout the entire active period, net of transfer penalties and legal fees. In addition, the Private Pension System Rights Guarantee Fund is an additional security element of the private pension system.

- In terms of profitability risk, it should be mentioned that the investment horizon of private pension funds should be seen as long-term, given the contributory period of 30-40 years in the private pension system. The rates of return of private pension funds have been on an upward trend since March 2020.

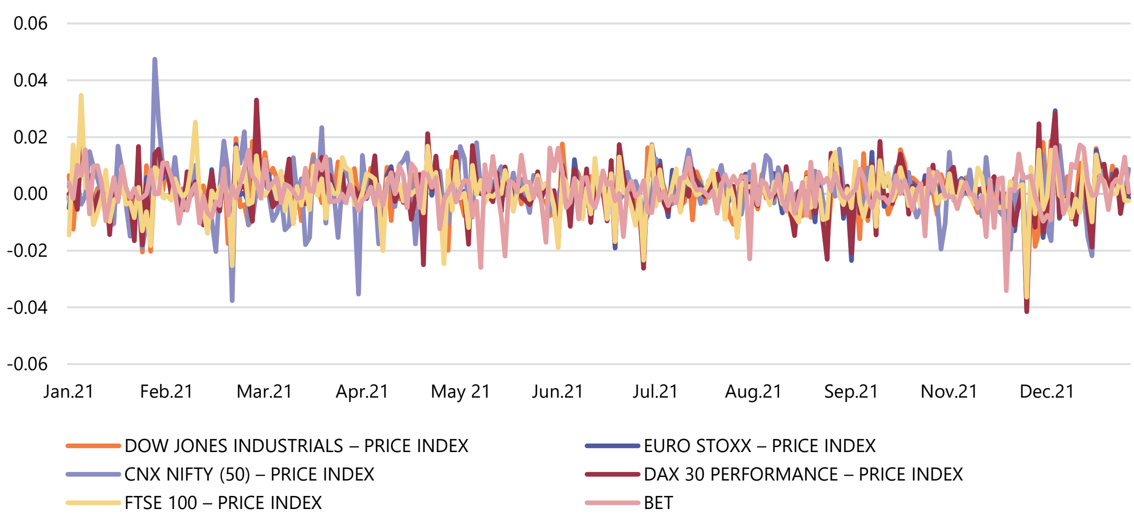
- Concentration risk is structural and remains high for private pension funds in Romania and their depositories. Nevertheless, the regulatory framework has been developed so as to allow numerous check mechanisms and increased transparency, in order to eliminate from the very beginning the potential vulnerabilities that may arise from concentration risk.

2.2.2.2. Capital market

The global nature of the COVID-19 pandemic has had a significant impact on world economy since early 2020, as part of those infrequent, unpredictable and uncommon events that may lead to adverse chain reactions and market dysfunction.

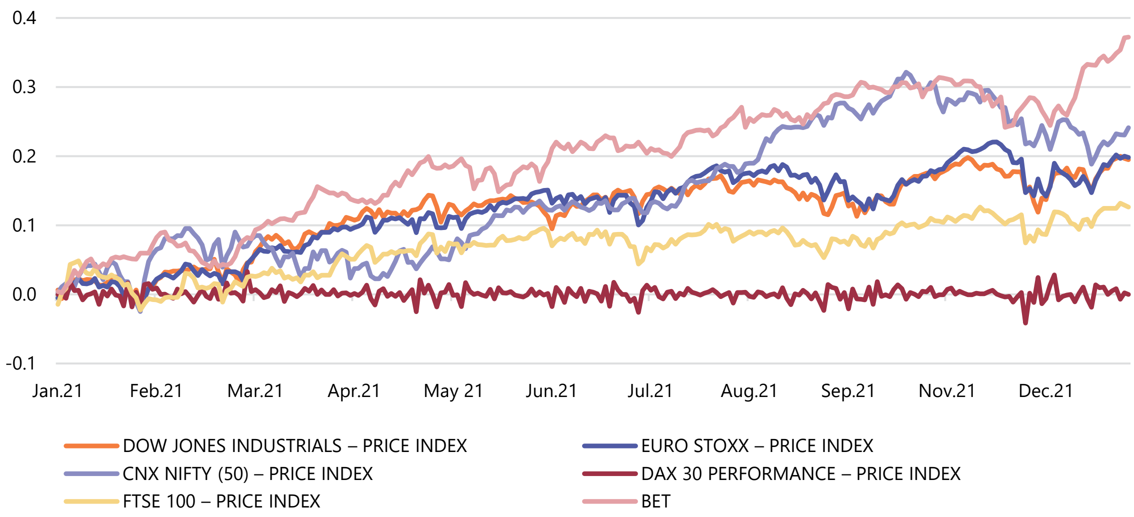
At the end of 2021, international stock markets recovered after having experienced, in March 2020, the most severe slump because of the COVID-19 pandemic. International stock markets saw significant growth in July-August thanks to investors' strong positive sentiment.

Chart 2.15. Profitability of stock exchange indices in January-December 2021



Source: BSE, Refinitiv, FSA calculations

Chart 2.16. Profitability of stock exchange indices in January-December 2021 (2020=100)



Source: BSE, Refinitiv, FSA calculations

Romania's stock exchange indices posted positive developments at end-2021 against end-2020. The BET benchmark index, which captures developments in the most heavily traded companies on the BSE regulated market, stood 33 percent higher at end-2021 against end-2020. The fastest growth pace, i.e. 40 percent, was that of the BET-TR index, which captures developments in prices of the constituent companies, as well as the dividends they pay. The BET-NG index, which reflects the evolution of companies listed on the BSE regulated market whose core business covers energy and related utilities, rose by approximately 29 percent as at 31 December 2021.

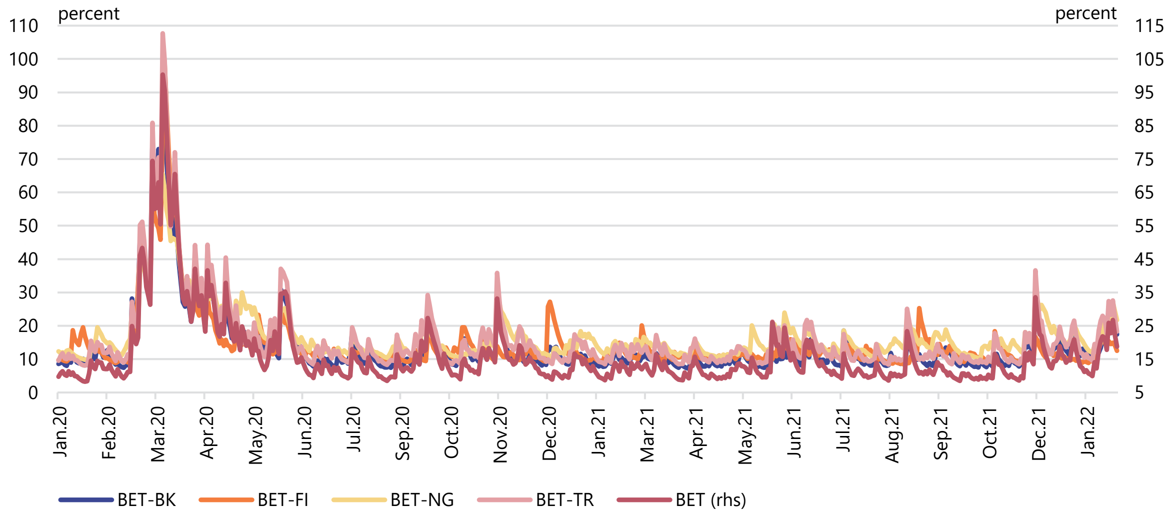
In times of uncertainty, market volatility increases, along with contagion effects, so that markets become more highly correlated with each other. The volatility of BSE indices decreased in recent years, yet the regime is still medium to low for the time being.

Market capitalisation grew by about 48.40 percent on 31 December 2021 against end-2020 and by approximately 53 percent on 26 January 2022 over end-2021. Compared to end-2019, capitalisation rose by about 30.41 percent, with the market value of local firms listed on the main BSE market exceeding the pre-pandemic level.

At end-December 2021, 18 investment management companies, 82 open-end investment funds, 25 closed-end investment funds, 5 financial investment companies, Fondul Proprietatea and 4 depositories operated on Romania's stock market. Assets of UCITS in Romania totalled lei 49.98 billion as at 31 December 2021, up around 21 percent from the same year-earlier period.

The two main segments of the local capital market, i.e. undertakings for collective investment and the stock exchange, exhibited moderate volatility in 2021, in line with the trend manifest on most capital markets across the region. In 2021, all stock market indices made up for earlier losses, with the BET index hitting a fresh historical high above 13,000 points, after the outbreak of the health crisis entailed significant fluctuations in the domestic capital market throughout 2020.

Chart 2.17. Volatility of local stock exchange indices



Source: BSE, FSA calculations

On the whole, the capital market risk in Romania remains high and trending upwards, in a context where, structurally, stock exchanges react in a quick and forward-looking manner to any stress factor that could disrupt economic, social, political developments, etc.

Liquidity risk on the Bucharest Stock Exchange is further assessed as medium. The average daily trading value in 2021 dropped 11 percent versus the 2020 average. Furthermore, the BSE capitalisation fully regained the ground lost in 2020, reaching lei 229 billion at end-December 2021, up about 48 percent over December 2020.

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

2.2.2.3. Insurance market

In 2021, gross premiums written by insurance companies licensed and regulated by the FSA amounted to approximately lei 14.2 billion, up by roughly 24 percent from the previous year. The information is based on the insurance companies' reports sent to the FSA and also includes the indicators of City Insurance, a company whose operating licence was withdrawn[25] in September. Given the considerable market share of this company and the fact that City Insurance operated until September 2021, the indicators in this *Report* referring to the gross premiums written and gross compensation paid also include the data related to City Insurance until September 2021.

The insurance market in Romania remains focused on non-life insurance business, with an 82 percent share in total gross premiums written by insurance companies licensed and regulated by the FSA.

[25] FSA Decision No. 1148/17.09.2021.

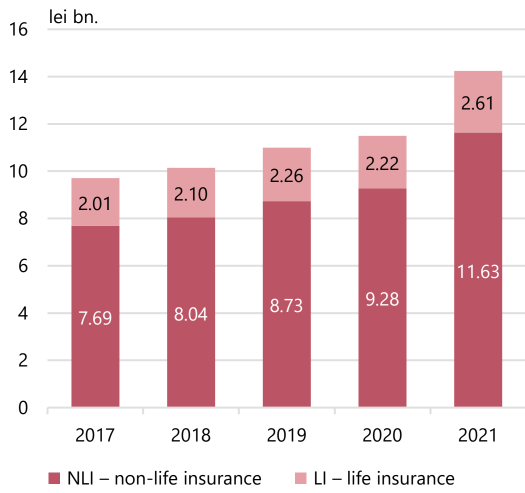
However, mention should be made about a sustained increase in the volume of gross premiums written (GPW) for life insurance, which stood at lei 2.6 billion in 2021, 18 percent higher than in 2020.

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), and therefore make up for approximately 76 percent of total GPW for non-life insurance and 62 percent of total GPW by insurance companies in 2021.

The volume of gross premiums written for life insurance (lei 2.6 billion) was supported by the increases in subscriptions for class C1 (Life insurance, annuities and additional life insurance) and class C3 (Life insurance and annuities related to investment funds) by around 15 percent and 25 percent, respectively.

Health insurance continued to post positive dynamics in 2021, with a subscription volume of around lei 497 million, up by over 10 percent versus the previous year, holding a share of 3.5 percent in total GPW by insurance companies licensed and regulated by the FSA (lei 14.2 billion).

Chart 2.18. Volume of gross premiums written in 2017-2021



Source: FSA

As for the guarantee insurance, the volume of gross premiums written was of approximately lei 345 million in 2021, down by 25 percent from 2020 (lei 460 million).

Out of the total gross premiums written by insurance companies licensed and regulated by the FSA in 2021 (lei 14.2 billion), the gross premiums written in other countries recorded a volume of around lei 264 million, i.e. approximately 1.9 percent of total volume of GPW, on a decline compared to the same year-ago period (around lei 355 million).

The volume of gross premiums written by insurance companies licensed in other EU Member States amounted to approximately lei 1.21 billion (8.51 percent of total gross premiums written in Romania by local FSA-licensed companies) in 2021, based on the freedom of establishment (FOE) in Romania, via 13 branches.

The solvency capital requirements (SCR) and the minimum capital requirements (MCR), calculated at aggregate level for the entire insurance market stood at above-one levels at end-December 2021.

At end-December 2021, the assets and liabilities of insurance companies (measured in accordance with the Solvency II requirements) recorded higher values than those seen in the same year-earlier period. Total assets went up slightly, by 1.4 percent, across the entire insurance market, while total liabilities of insurance companies rose by 1.5 percent at 31 December 2021 compared to end-December 2020.

Gross compensation paid by insurance companies for non-life and life insurance (including partial and total redemptions and maturities) amounted to around lei 7.6 billion in 2021, i.e. approximately 54 percent of the total GPW volume throughout the reference period.

The combined ratio calculated based on cumulated data for all classes of non-life insurance was above one (121 percent) in 2021, on the rise compared to the same year-ago period (110 percent).

At end-2021, the total value of gross technical reserves of insurance companies exceeded lei 20 billion, up by 6 percent versus 2020 (approximately lei 19 billion). Out of the total value of gross technical reserves, 54 percent are reserves for non-life insurance, whereas 46 percent of total technical reserves are for life insurance.

The liquidity coefficient was on the rise at end-December 2021 compared to end-December 2020 for both non-life and life insurance.

Premiums paid up by non-life and life insurance companies stood at lei 9.91 billion in 2021, up by around 26 percent versus 2020 (lei 7.86 billion). The share of income from intermediation activities in the volume of premiums written on the insurance market was 17.52 percent, the related volume for non-life and life business standing at 16.86 percent and 35.53 percent, respectively.

3. Measures implemented for achieving national macroprudential objectives

3.1. Macroprudential measures adopted in the EU in 2021

Macroprudential policy was an important pillar for the European authorities in their effort to tackle the effects of the pandemic and to support the subsequent economic recovery. After 2020, which was marked by numerous measures aimed at stimulating the real economy, especially via the recalibration of instruments to support financing, 2021 saw the emergence of a new paradigm, i.e. that of macroprudential policy normalisation, once the initial shock had been overcome and so as to prevent the build-up of systemic risks.

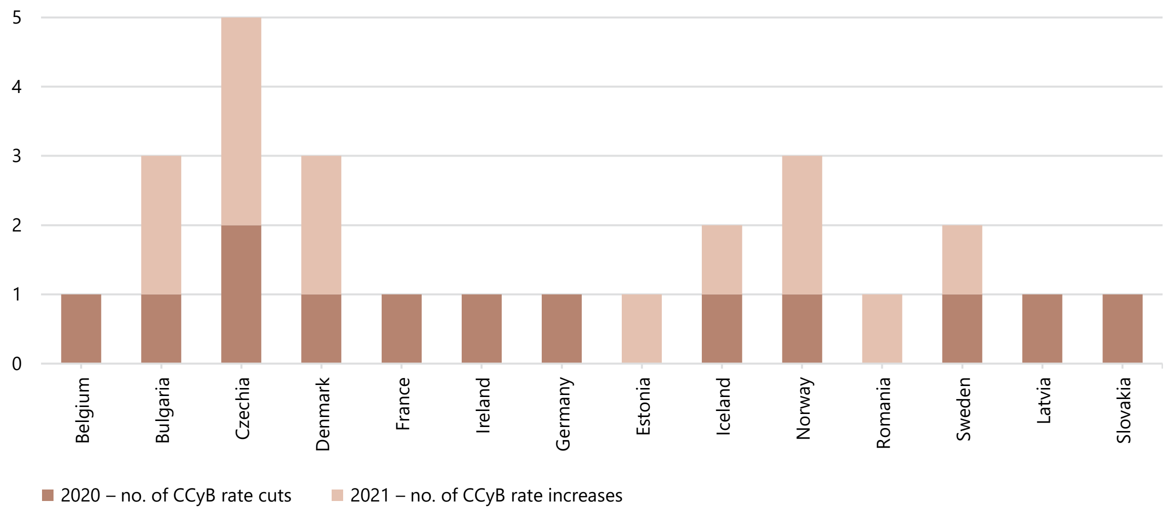
In this respect, the main regions standing out include the Nordic and Central and Eastern European countries. In fact, the Nordic countries benefited from the largest macroprudential space during the pandemic crisis, which gave the real economy a significant boost. The release of the countercyclical capital buffer was one of the most widely used measures by the European authorities during the period of distress, a recovery trend from the stimulative measures being subsequently visible. Specifically, over the course of 2021, some countries began to replenish the CCyB buffer released previously, while others decided for the first time to implement a positive buffer rate (Chart 3.1), as the pandemic shock showed the need for a timely build-up of capital buffers available for release during periods of distress. Mention should be made that, at the onset of the pandemic, some Member States, which did not hold reserves in the form of the CCyB (the only buffer that, by its nature, can be released in such a situation), resorted to the downward recalibration of other capital buffer requirements.

Improved economic conditions allowed the European Central Bank to announce that it decided to waive the recommendation on dividend distribution starting October 2021, as the stress test results indicated that the European banking sector was sufficiently capitalised and robust to withstand potential adverse shocks. Subsequently, the European Systemic Risk Board (ESRB) also announced that it would not extend the implementation deadline of Recommendation ESRB/2020/15[26].

A growing concern in Western European countries is related to the developments in the real estate market, which has witnessed significant price increases, a trend further accentuated by the new housing market priorities of the European consumers under the

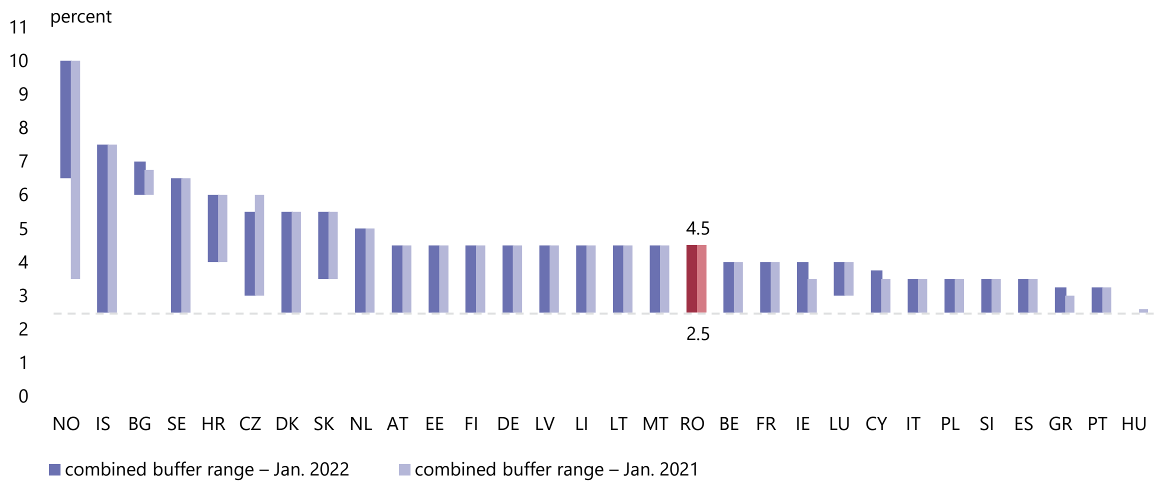
[26] Recommendation ESRB/2020/15 amending Recommendation ESRB/2020/7 on restriction of distributions during the COVID-19 pandemic.

Chart 3.1. Number of decisions on the CCyB rate in 2020 and 2021



Source: ESRB

Chart 3.2. Combined capital buffer applicable in January 2022 and January 2021 – European comparisons



Note: In Romania, the structural systemic risk buffer was calculated based on the higher of O-SII and SyRB buffer rate.

Source: ESRB

impact the pandemic. Furthermore, in 2021 the ESRB announced that the authorities' radar detected two new types of risks – climate change and cyberattacks. Hence, technological developments require an update of the set of vulnerabilities to financial stability and of the tools to prevent and tackle them.

A comparative analysis of the requirements applicable across the EU shows that, in January 2022, Romania was in the median range in terms of the combined buffer rate. The countries in northern Europe further rank topmost (Chart 3.2). It should be noted that the data presented do not cover the CCyB rate increases seen in several countries, Romania included, which are to enter into force as of the second half of this year. Moreover, given the complete transposition of the CRD V Directive into the Romanian legislation, the two structural buffers provided for in the European regulatory framework (SyRB and O-SII) are cumulated, credit institutions in Romania maintaining a combined buffer in the range of 2.5 percent to 5.5 percent as of 7 February 2022.

3.2. Macroprudential measures adopted in Romania in 2021

3.2.1. Capital buffers

The banking sector capitalisation remained at high levels throughout 2021 and the liquidity ratios did not create constraints on lending. At the same time, profitability stood at levels close to those recorded before the outbreak of the pandemic crisis. Specifically, the banking sector's resilience has strengthened, due also to the implementation of the macroprudential policy framework for capital buffers, i.e.:

- the capital conservation buffer (CCoB) applies to all banks in order to create a primary loss-absorption capacity and support 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 zero percent, but it should be noted that following the General Board meeting of 14 October 2021, the NCMO recommended the NBR to raise it to 0.5 percent, as of 17 October 2022. The recommendation was implemented by issuing NBR Order No. 6/2021 amending NBR Order No. 12/2015 on the capital conservation buffer and the countercyclical capital buffer (published in *Monitorul Oficial al României*, Part I, No. 1130/26 November 2021). The main arguments underpinning this recommendation were: (i) the fast increase in lending, its growth rate accelerating particularly during 2021, amid the recovery from the sharp economic contraction seen in the context of the pandemic outbreak, (ii) the tensions surrounding macroeconomic equilibria persist, especially via the twin deficits, i.e. budget and current account deficits, (iii) the increase in the countercyclical buffer rates announced by several Member States, concurrently with waiving the restrictions on dividend distribution, (iv) the high levels of voluntary capital reserves built up by the banking sector and of liquidity indicators, exceeding the EU averages, which allow capital to be conserved, without affecting the loan supply, in the context of a robust profitability in recent years, and (v) the access to finance for eligible borrowers, with credit institutions estimating credit standards to remain unchanged in the case of loans to non-financial corporations and for both categories of loans to households;

- the other systemically important institutions buffer (O-SII) aims to avoid the moral hazard generated by the largest credit institutions in the banking sector. The O-SII buffer applies to systemically important banks and, in 2021, its rate was in the range between 1 and 2 percent of total risk exposure amount. As of 1 January 2022, a new approach to the O-SII buffer calibration methodology was implemented (based on the EBA-recommended mandatory indicators). The bank score range is divided into six equal 500-basis point buckets, which are assigned O-SII buffer values in equal increments of 0.5 percentage points (from 0.5 percent to 3 percent);

- the systemic risk buffer (SyRB) is the main instrument available to EU macroprudential authorities, which can be tailored to national specificities in order to mitigate structural risks that could threaten the stability of the financial system in a given jurisdiction. It 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 and 2 percent of total risk exposure amount, depending on the non-performing loan ratio and the coverage ratio.

3.2.1.1. The countercyclical capital buffer

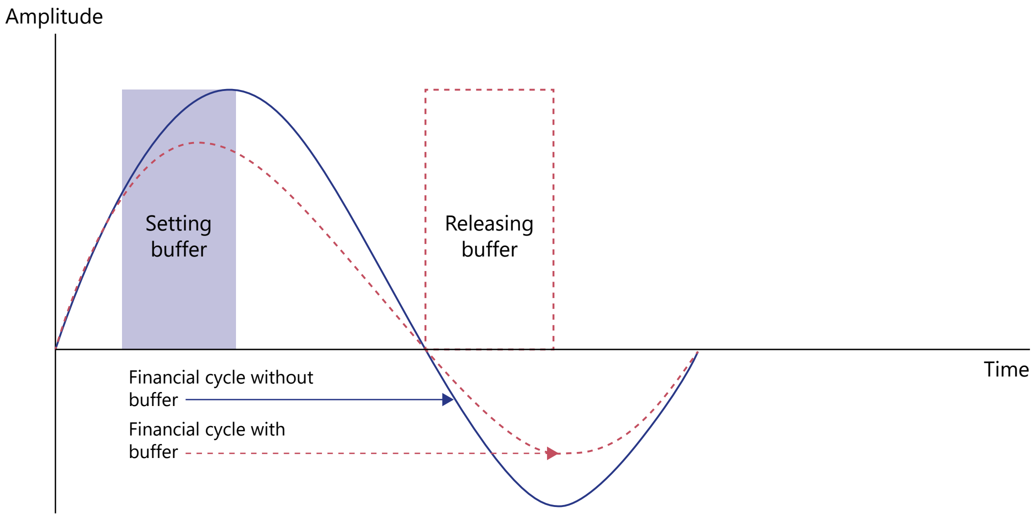
The implementation framework of the macroprudential instrument

The countercyclical capital buffer (CCyB), defined in CRD V, and previously in CRD IV, is one of the tools recommended by the European Systemic Risk Board (ESRB) to achieve the intermediate objective of macroprudential policy on mitigating and preventing excessive credit growth and leverage[27]. Moreover, in order to support the national authorities in making decisions and to provide a common basis for analysis across Member States, the ESRB issued a recommendation on the operationalisation of this tool, namely Recommendation on guidance for setting countercyclical buffer rates (ESRB/2014/1). Recommendation ESRB/2014/1 is composed of four subrecommendations: A – Principles guiding the setting of CCyB rates, B – General guidance on the measurement and calculation of the credit-to-GDP gap, and the calculation of the benchmark buffer rate and the buffer guide, C – Guidance on variables which indicate the build-up of system-wide risks associated with periods of excessive credit growth and D – Guidance on variables that indicate that the buffer should be maintained, reduced or fully released. At national level, the NCMO, in its capacity as designated authority, shall set on a regular basis the countercyclical buffer rate, in compliance with its tasks under Art. 3, para. (1) of Law No. 12/2017 on the macroprudential oversight of the national financial system.

The CCyB instrument is designed to prevent excessive credit growth during the expansion phase of the financial cycle, but also to enhance the banking sector's resilience with a view to ensuring a good absorption capacity of potential losses generated by an unfavourable

[27] Recommendation ESRB/2013/1 on intermediate objectives and instruments of macroprudential policy, subrecommendation B on the selection of macroprudential instruments.

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



Source: ESRB, *Flagship Report on Macro-prudential Policy in the Banking Sector*

evolution of the economy (Figure 3.1). Consequently, during periods of distress, the buffer acts in two ways to support the continued provision of financial services to the real economy, namely by (i) absorbing losses due to the additional capital buffers above the minimum requirements and (ii) releasing additional capital, raised from buffer reduction/deactivation, thus contributing to mitigating credit institutions' trend towards deleveraging.

In accordance with Article 136(5) of the CRD, the countercyclical capital buffer shall be implemented 12 months after the measure is announced; a shorter deadline for application shall be justified in exceptional cases. Instead, a reduction in the buffer rate can be made effective immediately. Where the CCyB rate is reduced, the designated authority shall also set an indicative period during which no increase in the buffer rate is expected.

The countercyclical capital buffer consists of Common Equity Tier 1 capital (CET1), ranging from 0 percent to 2.5 percent of the total risk exposure amount. However, the buffer rate may exceed the upper limit of 2.5 percent where high risks are identified.

In order to substantiate the decision on the appropriate countercyclical buffer rate, the CRD follows the principle of "guided discretion", according to which the responsible authorities combine the rule-based approach with the exercise of discretionary powers. Thus, the decision to activate this instrument is based on the information provided by the deviation of the total credit-to-GDP ratio from its long-term trend, which can be complemented with the analysis of indicators on the real estate market, macroeconomic environment, private sector indebtedness or credit standards.

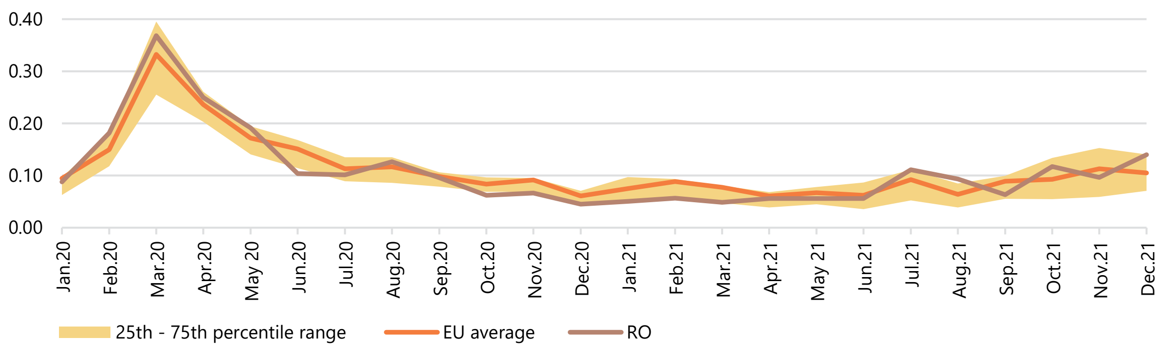
According to the provisions of Recommendation ESRB/2014/1, Member States are requested to send to the ESRB a report explaining the measures taken to comply with the Recommendation every three years. The first reporting deadline was 30 June 2016, but owing to the pandemic effects, the next deadline set for 30 June 2019 was initially postponed by one year via Decision ESRB/2019/15, and then cancelled in accordance with

Decision ESRB/2020/10. Thus, the second deadline for the submission of reports to the ESRB is 30 June 2022. In May 2019, the ESRB published the first assessment of the level of implementation of Recommendation ESRB/2014/1 by Member States and the European Central Bank. According to the assessment results, Romania was given an overall grade of fully compliant (FC) with the Recommendation.

The experience across the EU

The year 2021 saw a strong recovery of the European economy, concurrently with sustained credit growth, following the financial market turmoil during 2020 (Chart 3.3) and the uncertainties that marked the onset of the pandemic, which is why the designated authorities started to replenish the capital buffers previously released. The main macroprudential instrument used in early COVID-19 pandemic to provide a direct stimulus to the banking sector and real economy was the countercyclical capital buffer (CCyB), with 12 countries reducing partially or fully the rate pending for 2020. Symmetrically, in the course of 2021, most countries resorted to the same buffer, except this time by recalibrating its rates to the upside. Thus, eight EEA countries[28] decided to increase the CCyB rates in 2021, with most measures being due for implementation in 2022 and 2023, due to the fact that the provisions of the legislative framework provide for a 12-month period since the decision is made until its actual implementation. In 2021, some states adopted a single decision to raise the buffer rate, while others followed a gradual approach to the macroprudential policy normalisation by means of consecutive decisions to increase the CCyB rate (Czechia, Bulgaria, Denmark and Sweden).

Chart 3.3. Country-Level Index of Financial Stress (CLIFS*) estimated by the ECB for EU Member States



*) 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".

Note: The 25th - 75th percentile range is the distance between the value of CLIFS for which only 25 percent of the scores recorded across Member States are below that value and that for which only 25 percent of the scores reported across Member States are above that value.

Source: ECB

[28] The following states decided to raise the CCyB rates: Bulgaria, Czechia, Denmark, Estonia, Iceland, Norway, Romania and Sweden.

Chart 3.4. CCyB rate in EEA countries at end-2016

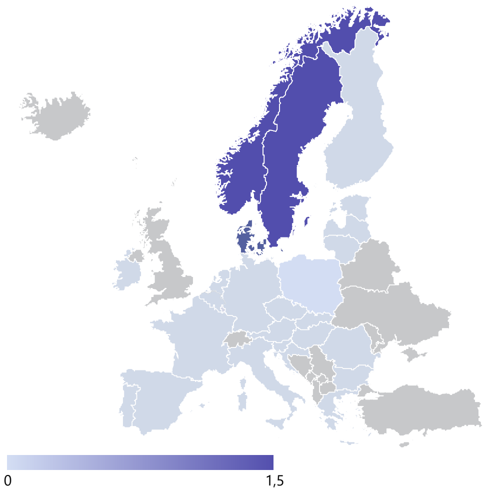


Chart 3.5. CCyB rate in EEA countries at end-2019

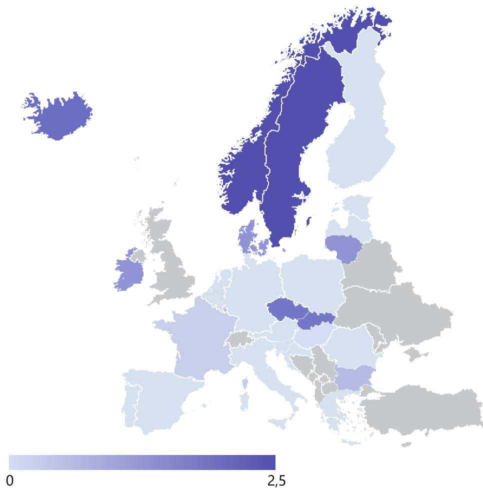


Chart 3.6. CCyB rate in EEA countries in early 2021

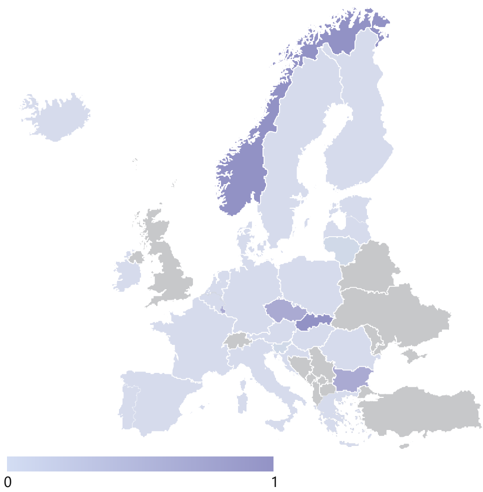
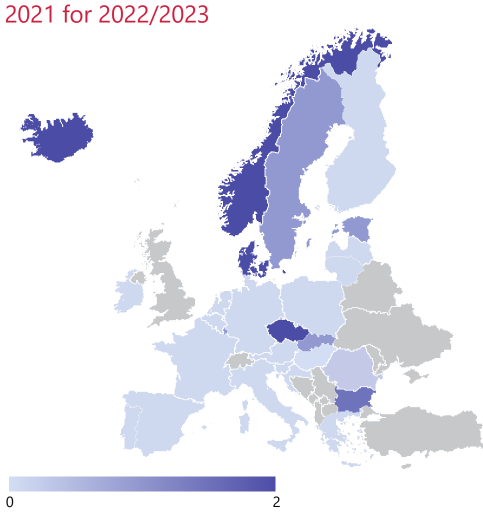


Chart 3.7. CCyB rate in EEA countries announced in 2021 for 2022/2023



Source: ESRB

Looking at data records (Charts 3.4-3.7), a trend emerges for countercyclical buffer rates. Thus, after a cautious beginning of the process, at-end 2019, 10 states applied a countercyclical buffer rate above 0 (zero) percent, whereas three other countries had decided to implement positive rates during the following year. However, the outbreak of the COVID-19 pandemic put an end to both the tendency to raise applicable rates and to the growing number of countries applying positive buffer rates.

The most significant changes in the CCyB rate during 2021 were seen in Denmark and Iceland, where decisions were taken to increase the buffer rate by 2 percentage points. In Denmark, the decision was to gradually raise the buffer rate, i.e. during the June meeting, the Danish authorities set a 1 percentage point rise to be applied from 30 September 2022, while, during the December meeting, the macroprudential authority of Denmark decided on a further increase by 1 percentage point in the CCyB rate to be effective from 31 December 2022. In Iceland, the decision on the 2 percentage point hike in the CCyB rate was made in one meeting only and is effective as of 29 September 2022. The measures taken by Denmark were explained, *inter alia*, by the relatively low interest rate and the recent fast rise in lending to households, alongside the expansion of real estate activity. In the case of Iceland, the main reasons behind the decision are high household debt and the rapid increase in financial asset prices, as cyclical systemic risks are deemed to be at pre-pandemic levels.

Table 3.1. Current CCyB rates and pending CCyB rates for the coming years in the EEA countries

Country	CCyB rate (%) in early 2021	CCyB rate (%) announced in 2021 for 2022/2023	The date of the last revision
Austria	0	0	1 January 2016
Belgium	0	0	1 April 2020
Bulgaria	0.5	1.5	16 December 2021
Croatia	0	0	1 January 2016
Cyprus	0	0	1 January 2016
Czechia	0.5	2	25 November 2021
Denmark	0	2	14 December 2021
Estonia	0	1	30 November 2021
Finland	0	0	16 March 2015
France	0	0	1 April 2020
Germany	0	0	1 April 2020
Greece	0	0	1 January 2016
Hungary	0	0	1 January 2016
Iceland	0	2	29 September 2021
Ireland	0	0	1 April 2020
Italy	0	0	1 January 2016
Latvia	0	0	1 February 2016
Liechtenstein	0	0	1 July 2019
Lithuania	0	0	1 April 2020
Luxembourg	0.5	0.5	1 January 2021
Malta	0	0	1 January 2016
Netherlands	0	0	1 January 2016
Norway	1	2	15 December 2021
Poland	0	0	1 January 2016
Portugal	0	0	1 January 2016
Romania	0	0.5	14 October 2021
Slovakia	1	1	1 August 2021
Slovenia	0	0	1 January 2016
Spain	0	0	1 January 2016
Sweden	0	1	28 September 2021
EEA average	**0.1**	**0.4**	-

unchanged 0.5 pp increase 1 pp increase 1.5 pp increase 2 pp increase

Source: ESRB

At the end of 2021, a third of the EEA countries applied/planned to apply a CCyB rate above zero. Romania and Estonia are among them, setting a CCyB rate above zero percent for the first time since the buffer was implemented. Romania will apply a 0.5 percent CCyB rate as of 17 October 2022, while Estonia will set a 1 percent CCyB rate as of 12 July 2022. The countries with the highest pending buffer rates (2 percent) are Czechia, Denmark, Iceland and Norway, followed by Bulgaria, with a 1.5 percent CCyB rate.

Box D. The positive neutral countercyclical capital buffer rate

Some European countries (Lithuania, Estonia, Sweden and the United Kingdom) have adopted an approach that implies a positive neutral countercyclical capital buffer rate for those periods when no excessive credit growth is reported yet. In these cases, the national macroprudential authorities built on the premise that the CCyB rate should not be set at 0 percent in the beginning, as most countries decided to do, but at an equilibrium level above 0 percent (Table A). By setting a positive neutral countercyclical capital buffer rate, a larger leeway is created for macroprudential measures ever since they started to be assessed. This strategy is also very useful following the time lags between the risk build-up and the macroprudential policies currently under implementation, the measures being implemented, as a rule, 12 months after the adoption. Thus, activating the buffer before the level of risk becomes elevated provides the banking sector with a safety net that can be used in the event of a material adverse shock disrupting the financial system.

Table A. Positive neutral CCyB rates in the countries taking this approach

Country	Positive neutral CCyB rate
Lithuania	1%
Estonia	1%
Sweden	2%
United Kingdom	1%

Source: ESRB

Lithuania used this approach until the outbreak of the COVID-19 pandemic, maintaining a positive 1 percent CCyB rate, although the calibration indicators showed no signs of a faster increase in cyclical risks. However, following the outbreak of the COVID-19 pandemic, the designated national authority decided to fully release the buffer to support lending to the economy, but also to help credit institutions absorb potential losses induced by this shock.

Estonia plans to revise the national macroprudential policy framework so as to launch the early application of the CCyB. To this end, the first step was taken at the November 2021 meeting, when the designated authority decided to apply a 1 percent CCyB rate as of December 2022. According to the new framework, the overall CCyB requirement will have two parts:

1. a base requirement, which is normally set at a positive rate and will only be released in exceptional stress situations. It is currently planned to set a CCyB base requirement at the level of 1 percent, which would replace the previous 1 percent SyRB requirement on domestic exposures;
2. a cyclical requirement, which is additional to the base requirement and is determined on the basis of a periodic risk assessment of the financial system.

Thus, the overall CCyB rate in Estonia will be equal to the sum of the base rate, i.e. 1 percent and the cyclical requirement established after each quarterly analysis: $CCyB_G = CCyB_{RP} + CCyB_{CICL}$.

In March 2021, the Swedish macroprudential authority published a memorandum[29] describing the general principles and the approach for the application and setting of the countercyclical buffer rate. The approach refers to introducing a positive neutral CCyB rate of 2 percent, with the Swedish macroprudential authority pursuing a strategy that will increase the buffer rate earlier and faster than would be justified by systemic risk indicators. However, the buffer will be raised gradually in order to give banks sufficient time to set up the new capital requirement.

In the United Kingdom, the macroprudential authority built on the premise that long-term requirements for cyclical systemic risks should be set at a non-zero level, namely an equilibrium level of 1 percent. This perspective takes into account the fact that the countercyclical capital buffer cannot fall below zero, while the decisions on the buffer use must consider the entire financial cycle. The use of a positive neutral CCyB rate has, *inter alia*, the advantage of increasing the resilience to the uncertainty inherent to assessing risks to financial stability.

Another approach of interest to the recalibration of the countercyclical buffer from the perspective of a full financial cycle approach belongs to Czechia, which uses the standard CCyB rate. Thus, in order to ensure the early build-up of countercyclical capital buffers, but also to avoid the need to make radical changes to the buffer rate as a result of future events, the macroprudential authority of this country sets a standard CCyB rate, other than zero, while cyclical risks are still benign. The analyses[30] carried out indicated a 1 percent standard CCyB rate for Czechia, while the buffer should be gradually raised to this level within two years after the acute phase of a cyclical contraction or financial crisis has subsided. However, once the standard CCyB rate has been reached, the buffer rate can be considered to be raised even above this level, where the developments in the credit or real estate market justify this decision.

[29] FI's approach to setting the countercyclical capital buffer | Finansinspektionen

[30] Plašil, M., "The countercyclical capital buffer rate for covering the usual level of cyclical risks in the Czech Republic", CNB thematic article, 2019.

In accordance with the provisions of Article 136(2) of CRD V, each designated national authority shall calculate, on a quarterly basis, a buffer guide as a reference for setting the countercyclical buffer rate, based on the deviation of credit-to-GDP-ratio from its long-term trend, known as the Basel indicator. The calculation of the deviation[31] and of the benchmark buffer rate[32] was detailed in Recommendation ESRB/2014/1 on guidance for setting countercyclical buffer rates. Given the heterogeneity and dynamic nature of financial systems, but also the specificities of national economies, in addition to this standard indicator, most European countries monitor on a regular basis a set of additional indicators to substantiate their decisions on the buffer rate.

A case in point is Czechia which uses 3 types of indicators to calibrate the CCyB buffer: (i) macro-financial indicators (the dynamics of the stock of loans in the economy, financial market conditions, the dynamics of property market indicators, credit standards, stock market indices, the current account-to-GDP ratio, as well as the dynamics of the composite indicator of systemic stress (CISS), (ii) banking sector indicators (capital structure and its dynamics, loan margins, asset quality, provisioning, the structure and evolution of profit, as well as other indicators on credit supply and demand and (iii) indicators on stress test results.

The outbreak of the COVID-19 pandemic provided further evidence on the low capacity of the Basel standard indicator to capture the phases of the financial cycle, which is why it came to rank second in substantiating the decision. In fact, the literature shows an increasing number of evidence on the subdued capacity of the Hodrick-Prescott filter methodology with a standard smoothing parameter λ of 400,000 to decompose the financial cycle accordingly for emerging economies with highly volatile macro-financial conditions.

Implementation of the countercyclical capital buffer in Romania

As a result of the acceleration in the recent dynamics of loans to the private sector, amid the recovery from the severe economic contraction triggered by the pandemic outbreak, as well as of the persistent tensions surrounding macroeconomic equilibria, during the third quarterly meeting of 2021, the NCMO General Board recommended for the first time the NBR to increase the countercyclical buffer rate from 0 percent to 0.5 percent[33]. Based on the methodology to apply the buffer, the measure will come into force in October 2022, i.e. 12 months after the announcement of the approval of the NCMO recommendation addressed to the National Bank of Romania. The NBR implemented the recommendation by issuing NBR Order No. 6 of 19 November 2021 amending NBR Order No. 12/2015 on

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31 The credit-to-GDP ratio deviation from trend is calculated based on the standard methodology, using the Hodrick-Prescott filter with a smoothing parameter of 400,000, corresponding to a long financial cycle, specific to developed economies.

32 The following rules are used to calibrate the buffer:
If GAP $<$ 2 pp => CCyB rate = 0%;
If GAP $\in$ (2 pp; 10 pp) => CCyB rate = (0.3125 GAP – 0.625)%
If GAP $>$ 10 pp => CCyB rate = 2.5%

33 NCMO Recommendation No. R/7/2021 on the countercyclical capital buffer in Romania.

the capital conservation buffer and the countercyclical capital buffer. Given the persistently high health and economic uncertainties, a 12-month period was deemed appropriate to ensure a possible revision of the countercyclical buffer rate should the macro-financial environment at that time require it.

It is worth noting that, according to the macroprudential buffer framework, this instrument is the only one explicitly designed to be released in the event of economic or financial difficulties, in line with the current macroprudential framework. The recent experience of the COVID-19 crisis has proven the usefulness of the early build-up of buffers through countercyclical instruments and their release in case of urgent need.

Thus, the NCMO decision meets the purpose of the countercyclical capital buffer, namely the build-up of adequate capital buffers when this measure has a minimum impact on lending conditions, so that it can subsequently have the capacity to support lending and real economy too in times of crisis, thereby mitigating the contraction and accelerating economic recovery.

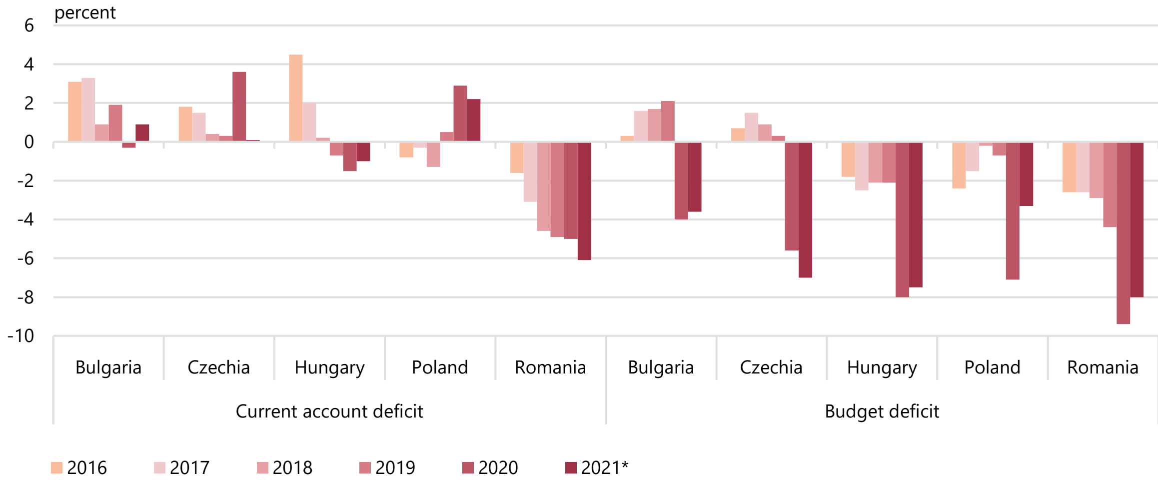
Based on the analyses underlying the decision, the measure will not require any effort (such as a new capital infusion) on the part of credit institutions, considering the available capital surplus; instead it will preserve part of the capital given that, on the one hand, (i) the additional capital buffers are expected to dissipate following the expiry of the recommendation on the restriction of dividend distributions and other measures included in the "quick fix" package[34] during the COVID-19 pandemic, and, on the other hand, (ii) increasing credit risk vulnerabilities are accumulating.

By this decision, Romania was among the first Member States that pointed to macroprudential policy moving back from the stimulus area where all Member States had been following the outbreak of the pandemic and the associated economic shocks. Moreover, once with the decisions made by the ECB and the ESRB not to extend the period to refrain from dividend distribution, steps were taken for the first time to discard the exceptional measures applied for prudential reasons in the context of the pandemic. Behind the decision to increase the buffer rate stood several reasons, including especially a sharp upward trend in lending, amid mounting tensions surrounding macroeconomic equilibria, particularly via the twin deficits, which was a structural problem facing Romania's economy throughout the period under review (Chart 3.8).

Thus, over the last five years, the current account deficit saw a deepening – mainly on the back of the goods imbalance. The current account deficit followed an upward trend every year, from 1.6 percent in 2016 to 6.1 percent in 2021. Romania recorded a budget deficit close to the 3 percent-of-GDP ceiling, but in 2019 – in a pre-pandemic context – the deficit exceeded this threshold (to reach 4.4 percent), while in 2020, amid the pandemic-shaped

[34] Regulation (EU) 2020/873 of the European Parliament and of the Council of 24 June 2020 amending Regulations (EU) No 575/2013 and (EU) 2019/876 as regards certain adjustments in response to the COVID-19 pandemic.

Chart 3.8. Budget deficit and current account deficit in Romania and in the region



*) end-2021 data are estimates

Source: AMECO

fiscal stance, it reached 9.4 percent of GDP. In fact, following the urgent health needs, the European Commission suspended the implementation of the Stability and Growth Pact provisions. The countries having reported surpluses in the previous years benefited from a more generous fiscal space and could maintain the budget deficit in a more sustainable area.

An increasingly larger deviation from the trend in the region also entails a higher cost of financing, given that all the countries in the region are subject to the same requirements and criteria for the financing from foreign investors, while leaving the mainstream results in a higher risk premium. Thus, addressing the issue becomes urgent, as this makes domestic economy vulnerable and poses significant risks to financial stability.

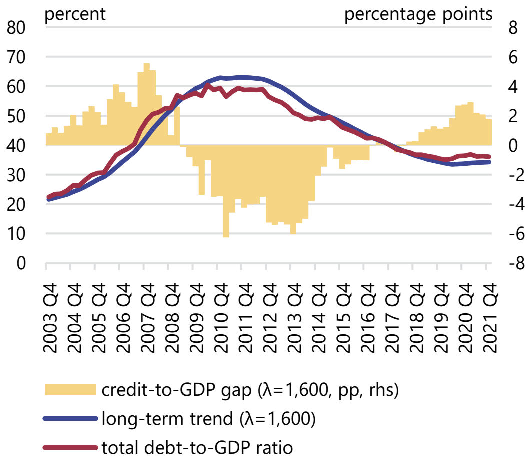
The Basel Committee provides a set of tools to analyse the decisions on setting the CCyB rate, namely the standard indicator and the alternative indicator, which measure the deviation of the credit-to-GDP ratio from its long-term trend for developed economies (a long financial cycle of over 20 years) and a variant better adapted to the specificities of the domestic economy (a short financial cycle with a similar length to that of the business cycle).

The analyses carried out during 2021 based on the alternative methodology showed a deviation of the total credit-to-GDP ratio from the positive trend (see Chart 3.9). The sharp deviation in 2020 can also be attributed to the strong economic contraction that led to a surge in the total debt-to-GDP ratio. However, the deviation from the trend remained high in 2021 too when economic growth was more robust, illustrating a continued acceleration in the financial cycle.

The first year of the pandemic was also a moment of expectation, when most economic agents and lenders alike preferred to delay potential major purchase plans or investments in order to outline a medium-term strategy.

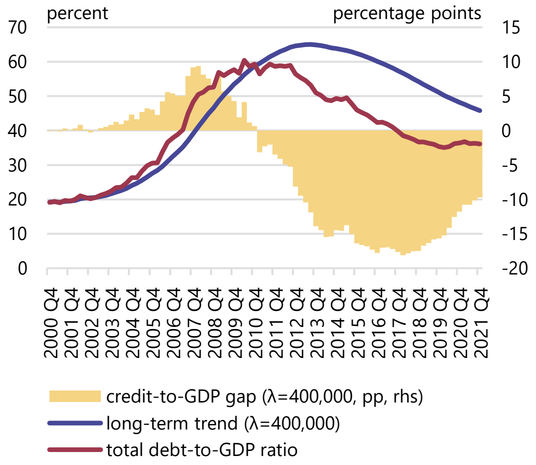
The build-up and maturing of these expectations, coupled with the roll-out of the vaccination campaign, which instilled new optimism, led later on to a significant rebound in lending

Chart 3.9. Analysis of the countercyclical capital buffer in Romania (2000 Q4 – 2021 Q4), assuming a short financial cycle[35] (alternative indicator)



Source: NBR

Chart 3.10. Analysis of the countercyclical capital buffer in Romania (2000 Q4 – 2021 Q4), assuming a long financial cycle (Basel indicator)



Source: NBR

in all segments (Chart 3.11), including consumer credit – the most affected component in the immediate aftermath of the health emergency. The year 2021 also saw a step-up in the appetite for lending especially from companies, but also for the house purchases by households.

The growth rate of corporate loans ranked second at European level in December 2021 (Chart 3.12), after a twofold increase in their stock compared to the average of the past three years, with government programmes playing an important part in this evolution. Moreover, the trend prevalent in the aftermath of the 2007-2008 international financial crisis saw a reversal. Specifically, the speed of credit expansion seemed to slightly exceed for the first time that of deposit growth reported by non-financial corporations.

Apart from the healthcare issues, the second half of the year saw the strong increase in energy prices, with an impact on inflation, production and supply chain disruptions, as well as renewed geopolitical tensions in areas close to Romania.

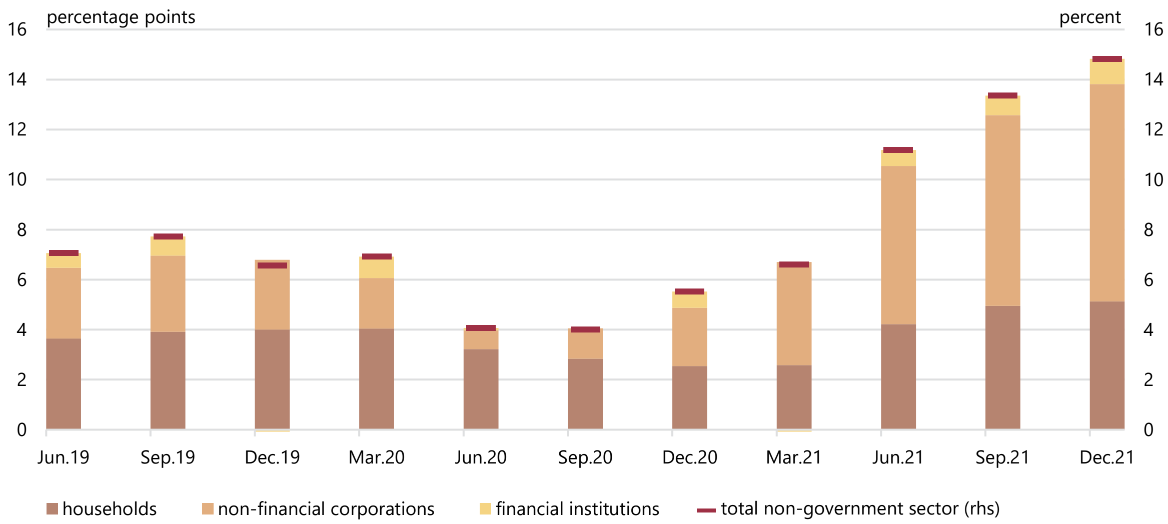
However, lending was not significantly influenced by the ongoing updates on the epidemiological expectations, but instead strengthened its upward trend.

Real estate lending to households was particularly buoyant in 2021, the stock of housing loans added 3 percentage points versus the previous year to reach 12.9 percent, this segment being the most robust throughout the pandemic period.

After a long period when the volume of transactions and the growth rate of house prices ran below the EU average, the rising trend in households' house purchases strengthened in 2021.

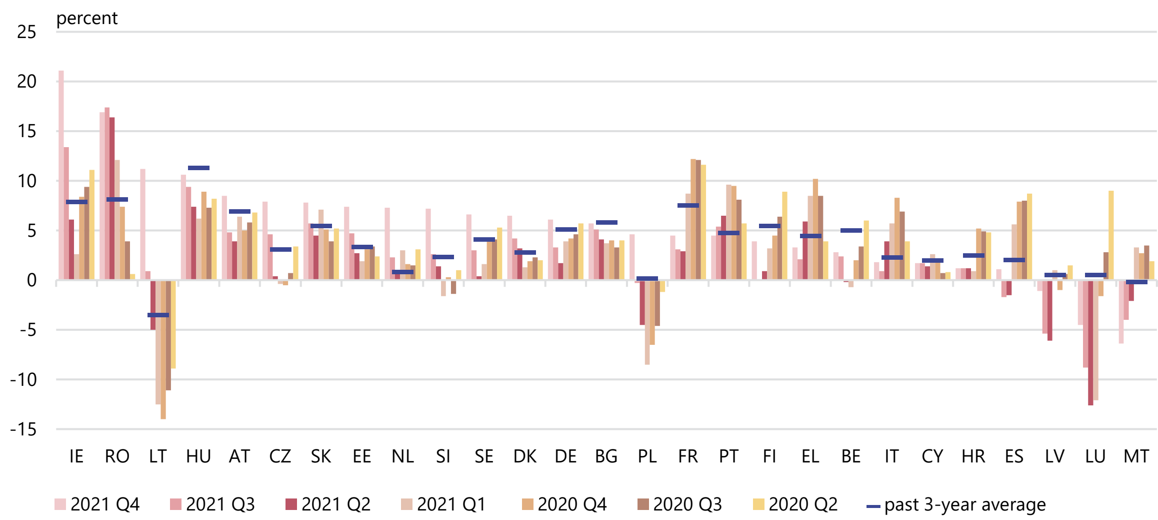
[35] The smoothing parameter of 1,600 is used in financial cycles with a length similar to that of business cycles, referred to as short cycles (less than 8 years) in the literature.

Chart 3.11. Contribution to the annual dynamics of loans to the private sector by institutional sector



Source: NBR

Chart 3.12. Annual growth rates of loans to non-financial corporations in EU countries



Source: ECB

On the other hand, the second important component of the real estate market, namely the commercial property market, saw a slowdown in its activity, partly owing to the new health habits inspired by the COVID-19 pandemic, but also to market projections on the post-pandemic scenario, with many of the changes triggered by the epidemiological crisis being likely to become permanent.

3.2.1.2. Buffer for other systemically important institutions

In order to prevent the build-up of systemic risks generated by misaligned incentives and moral hazard, the ESRB recommends national authorities to use, as a dedicated macroprudential instrument, the additional capital requirements applicable to other systemically important institutions (O-SIIs). Unlike the global systemically important institutions buffer (G-SII buffer), the instrument is tailored for banks that may jeopardise the financial stability of the national financial system.

Global macroeconomic events, such as the 2007-2008 financial crisis and the health crisis caused by SARS-CoV-2, have once again highlighted the importance of a well-structured institutional system of macroprudential oversight, as well as of financial institutions with a sound prudential position that can help them cope more easily with both endogenous and exogenous vulnerabilities and shocks. The capital buffer for other systemically important institutions was introduced in accordance with the European regulatory framework CRD IV, aiming to make institutions that are key to the national economy more resilient to unfavourable developments, ensuring the continuous provision of financial services to the real sector. The macroprudential instrument consisting of the O-SII buffer requirements aims the structural dimension of systemic risk, meaning that relative to risk distribution across the financial system.

The systemic nature of these institutions results from the risks they can spread across the national financial system and the real economy due to their importance, as reflected by the size of balance sheet assets, the substitutability of services (loans, payments, deposits), the complexity of their activity (commensurate with the size of cross-jurisdictional claims and liabilities, as well as of value of OTC derivatives), the interconnectedness with other financial institutions (calculated based on the volume of intra-financial system assets and liabilities, as well as of debt securities outstanding), and the perception that they are "too big to fail".

The CRD V framework amended the previous regulatory framework (CRD IV) for the O-SII buffer that may be imposed by the competent authorities of EU countries. The amended regulatory framework has provided national competent authorities with more flexibility in setting the O-SII buffer rate, taking into account the specificities of the national banking sector, such as the structure of the systemic bank group and the concentration of the banking sector. Specifically, CRD V stipulated the increase in the O-SII buffer rate that competent authorities in the country of origin may impose on banks with domestic capital (3 percent of the total risk exposure amount, as compared to the previous 2 percent level). National authorities may recommend the implementation of an O-SII buffer rate higher than 3 percent of the total risk exposure amount, subject to approval by the European Commission. The maximum amount the authorities in host countries may set for foreign bank subsidiaries was also raised. In this vein, where a systemic bank is a subsidiary of either a G-SII or an O-SII institution that represents an institution or group whose parent undertaking is an EU parent institution and is subject to an O-SII buffer on a consolidated basis, the O-SII buffer rate, which shall apply at individual or sub-consolidated level, shall not exceed the minimum of the following: (i) the sum of the higher of the G-SII or O-SII buffer rate applicable to the group at consolidated level and 1 percent of the total risk exposure amount calculated in accordance with Article 92(3) of Regulation (EU) No 575/2013 and (ii) 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 and has been recommended by the NCMO.

As the two structural buffers (the O-SII buffer and the systemic risk buffer – SyRB) are used to cover different risks (arising from the size and importance of credit institutions, as well as from the structural vulnerabilities identified in the financial system), the new regulation has also brought a novelty in terms of their implementation. According to CRD IV, where a credit institution is subject to a systemic risk buffer and an O-SII buffer on the same type of exposures, the higher of the buffers shall apply. The change brought about by CRD V is that, where a systemic bank is subject to a systemic risk buffer, that buffer shall be exclusively cumulative with the O-SII buffer. However, where the sum of the O-SII buffer rate and the SyRB rate would be higher than 5 percent, the national authorities shall apply for the approval of the European Commission before the measure becomes effective. At this stage, most European countries have amended the national legislation with the new European provisions and have thus adjusted their strategy for implementing macroprudential instruments accordingly.

Implementing a capital buffer for systemically important institutions ensures the stability of the national financial system by enhancing banks' capacity to absorb potential losses, creating the prerequisites for the continued provision of financial services in times of economic distress, and reducing the severe impact of potential financial difficulties. These objectives are also listed in Table 3.2 below:

Table 3.2. Objectives of imposing an O-SII buffer

Enhance the loss-absorption capacity of institutions
Lower the likelihood of financial difficulties in the case of systemic banks
Reduce the severity of the potential impact of stress episodes
Continue the financial intermediation during the downturn of business and financial cycles
Ensure a level playing field in the market for all credit institutions

Source: ESRB

The experience across the EU

Considering the need to harmonise at European level the analyses to identify the systemic institutions in Member States in order to ensure the implementation of level playing field criteria in the EU banking market, the European Banking Authority developed a common methodology with the support of national authorities. The methodology outlines a number of guidelines that apply to the analyses aimed at identifying systemic banks, ensuring the standardisation of assessments, while leaving a flexibility margin for the national authorities, given the significant differences in the characteristics of Member States' financial systems. Thus, in December 2014, the EBA released the final version of Guidelines EBA/GL/2014/10[36].

[36] 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) – EBA/GL/2014/10.

Chart 3.13. Number of O-SIIs in EEA countries in 2021

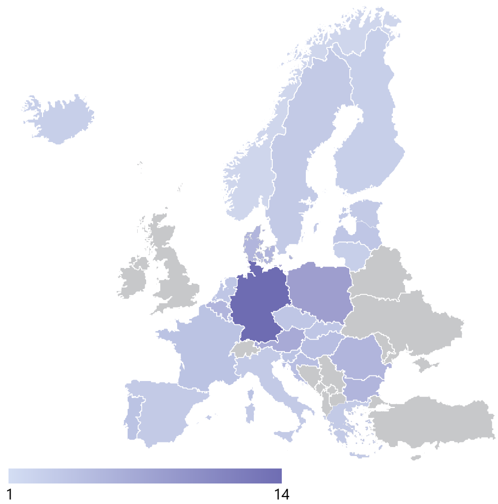
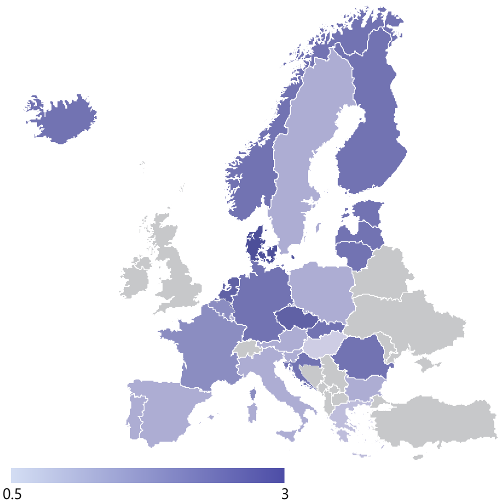


Chart 3.14. Maximum O-SII buffer rate in EEA countries in 2021



Source: ESRB

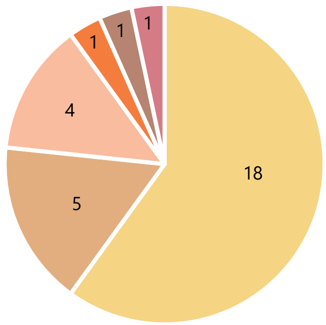
The methodology[37] for identifying systemic credit institutions used by the NBR in its capacity as national sectoral supervisory authority is harmonised with the EBA methodology. This methodology is based, in the first stage, on the calculation of 10 indicators that are covered by the following criteria: (a) size; (b) importance for the economy of the relevant Member State, capturing substitutability and the financial institution infrastructure; (c) complexity of cross-border activities; (d) interconnectedness of the institution or group with the financial system. In the first stage, the comparability and transparency requirements for the assessment of systemically important institutions are harmonised in every Member State. In the second stage of assessment, the specificities of national financial systems may be captured, 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.

The number of systemically important institutions in the EEA was smaller in 2021 than in the previous year, with 173 entities being classified as O-SIIs. The largest decrease was reported by Cyprus, where the number of systemic banks dropped by five. In Czechia, France, Norway, Spain and Hungary, the number of O-SIIs fell by one in each case. However, there were also countries (Denmark, Germany and Latvia) where the number of systemic banks increased by one entity. The number of O-SIIs varies across Member States, i.e. from 14 in Germany to one in Norway, depending on the concentration and specificities of every national banking sector (Chart 3.13).

In some countries, as is the case with Romania, the transition from CRD IV to CRD V and the economic situation caused by the COVID-19 pandemic led to changes in the O-SII buffer calibration methods. During 2021, seven Member States amended the O-SII buffer rate

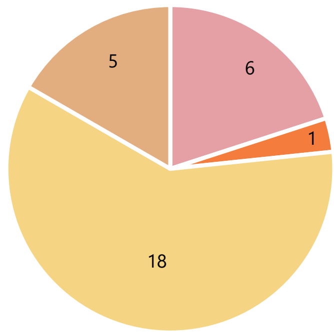
[37] An overview of the methodology used to identify systemic banks is published on the National Bank of Romania's website: https://www.bnro.ro/Methodology-for-identifying-systemic-credit-institutions-and-calibrating-the-O-SII-buffer-15316.aspx

Chart 3.15. O-SII buffer calibration method



Source: ESRB, based on the data submitted by competent authorities for the 2020 exercise to identify systemically important banks

Chart 3.16. Minimum thresholds used to identify O-SIIs[38]



Source: ESRB, based on the data submitted by competent authorities for the 2020 exercise to identify systemically important banks

(Chart 3.14). Out of them, five countries decided to lower the capital buffer requirements (Austria, Cyprus, Greece, Luxembourg, Hungary), while other two chose to impose additional capital requirements (Czechia, Slovakia). Czechia decided to increase the O-SII buffer rate[39] from 0 percent in 2020 to 2.5 percent. This significant change was due to the increase to 425 basis points in the threshold for designating entities as O-SIIs, aiming to ensure the homogeneity of the group of O-SIIs.

Looking at the O-SII buffer calibration methods imposed by Member States on systemically important institutions (Chart 3.15), it can be noticed that the bucketing approach is the most widely used practice. This method consists of defining a number of "buckets" of varying width applied to the score determined for credit institutions after calculating the mandatory indicators recommended by EBA. Subsequently, each bucket is assigned an O-SII buffer rate, depending on the importance of the institution. At European level, according to the latest data submitted by competent authorities, 22 countries use this O-SII buffer calibration method. For 18 of these countries, the bucketing approach is the only method used to calibrate the buffer rate.

The Equal Expected Impact (EEI) is the second most widely used O-SII buffer calibration method, being chosen as a single method by nine Member States, including Croatia, Hungary, Lithuania, Ireland and Latvia. The EEI seeks to achieve a level of expected loss of a systemically important institution, which is equal to that of a non-systemic institution. The *EBA Report on the appropriate methodology to calibrate O-SII buffer rates*[40] shows that this method is more common for economies with smaller, but more concentrated banking sectors.

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38 The minimum 500 basis point threshold for the identification of O-SIIs is applicable to Slovenia, the only country that does not comply with paragraph 9 of EBA Guidelines. Starting with 2017, Banka Slovenije decided to raise the minimum threshold for the identification of O-SIIs from 350 to 500 basis points.The decision was informed by the systemic relevance scores of the banks gained on the basis of EBA methodology.

39 As of 1 October 2021, List of other systemically important institutions – Czech National Bank (cnb.cz)

40 EBA report on calibration of O-SII buffer rates.docx (europa.eu)

Chart 3.16 shows the minimum threshold from which a bank is automatically designated as systemically important. At European level, there are differences between Member States in terms of thresholds from which entities are designated as eligible to apply the O-SII buffer, which is an element of flexibility provided for by the regulatory framework based on EBA/GL/2014/10 Guidelines. Thus, in paragraph 9 of Title II – Scoring methodology for the assessment of the O-SIIs, the Guidelines specify that relevant authorities should designate relevant entities with a total score equal to or higher than 350 basis points as O-SIIs. Relevant authorities may raise this threshold up to 425 basis points as a maximum or decrease it to 275 basis points as a minimum to take into account the specificities of the Member State's banking sector and the resulting statistical distribution of the scores, thereby ensuring the homogeneity of the group of OSIIs designated in this way based on the O-SIIs' systemic importance.

Implementation in Romania

According to the legal provisions in force, the NCMO's mission is to ensure coordination in the field of macroprudential oversight of the national financial system by setting the macroprudential policy and the appropriate instruments for its implementation. Thus, in accordance with Art. 21 para. (1) and Art. 23^2 para. (6) of NCMO Regulation No. 2/2017[41], the NCMO reviews the Romanian banking sector at least annually from the perspective of (i) systemically important institutions and (ii) additional capital requirements consisting in the buffer for other systemically important institutions (O-SII buffer).

After the NCMO issued Recommendation No. R/4/2018[42], the NBR assumed the implementation of the macroprudential instrument, namely the O-SII buffer, to achieve the intermediate objective limiting the systemic impact of misaligned incentives with a view to reducing moral hazard. The methodology to identify systemic banks is harmonised with the recommendations of Guidelines EBA/GL/2014/10 and is applied by the NBR, in its capacity as sectoral supervisory authority.

In 2021, the central bank implemented NBR Order No. 5/2020[43], setting forth that eight banks were 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), Banca Transilvania S.A. (consolidated level), CEC Bank S.A. (individual level) and (ii) 1 percent for UniCredit Bank S.A. (consolidated level), BRD – Groupe Société Générale S.A. (consolidated level), OTP Bank România S.A. (consolidated level) and Alpha Bank S.A. (individual level). NBR Order No. 5/2020 was

41 Regulation NCMO No. 2/2017 on the methodology and procedures used for setting capital buffers and the scope of these instruments, as subsequently amended and supplemented.

42 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.

43 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 (National Bank of Romania – Legislative act (bnro.ro).

issued in order to implement NCMO Recommendation No. R/8/2020[44]. The assessment of systemic banks was made based on the financial data reported as at 31 December 2019.

A new assessment to identify systemic banks was carried out in 2021, taking into account the amendments to the applicable regulatory framework. In order to implement the CRD V provisions, the NCMO issued Regulation No. 1/2020[45], effective as of 22 December 2020, after being published in *Monitorul Oficial al României*, Part I, No. 1277/2020. In this context, it was necessary to modify the methodology for identifying systemic credit institutions at least by updating it with the applicable provisions of the European regulatory framework – CRD V. Thus, the NBR Board approved the Methodology for identifying systemic credit institutions, harmonised with the provisions of the European Banking Authority's 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) and for calibrating the buffer for other systemically important institutions (O-SII buffer), used to implement the CRD V provisions for the buffer applicable to the national systemic banks. This document also includes a new O-SII buffer calibration method, applicable as of 1 January 2022, which uses the new (higher) CRD V limits that will be applied to the national systemic banks, including the subsidiaries of foreign banks in host countries.

Thus, the amendment of the applicable European framework prompted the NBR to develop an O-SII buffer calibration method, based on the scores calculated for banks during the first stage of assessment (consisting in determining the mandatory indicators recommended by EBA), taking into account the specificities of the national banking sector and the structure of the systemic bank group. The range of scores assigned to banks while calculating mandatory indicators recommended by EBA is divided into six buckets of 500 basis points each, which are assigned O-SII buffer values in ascending order based on systemic importance, in equal increments of 0.5 percentage points (from 0.5 percent to 3 percent) as presented in Table 3.3.

Table 3.3. O-SII buffer calibration methodology based on the bucketing approach

Bucket	Limits (minimum – maximum) (basis points)	Maximum O-SII buffer rate (% of total risk-weighted exposures)
1	275 - 500	0.5
2	501 - 1,000	1
3	1,001 - 1,500	1.5
4	1,501 - 2,000	2
5	2,001 - 2,500	2.5
6	over 2,500	3

Note: The first bucket has a minimum threshold of 275 basis points, from which banks are automatically designated as being systemically important, according to the methodology approved by the NBR, in its capacity as sectoral supervisory authority. Where a bank is assessed as being systemic based on additional indicators, but its score assigned by the mandatory indicators stands below the 275 basis point threshold, then the institution falls within the first bucket.

Source: NBR

44 NCMO Recommendation No. R/8/2020 on the capital buffer for other systemically important institutions in Romania is published on the NCMO website: Recommendations | National Committee for Macroprudential Oversight (cnsmro.ro/en)

45 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.

Following the assessment of the banking sector from the perspective of systemic banks, based on the data reported as at 30 June 2021, NCMO Recommendation No. R/8/2021[46] laid down the additional capital requirements for other systemically important institutions in Romania, consisting in the capital buffer for other systemically important institutions in Romania, applicable as of 1 January 2022, for nine credit institutions, Romanian legal entities, which scored over 275 basis points, namely: Banca Transilvania S.A. (consolidated level), Banca Comercială Română S.A. (consolidated level), UniCredit Bank S.A. (consolidated level), BRD – Groupe Société Générale S.A. (consolidated level), Raiffeisen Bank România S.A. (consolidated level), CEC Bank S.A. (individual level), Alpha Bank România S.A. (individual level), OTP Bank România S.A. (consolidated level) and Banca de Export Import a României EximBank S.A. (consolidated level). Compared with the previous period, the composition of the group of credit institutions identified as having a systemic nature changed, as EximBank S.A. was classified as an O-SII. The assessment was made at the highest consolidation level, in compliance with the requirements laid down in the aforementioned EBA Guidelines.

Six of the nine banks identified as having systemic importance in the assessment conducted in 2021 are subsidiaries of foreign banks in other Member States (Austria – BCR, Raiffeisen; Italy – UniCredit; Greece – Alpha Bank; France – BRD; Hungary – OTP Bank), which are O-SIIs in their home countries[47]. Three credit institutions included in the group of systemic banks have Romanian capital (EximBank S.A. and CEC Bank S.A.) or majority Romanian capital (Banca Transilvania), the National Bank of Romania being the competent authority. The O-SII buffer applicable to subsidiaries of foreign banks was set considering the limits established by the European CRD V framework effective at national level. Mention should be made that the competent authorities in the home countries of parent banks with subsidiaries in Romania have adjusted the macroprudential measures applicable to the credit institutions under their supervisory remit amid the implementation of the new CRD V regulatory framework (mainly with respect to the simultaneous application of structural buffers, namely the O-SII buffer and the systemic risk buffer) into the national law, as well as amid the need to ensure a balanced approach in the period when the effects of the COVID-19 pandemic were felt, with a view to maintaining sufficient capital reserves available to banks, so that the latter may secure the continuity of financial intermediation. The results of the latest assessment are shown in Table 3.4. The National Bank of Romania implemented NCMO Recommendation No. R/8/2021 by issuing NBR Order No 7/2021[48].

46 NCMO Recommendation No. R/8/2021 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-2021/).

47 The NBR may set an O-SII buffer for these institutions, but its maximum level is capped according to the European regulations in force.

48 NBR Order No. 7/2021 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. 1174 of 13 December 2021.

Table 3.4. O-SIIs identified in 2022

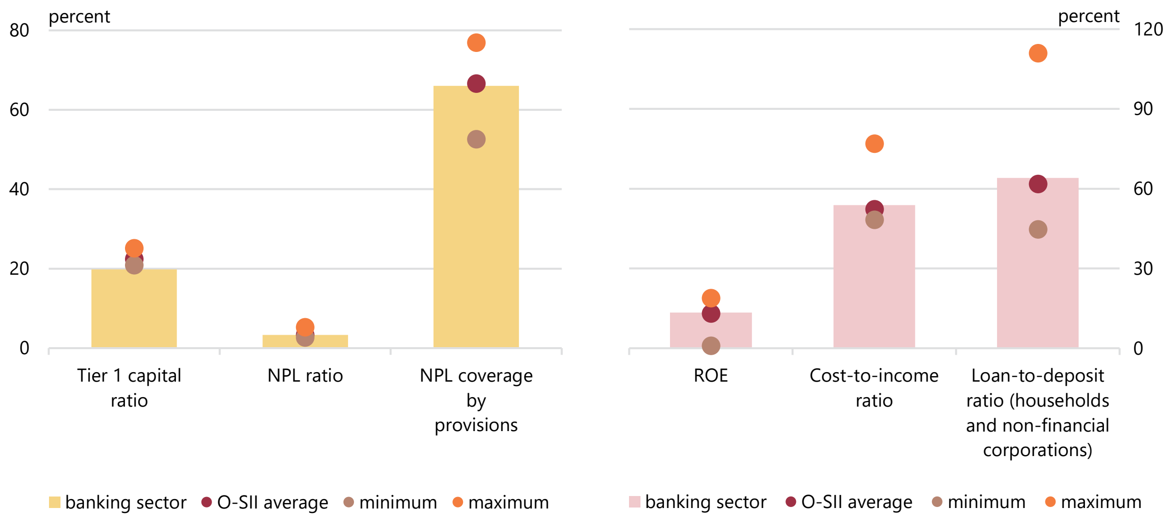
Credit institution	Score based on mandatory indicators (EBA Guidelines)	O-SII requirement (% of the total risk exposure amount)	Applicability of O-SII buffer
Banca Transilvania S.A.	1,666	2	consolidated basis
Banca Comercială Română S.A.	1,262	1.5	consolidated basis
UniCredit Bank S.A.	1,218	1.5	consolidated basis
BRD – Groupe Société Générale S.A.	1,187	1.5	consolidated basis
Raiffeisen Bank România S.A.	997	1	consolidated basis
CEC Bank S.A.	408	0.5	individual basis
Alpha Bank România S.A.	383	0.5	individual basis
OTP Bank România S.A.	373	0.5	consolidated basis
Banca de Export Import a României EximBank S.A.	287	0.5	consolidated basis

Source: NCMO

The O-SIIs play a key role in the Romanian banking sector, as shown by the next indicators that make up the assessment criteria recommended by the European Banking Authority, as follows: (i) they held 78.2 percent of bank assets as at 30 June 2021; (ii) they provide a significant part of financial services to the real economy (77.9 percent of loans in stock, 77.8 percent of deposits taken, and 59.0 percent of payments made); (iii) in terms of complexity, they conduct 90.8 percent of transactions in OTC derivatives, place 95.3 percent of cross-border assets and raise 82.6 percent of foreign liabilities, while (iv) in terms of interconnectedness with the other undertakings conducting financial activities, they provide 66.0 percent of intra-financial assets, use 80.9 percent of intra-financial liabilities and hold 97.7 percent of bonds issued.

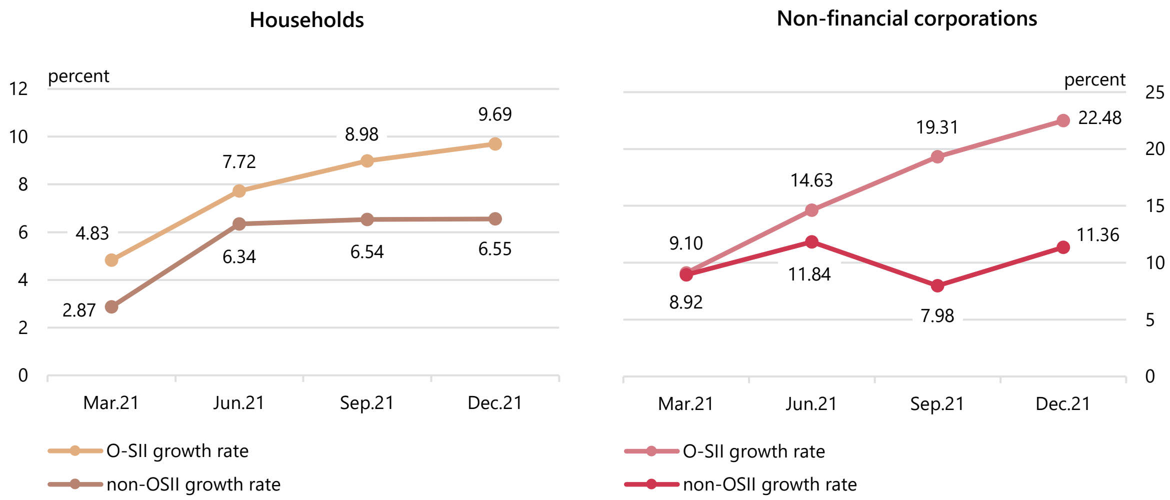
From a prudential perspective, the O-SIIs are well capitalised, with an average Tier 1 capital ratio of 22.4 percent (December 2021), which declined slightly from 25.4 percent in the same year-ago period. As far as asset quality is concerned, the NPL ratio went down from 3.9 percent in December 2020 to 3.4 percent in December 2021. In addition, the profitability of other systemically important institutions also improved, their return on equity (ROE) rising to 13.1 percent from 8.5 percent in December 2020. Nevertheless, mention should be made that this indicator is substantially different between the O-SIIs under review, some of them reporting well above average performance in this respect. In comparison with the banking sector, both the return on equity and the loan-to-deposit ratio (households and non-financial corporations) of the O-SIIs were below those across the banking sector in December 2021 (ROE: 13.1 percent for O-SIIs, 13.4 percent for credit institutions, LTD ratio: 61.7 percent for O-SIIs, 64 percent for credit institutions), which calls for renewed efforts to increase profitability and the level of financial intermediation (Chart 3.17).

Chart 3.17. Prudential and efficiency indicators of systemically important institutions (December 2021)



Source: NBR, prudential reports

Chart 3.18. Annual growth rate of loans and advances granted to households and non-financial corporations by O-SIIs and non-O-SIIs



Source: NBR, prudential reports

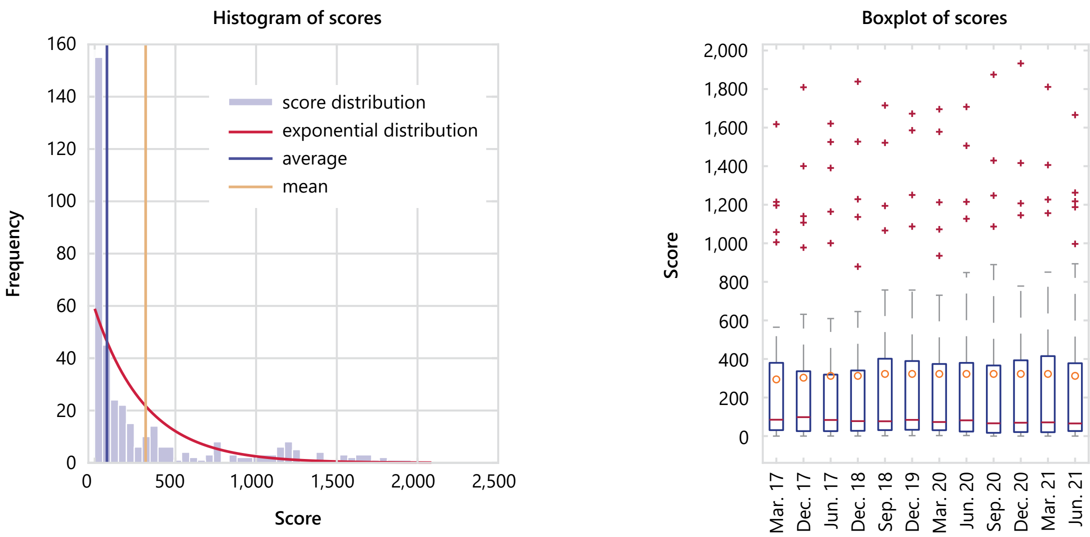
Given that in 2021 most economic sectors witnessed a strong economic recovery, while a feeling emerged that the pandemic crisis was overcome once the vaccination campaign had started and mobility restrictions had been eased, substantial increases in lending to both households and non-financial corporations can be noticed. Special mention deserves the role of systemic institutions with respect to the pick-up in lending in 2021 to households (loans and advances rose by 9.7 percent in December 2021 versus the same year-ago period) and especially to non-financial corporations, in which case lending by O-SIIs added 22.5 percent against end-2020. The loans granted by non-systemically important institutions to both segments also posted strong increases, yet below the level of those extended by the O-SIIs, the evolution being shown in Chart 3.18. These developments pave the way for further bank concentration and the increasing divergence between the performance of O-SIIs and that of non-O-SIIs.

Box E. Statistical evidence on the banking sector arising from the identification of systemically important institutions

The methodology to identify systemically important banks, harmonised at European level by Guidelines EBA/GL/2014/10, implies to calculate, at the highest level of consolidation, a score for each domestically authorised credit institution, including the branches of foreign banks operating in the host country. Four criteria are used to calculate the scoring: size, importance, complexity and interconnectedness, which give the complete picture of the banks' systemic footprint. For each of the four criteria, the importance of an institution derives from the weight in the total that the bank covers under that criterion. Therefore, as a calculation based on market shares, the increase in an institution's score implies directly the decrease in another and vice versa.

Although this methodology can only capture the relative importance of credit institutions at a certain point in time, tracking the scores over a longer period leads to relevant conclusions from the perspective of trends in the breakdown of Romania's banking sector.

Chart A. O-SII score statistics



Source: NBR

From the introduction of the EBA methodology in 2017 until end-2021, the analysis on the identification of systemic banks in Romania based on the key indicators set out in the Guidelines covered twelve quarters, depending on the needs and data availability. The histogram of past scores (Chart A, left panel) points to a significant prevalence of low-ranking banks with scores below 50 basis points. The minimum scores are generally recorded by the branches of foreign banks with limited activity in Romania, but there are also Romanian banks with a very low systemic footprint. This distribution breakdown entails a notable difference between the mean of values (315.69 basis points) and the median of values (75.91 basis points) as well as a large standard deviation (466.35 basis points). The form of the histogram can be proxied by an exponential distribution, but using the same statistical moments for its parameterisation, the agglomeration of values in the first ranges cannot be fully explained. In other words, the distribution underestimates the number of banks falling within the range of the lowest scores that measure the systemic importance of institutions.

Looking at how the distribution of systemic scores evolved over time through boxplot charts[49] (Chart A, right panel), some relevant trends can be noted. Even though the distribution mean and median stayed relatively flat, the variability of results shown by the standard deviation rose steadily over time, pinpointing a larger difference between large- and small-sized banks across the domestic banking sector. Moreover, given the 275 basis-point threshold from which banks are automatically designated as systemic, there are two types of credit institutions above this threshold: (i) banks that are within error ranges around the score average and (ii) banks representing extreme value distributions with a significantly higher systemic footprint (4 or 5 banks per time interval). In this context, the approach taken since 2022, i.e. to impose a level of capital buffer for systemically important institutions commensurate with their score, is substantiated by the aim of ensuring a prudential capital buffer adequate to the institution's impact on the financial system.

3.2.1.3. The systemic risk buffer

Implementation framework of the macroprudential instrument

The systemic risk buffer (SyRB) is the instrument available to EU macroprudential authorities, which can be tailored to national specificities in order to mitigate structural risks with a potential impact on financial stability. The instrument aims to address systemic or macroprudential risks that are not covered by the CRR[50] or by the other capital buffers. The flexibility of this structural macroprudential instrument stems from the fact that no limitations are set forth in terms of calibration methodology and exposures based on which it is calculated. Even though there is no maximum limit for the calibration of buffer rates, depending on the impact on other Member States and the single European market, authorisation from the European Commission may be required[51]. Moreover, Member States

49 The boxplot chart is a method to show several statistical moments of a data distribution in the same chart. The values that fall between quantile 1 and quantile 3 of the distribution are represented by frames. The red line is the median of the distribution and the circle is its mean. Variation ranges according to the standard deviation of the distribution are formed around the frames. The values with a "+" are outliers that do not fall within these variation ranges.

50 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

51 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, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

may recognise the SyRB rate set by another member country and may apply that buffer rate to domestically authorised institutions for the exposures located in the Member State that set the buffer rate.

The SyRB shows its structural nature in terms of approaching the distribution of risks across the financial system by categories of exposures, institutions, sectors or any other types of manifestation of endogenous or exogenous vulnerabilities. In this vein, the buffer can also act towards moderating a significant rise in lending on certain segments, at a sectoral level, by types of exposures, risk profile or geographical area. During past financial crises, for want of a macroprudential policy framework, the costs of a bank recapitalisation were borne by the public sector in order to cushion the negative effects on the real economy. Therefore, the purpose of the systemic risk buffer is to reduce the likelihood of a crisis occurring, as well as to diminish *ex ante* the potential costs stemming from a halt in economic activity by strengthening banking sector resilience.

The *ESRB handbook on operationalising macroprudential policy in the banking sector*[52] refers to three broad and non-restrictive categories of risks that can be potentially addressed with a systemic risk buffer:

1. Risks stemming from the propagation and amplification of shocks within the financial system: financial crises become systemic in nature through the propagation and amplification of the initial shock. Contagion channels can arise from common exposures or similar business models, being established through direct links between financial agents or through other financial intermediaries.

2. Risks stemming from structural characteristics of the banking sector: certain structural characteristics of the banking system have the potential to become amplification channels in the event of a financial crisis. Such structural aspects are related to the institutional set-up of the domestic financial system and to market-specific developments. This warrants the introduction of measures aimed at reducing the overall impact of systemic events on the financial sector and, consequently, on the real economy.

3. Structural risks to the banking sector stemming from the real economy: such risks can arise from specific economic sectors which are in distress. Moreover, another channel whereby structural risks may emerge consists in the demand shocks coming, as a result of contagion, from a crisis in another country. This scenario is especially relevant for countries with small and open economies.

Furthermore, depending on the aim, the ESRB Handbook provides examples of several risk metrics that may point to the need for activating or deactivating the SyRB (Table 3.5).

52 https://www.esrb.europa.eu/pub/pdf/reports/esrb.report180115_handbook~c9160ed5b1.en.pdf

Table 3.5. Risk metrics for activating or deactivating the SyRB

Risk category	Metrics
Structural characteristics of the banking sector	• Size of assets and retail deposits • Share of bank credit to the private sector • Herfindahl-Hirschman Index of banks assets • Structure of foreign bank ownership • Contribution of host country deposits to the financing of the entire banking group • Sum of trading assets and liabilities net of derivatives
Propagation and amplification of shocks	• Herfindahl-Hirschman Index of asset classes • Share of forex loans • Common exposures of bank assets • Funding structure • Maturity mismatch
Systemic risks stemming from the real economy	• Trade openness • Current account balance-to-GDP ratio • Insolvency rates for the non-financial corporations sector, households and the public sector • Financial innovation

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

The risks originating from the real estate sector serve as an example for how the systemic risk buffer and the Capital Requirements Regulation (CRR)[53] interact. Thus, while the CRR provides the necessary tools to address credit and market risks in the real estate sector, there are some risks, such as the macroprudential ones of large common exposures, which are not captured by regulation. This is further evidence of the importance of using a systemic risk buffer to help mitigate the structural vulnerabilities in the real estate sector.

The new European provisions introduced by the CRD V/CRR II legislative package[54] consolidated the flexible nature of the SyRB and clarified the roles of structural buffers in the macroprudential toolkit. A major change refers to the way of determining the combined buffer requirement, by setting clear boundaries between the roles and expressly cumulating the two buffer rates, i.e. O-SII and SyRB. Moreover, the new regulation provides flexibility via the manner of addressing systemic risks as well, both at aggregate level and at sectoral level based on exposures. Specifically, it introduces the possibility of multiple application of the SyRB to several types of exposures or at the level of total exposures[55]. Through this

53 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

54 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.

55 Article 133 of 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.

change, macroprudential authorities can address multiple systemic risks occurring across several layers of the financial system. The change also contributes to enhanced transparency and helps with the reciprocation of measures. The value of the buffer is determined as the sum of individual requirements, as follows:

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

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).

The experience at European level

While some of the Member States had resorted to rate cuts or even a full release of the SyRB during 2020, amid the effects of the COVID-19 pandemic, most changes in this buffer in 2021 were carried out with a view to implementing the provisions of the CRD V regulatory framework into national law. By end-2021, the SyRB was in place in 13 EEA countries, as compared to 15 a year earlier, following the deactivation of this instrument by Estonia and Czechia. However, in three of the 13 states the SyRB rate has been 0 percent ever since 2020 (Finland, Hungary and the Netherlands). Behind the decision to maintain the buffer rate at 0 percent, without deactivating the buffer, stands especially the possibility of resorting to this instrument when required by financial market conditions. Compared with the previous year, as regards the rates in place, the only country reporting changes was Norway, which currently applies a 3 percent or 4.5 percent rate depending on the type of credit institution, whereas 2020 saw a single 3 percent rate for all credit institutions under the scope of this

Chart 3.19. Maximum SyRB rate in EEA countries at end-2019

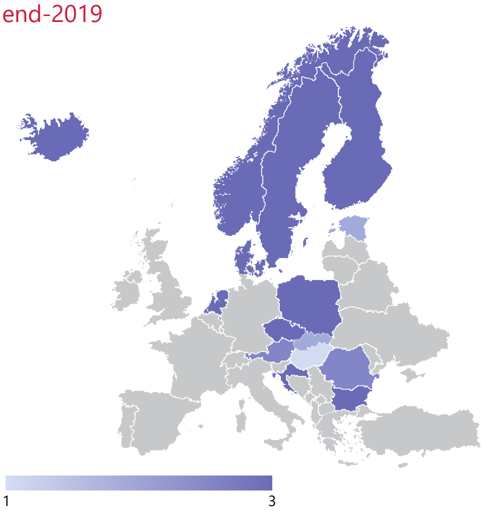
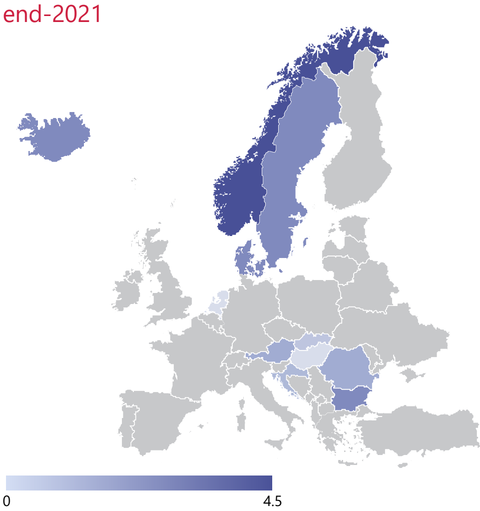


Chart 3.20. Maximum SyRB rate in EEA countries at end-2021



Note: The maximum SyRB rate refers to the level notified by Member States.

Source: ESRB

buffer. The change implemented by Norway follows the phase-in process witnessed by the buffer, which in the first stage was applied in a differentiated manner for banks using the Internal Ratings-Based Approach and those using the Standardised Approach; the rate will be set at 4.5 percent for all institutions starting 2023. For a clearer picture of developments in the SyRB rate, Charts 3.19 and 3.20 provide a comparison between maximum buffer rates prior to the outbreak of the COVID-19 pandemic and at end-2021 respectively.

Table 3.6. SyRB arrangements in EEA countries at end-2021

Country applying the SyRB	SyRB rate (%) at end-2021	Change in the SyRB rate at end-2021 versus 2019	Exposures to which the SyRB applies	Intermediate objective	No. of institutions under the scope of the buffer
Austria	0.5-2	↓	All exposures	Misaligned incentives	12
Bulgaria	3	→	Domestic exposures	Misaligned incentives	8
Croatia*	1.5	↓	All exposures	Credit expansion and leverage ratio	7
	1-3	→	All exposures	Misaligned incentives	
Denmark	3	→	Domestic exposures (Faroe Islands)	Misaligned incentives	8
Finland	0	↓	All exposures	Financial structure resilience	3
Hungary	0	→	Domestic exposures	Concentration of exposures	2
Iceland	3	→	Domestic exposures	Credit expansion and leverage ratio	8
Liechtenstein	1-2	↓	All exposures	Financial structure resilience	6
Netherlands	0	↓	All exposures	Misaligned incentives	5
Norway	3-4.5	↑	Domestic exposures	Misaligned incentives	3
Romania	0-2	→	All exposures	Misaligned incentives	23
Slovakia	1	→	Domestic exposures	Misaligned incentives	5
Sweden	3	→	All exposures	Misaligned incentives	3

*) Change in methodology, i.e. defining a single SyRB rate (1.5 percent), for transposing the CRD V into national law.

Source: ESRB

The experience accumulated so far at European level points to Member States' keen interest in using the SyRB, especially in the case of CEE and northern countries, given the high degree of flexibility in its implementation and calibration. Hungary applies this buffer considering the structural vulnerabilities generated by non-performing loans related to commercial real estate project-financing exposures. Austria applies the buffer considering the structural vulnerabilities triggered by the size of the banking sector, whereas in the case of Croatia the recalibration assessment has in view structural imbalances such as high external public and private debt, as well as vulnerability to global economic and financial conditions. Table 3.6 below describes the SyRB rates in place at end-2021 and their change versus end-2019.

Across the EEA, the application of this buffer by Member States has been heterogeneous. Thus, some decided to apply a single SyRB rate for all credit institutions, while others implemented distinct rates depending on the magnitude of systemic risk at the individual level of each institution, the same as with the O-SII buffer. However, the practice of covering the risks regarding the systemic importance of credit institutions by using the SyRB will no longer be an option in the period ahead, following the changes introduced via the new regulatory framework (CRD V). Hence, during 2021 some Member States amended the calibration methodologies for the two structural buffers.

Most countries apply the SyRB rate to all exposures (seven of the 13 states that still have the buffer in place), 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).

The CRD V framework allows countries to apply the SyRB for certain specific types of sectoral exposures. In this vein, some states have already expressed their intention to impose a systemic risk buffer at sectoral level starting 2022. The Bank of Lithuania notified the implementation of a 2 percent sectoral SyRB rate on all retail exposures secured by residential property as of 1 July 2022. Furthermore, the Belgian central bank intends to use a systemic risk buffer of 9 percent applied to retail exposures secured by residential property, replacing a previous macroprudential measure based on risk weight add-on and multiplier for the same types of exposures.

Implementation in Romania

The SyRB implementation domestically started in December 2017, via NCMO Recommendation No. 9/2017 on the systemic risk buffer in Romania, addressed to the NBR and applicable as of 30 June 2018. The NCMO recommendation was issued in a context in which the rise in the NPL stock was one of the main vulnerabilities facing the local banking sector in the aftermath of the international financial crisis, the balance sheet clean-up being a lengthy process.

As described in the section on the conceptual framework, the SyRB is the most flexible of the buffers introduced by the European regulatory framework, as national authorities can calibrate it depending on specific systemic risks in the respective Member State. In the case of Romania, the objective pursued via NCMO Recommendation No. 9/2017 was two-faceted, namely: (i) ensuring an adequate management of credit risk from a macroprudential perspective, amid the possible return of non-performing loan ratio onto an upward path, in the context of unfavourable circumstances related to credit institutions' potential future efforts to clean up their balance sheets and (ii) preserving financial stability, assuming that the tensions surrounding domestic macroeconomic equilibria and regional and global uncertainties will persist.

Thus, the systemic risk buffer is calibrated based on two indicators: (i) the non-performing loan ratio and (ii) the coverage ratio of NPLs in the credit institution's balance sheet. Depending on the average recorded by the two indicators over a 12-month period, the SyRB rate may be set at 0 percent, 1 percent or 2 percent, as shown in Table 3.7.

Table 3.7. 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: NCMO

SyRB rates are applied to all exposures of the credit institution, at the highest consolidation level. The assessment is conducted half-yearly to enable the real-time monitoring of developments in the two indicators.

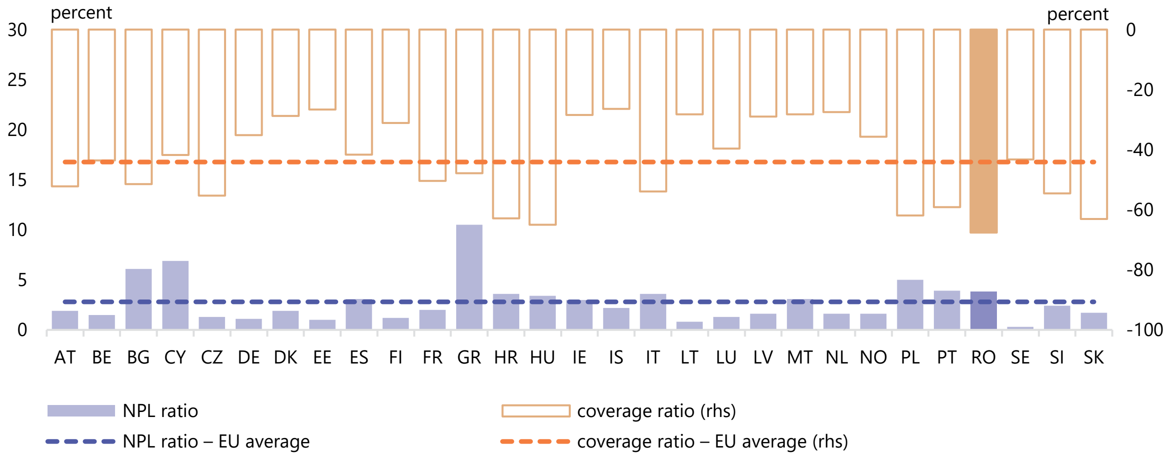
The effects of using the SyRB macroprudential instrument have been positive and noticeable in Romania, contributing to an improvement in the main indicators describing the soundness of the national banking sector, as well as in the resilience and response capacity in the event of a shock.

Since its implementation, the NPL ratio has continued to decline, inter alia as a result of the package of micro- and macro-prudential measures taken by the NBR and the NCMO, currently nearing the European average, while the coverage ratio exceeded 67 percent, placing Romania topmost in the EU by the level of this indicator (Chart 3.21).

The dynamics of the breakdown of credit institutions by SyRB rate is also indicative of an improvement in time of the national banking sector health. The number of institutions to which a 2 percent rate applies has decreased significantly, while that of institutions with a SyRB rate of 0 percent has increased, from 4 to 11, in the same time span (Chart 3.22). Looking at systemically important institutions, which jointly account for over 80 percent of the banking sector's total non-performing exposures, the NPL ratio has fallen visibly, from around 9 percent in March 2017 to 3.6 percent in mid-2021.

The effects of the COVID-19 pandemic crisis on the real economy notwithstanding, prudential indicators paint the picture of a robust banking sector. The NPL ratio has not seen worrisome dynamics, even if uncertainty has remained high throughout 2021.

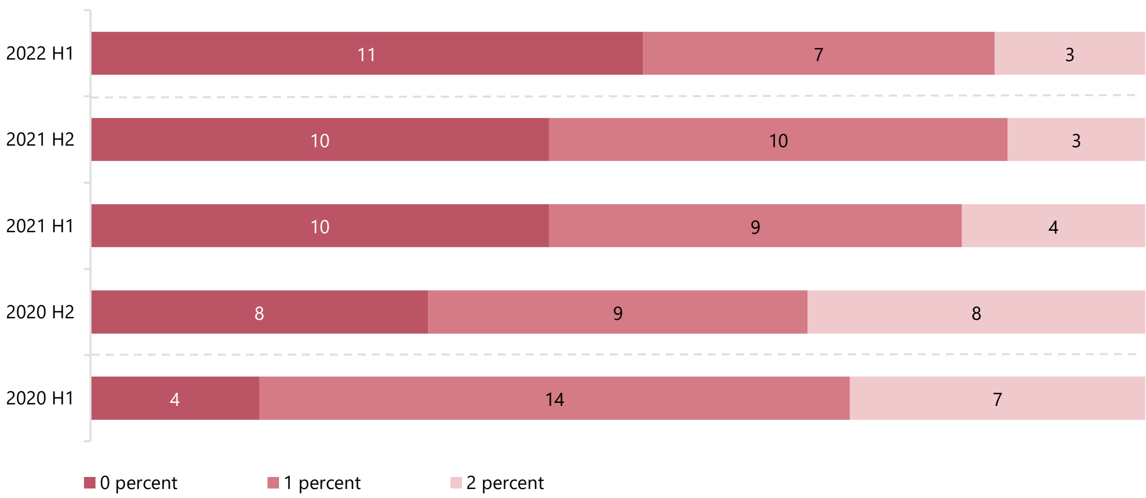
Chart 3.21. NPL ratio and coverage ratio in EEA countries



Note: Data are based on 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 existence and implementation of macroprudential tools in Romania have contributed to a better-capitalised and more resilient banking sector than during the previous crisis, having the necessary capacity to play an active role in the recovery and rebound of economic activity.

Also in 2021, the NCMO General Board decided to issue a decision to comply with the provisions of the Guidelines of the European Banking Authority on the appropriate subsets of sectoral exposures to which competent or designated authorities may apply a systemic risk buffer in accordance with Article 133(5)(f) of Directive 2013/36/EU – EBA/GL/2020/13, in the sense of using them to set and regularly reassess at a national level the systemic risk buffer as a macroprudential tool.

3.2.2. Other instruments with an impact on financial stability

The instruments described below are implemented by the NBR at the recommendation of the NCMO and are applicable to the banking sector. They provide important information in the implementation of measures, but do not represent macroprudential tools per se. Moreover, they have the role of enhancing financial system resilience via other channels than the previously-described instruments.

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

The liberalisation of capital flows, coexisting with the free movement of goods and services, laid the foundation for a European system characterised by financial conglomerates carrying out intense cross-border activities. Hence, the effects of a country's economic policies can be more easily replicated in other Member States. The stronger degree of interconnection among these groups, as well as among the entities within the respective groups, which carry out their activity in various jurisdictions, has generated a step-up in financial contagion. This was also fuelled by the regulations in force, which allow for the establishment of branches that are not under the scope of prudential requirements imposed by competent authorities in host countries, yet compete on the same market as the entities authorised in the host country and/or provide banking services directly to borrowers in the host country.

In order to avoid unwanted externalities in the macroprudential field, as well as to address opportunities for regulatory arbitrage, the European Systemic Risk Board issued Recommendation ESRB/2015/2 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures, whereby it may recommend the macroprudential or designated national authorities to recognise the macroprudential policy measures taken by other Member States. National authorities may exempt financial service providers under their jurisdiction from applying a particular measure if these financial service providers have non-material exposures to the identified macroprudential risk in the activating country (de minimis principle). At end-2021, the list of active measures recommended by the ESRB for reciprocation consisted of five items, as shown in Table 3.8.

Table 3.8. Measures recommended for reciprocation in Recommendation ESRB/2015/2

Country	Measure	Materiality threshold[56]	Reciprocating countries
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	• EUR 2 billion, at credit institution level	Croatia, Denmark, France, Lithuania, Netherlands, Norway and Portugal

[56] As proposed by the designated national authority requesting the measure. If the NCMO reciprocates a measure, it may set a lower threshold for credit institutions in Romania, depending on the materiality of exposures.

– continued –

Country	Measure	Materiality threshold	Reciprocating countries
	(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.		
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, for exposures identified in the measure	Belgium, Denmark, Ireland, Lithuania, Norway and Sweden
Luxembourg	Legally binding loan-to-value (LTV) limits for new mortgage loans on residential real estate located in Luxembourg, with different LTV limits applicable to different categories of borrowers: (i) LTV limit of 100 percent for first-time buyers acquiring their primary residence; (ii) LTV limit of 90 percent for other buyers, i.e. non first-time buyers acquiring their primary residence; (iii) LTV limit of 80 percent for other mortgage loans (including the buy-to-let segment).	• EUR 350 million (1 percent of the total residential real estate mortgage market in Luxembourg) • EUR 35 million (institution-specific materiality threshold for the total cross- border mortgage lending to Luxembourg)	Belgium, France, Germany and Portugal
Norway	(1) a 4.5 percent systemic risk buffer rate for exposures in Norway; (2) a 20 percent average risk weight floor for residential real estate exposures in Norway applied to authorised credit institutions using the internal ratings-based (IRB) approach; (3) a 35 percent average risk weight floor for commercial real estate exposures in Norway applied to authorised credit institutions using the IRB approach.	(1) NOK 32 billion (2) NOK 32.3 billion (3) NOK 7.6 billion	(1) Belgium, France and Portugal (2) Belgium, Denmark, Finland, France and Sweden (3) Belgium, Denmark, Finland, France and Sweden

– continued –

Country	Measure	Materiality threshold	Reciprocating countries
Sweden	A credit institution-specific floor of 25 percent 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, to all authorised credit institutions using the IRB approach.	• SEK 5 billion, at credit institution level	Belgium, Denmark, Finland, France, Lithuania, Norway and Portugal

Source: ESRB

With a view to applying the reciprocity principle based on voluntary recognition, in 2021, the NCMO examined the measures taken by Luxembourg and Norway in order to assess the appropriateness of reciprocating these macroprudential measures (the other measures were discussed in previous years)[57]. Thus, given that eligible exposures of the Romanian banking sector to Luxembourg and Norway are immaterial, the macroprudential authority adopted NCMO Decision No. D/4/2021, according to which the measures adopted by these two countries are not applied domestically. In particular, as regards the setting by Luxembourg authorities of LTV limits for mortgage loans, Romania's relevant exposures from loans backed with residential property to households in Luxembourg amounted to less than EUR 0.2 million at end-2020, well below the suggested materiality threshold. Moreover, the NCMO decision was also based on the fact that the LTV level active in Romania is generally already more restrictive than the new measure taken by Luxembourg. As for the macroprudential measures adopted by Norway, the overall exposures of credit institutions in Romania at end-2020 were worth approximately NOK 115 million, the equivalent of RON 53.4 million (below the indicated materiality thresholds), most of which were interbank exposures. The NCMO will monitor the related exposures on a regular basis and will take the necessary measures should they become material.

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 accordance with Basel III requirements, the national authorities are required to set the countercyclical buffer rate (CCyB) for the exposures within their jurisdiction. At the same time, in order to ensure the effectiveness and consistency of macroprudential policies, the EU law envisages the uniform application of requirements across the single market, irrespective of the Member State in which a certain institution is authorised, according to the principle of location of exposure[58]. To this end, a mechanism is established to recognise the

[57] See the dedicated sections on reciprocation measures in the previous NCMO *Annual Reports*, as well as the specific section on the NCMO website, http://www.cnsmro.ro/en/politica-macroprudentiala/alte-masuri-macroprudentiale/reciprocitatea-masurilor-macroprudentiale/

[58] The requirement to maintain an institution-specific countercyclical capital buffer is equivalent to the total risk exposure amount of that institution multiplied by the weighted average of the countercyclical buffer rates calculated depending on the jurisdictions in which those exposures are located.

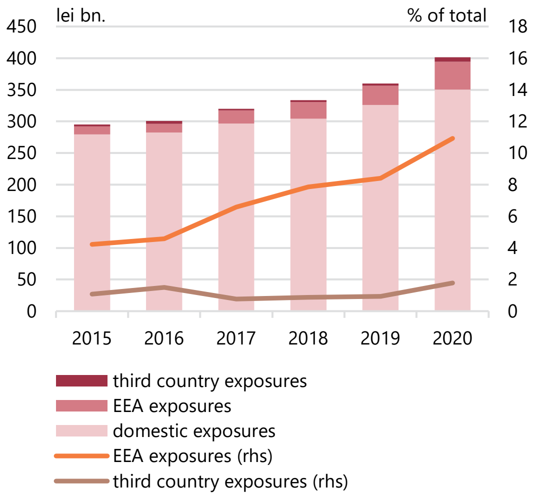
CCyB rates applied by other states based on two components: a) the mandatory reciprocity of rates up to 2.5 percent, regardless of whether they are set by other Member States or by third countries, a unique feature that distinguishes the CCyB from the other capital buffers, and b) the recognition through voluntary reciprocity of the rates above that level. In addition to this recognition framework, the CRD offers designated national authorities the possibility to set the CCyB rate applicable to the institutions authorised in their jurisdiction for their exposures to third countries where a countercyclical buffer rate has not been set and published by the relevant third-country authority for that third country, or where 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 that third country. Moreover, pursuant to Article 138 of Directive 2013/36/EU, the European Systemic Risk Board (ESRB) may issue a recommendation on the appropriate countercyclical buffer rate for exposures to third countries.

Therefore, the NCMO, in its capacity as designated national authority, may intervene in this mechanism of setting countercyclical capital buffer requirements with respect to the recognition through voluntary reciprocity arrangements and the setting of the CCyB rates for third-country exposures, and shall issue recommendations to the sectoral supervisory authority.

As regards the recognition and setting of countercyclical buffer rates for third-country exposures, Recommendation ESRB/2015/1 on recognising and setting countercyclical buffer rates for exposures to third countries and Decision ESRB/2015/3 on the assessment of materiality of third countries for the Union's banking system in relation to the recognition and setting of countercyclical buffer rates defined a coherent framework for the approach of Member States and European institutions to these exposures. A first step in setting those rates is the identification of third countries to which exposures are material, which is intended to steer monitoring efforts towards those states to which cross-border exposures are of the utmost importance. Thus, according to paragraph B1 of Recommendation ESRB/2015/1, designated authorities are recommended to identify material third countries on an annual basis and to submit a list of such material third countries to the ESRB in the second quarter of each year. A similar exercise is carried out by the ESRB (from the perspective of the European banking sector) and the ECB (given the tasks related to the Single Supervisory Mechanism). After material third countries are identified, they are monitored and, where the risks arising from exposures in those countries are not considered to be satisfactorily addressed, CCyB rates may be set on those exposures.

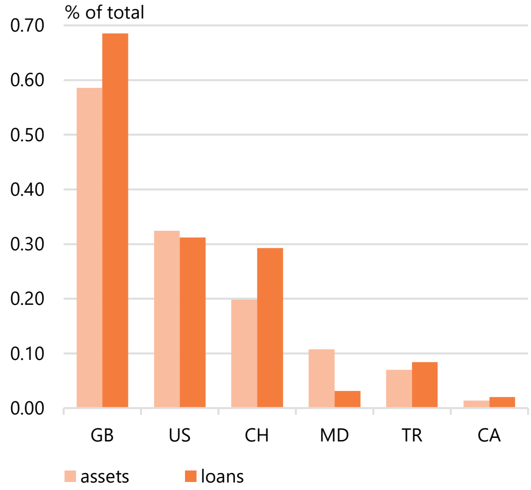
In order to implement Recommendation ESRB/2015/1 at a national level, the NCMO General Board adopted NCMO Recommendation No. 2 of 14 June 2017 whereby the National Bank of Romania is recommended to assess on a regular basis material third countries for the banking sector in Romania in terms of recognising and setting countercyclical buffer rates and to propose the necessary measures should these exposures become material. The assessments prepared by the NBR based on the data available for end-2020 were discussed during the NCMO meeting of 3 June 2021. Following the analysis of the information

Chart 3.23. Breakdown of credit exposures by type of country[59]



Source: NBR

Chart 3.24. Total exposures and credit exposures to the main third countries as at 31 December 2020



Source: NBR

presented, the NCMO adopted Decision No. D/5/2021, according to which no material third countries for the Romanian banking sector in relation to the recognition and setting of countercyclical buffer rates were identified.

The methodology used by the NBR to this end was developed based on the procedures applied by the ESRB to assess the materiality of third countries for the Union's banking sector in relation to the recognition and setting of countercyclical buffer rates[60]. This approach was incorporated into the national procedures by most Member States. To ensure the robustness of the results, the ESRB approach was supplemented at a national level by including additional indicators, which would allow the situation of non-domestic exposures to be determined as accurately as possible.

The results of the analysis for 2020 indicate that the exposures of the Romanian banking sector are mainly related to the domestic economy, non-domestic exposures being further of low importance. Moreover, exposures to third countries are of marginal significance in the Romanian banking sector, which is highlighted by the indicators set out in the ESRB methodology (whose reporting thresholds yielded inconclusive results, as shown in the 2020 *Annual Report* of the National Committee for Macroprudential Oversight) and the analysis of additional data sources. Thus, the reporting specific to the monetary balance sheet of credit institutions at end-2020 indicates that domestic loans account for the largest share (89.7 percent). Over the past years, Romanian banks have increased their foreign exposures, but the holdings have focused on the European Economic Area countries, exceeding the threshold of 10 percent of total exposures in 2020 (Chart 3.23). The exposures to third countries have not gathered the same momentum, remaining below 2 percent of the total loans. The non-European Economic Area countries with the largest

[59] In order to ensure data continuity, the same countries were taken into consideration in each category for all periods, regardless of changes (e.g. Brexit).

[60] The ESRB methodology identifies material third countries based on three exposure metrics: (i) risk-weighted assets, (ii) original exposure and (iii) defaulted exposures based on the data reported by credit institutions in the COREP templates.

exposures are the United Kingdom, the United States of America, Switzerland and the Republic of Moldova, but each of them accounts for less than 1 percent of the total loans granted (Chart 3.24).

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

In the NCMO General Board's meeting of 14 October 2021, the National Bank of Romania presented the results of the annual assessment of the impact of credit institutions' funding plans on the flow of credit to the real economy. The analysis was carried out in the context of Subrecommendation A3 of Recommendation of the European Systemic Risk Board of 20 December 2012 on funding of credit institutions (ESRB/2012/2) setting forth that national supervisory authorities and other authorities with a macroprudential mandate are recommended "to assess the impact of credit institutions' funding plans on the flow of credit to the real economy". Given the ESRB recommendation, the NCMO issued, at a national level, NCMO Recommendation No. 10/2017 on the impact of credit institutions' funding plans on the flow of credit to the real economy, whereby the National Bank of Romania was recommended to assess this impact on a regular basis.

The eight largest banks[61] in the Romanian banking sector have the obligation to regularly submit reports on funding plans. As at 31 December 2020, those banks jointly accounted for approximately 76 percent of total assets and loans to the private sector, which ensures good representativeness of the sample for the Romanian banking sector.

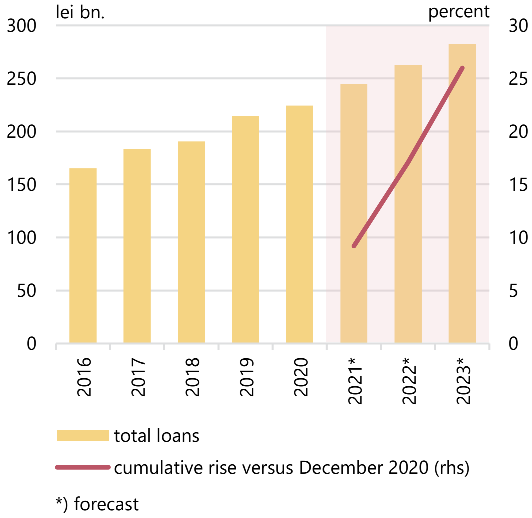
The annual reporting of credit institutions' funding plans takes place in the first quarter of the year and includes reports over a three-year horizon. Therefore, the submitted estimates might not fully incorporate the effects of the pandemic in the post-reporting period, the economic environment being further surrounded by uncertainty.

Credit institutions' funding plans may be used to guide macroprudential policy decisions. At the same time, due to the forward-looking nature of the data on loan dynamics or to potential vulnerabilities, risks that impact financial stability, the macroprudential authorities can make early use of macroprudential instruments, which would enhance their effectiveness and efficiency.

A new version of the reporting templates for funding plans has been submitted since 2021. The new reporting brings an improved level of detail for the already existing templates, as well as some entirely new forms, such as those referring to forecasts on the balance of non-performing loans, the profit and loss account, the deposits guaranteed by the Bank Deposit Guarantee Fund and securities issues. Another significant change is the discontinuation of the six-month forecast, the forecast horizon now covering the end of the next three financial years.

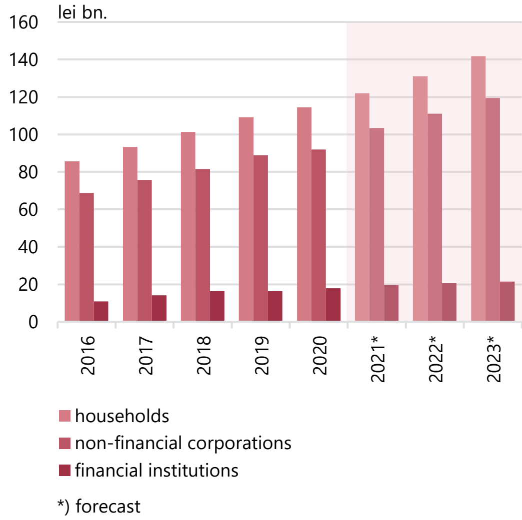
[61] The reporting banks are: Banca Transilvania S.A., Banca Comercială Română S.A., BRD – Groupe Société Générale S.A., Raiffeisen Bank România S.A., Unicredit Bank S.A., CEC Bank S.A., Alpha Bank România S.A. and OTP Bank România S.A.

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

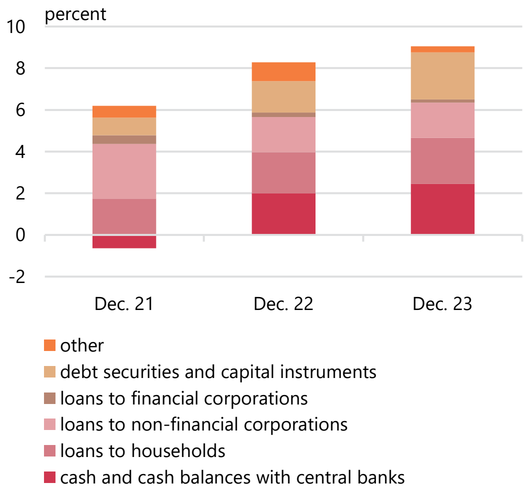
The assessment of the funding plans of reporting credit institutions over a three-year horizon shows the following forecasts on lending: a three-year cumulative rise of 26.5 percent in credit to the real sector, estimated for both households (up 23.9 percent) and non-financial corporations (up 29.7 percent) (Charts 3.25 and 3.26). The gap between household and corporate loans, which was 10.1 percent higher in 2020 than in 2019 on the back of the faster-paced lending to households, is expected to narrow in 2021, before re-embarking on an upward trend as of 2022.

According to the submitted forecasts, housing loans to residents will further play an important part in banks' lending activity (up 21.7 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 widening to approximately 69 percent of total corporate loans against 67.4 percent in December 2020.

The eight reporting banks forecasted a cumulative rise of 24.6 percent in assets between 2021 and 2023 versus December 2020. The breakdown by balance sheet component shows that the main assets contributing to the balance sheet increase are loans to the real sector, debt securities, capital instruments and cash (Chart 3.27). The normalisation of the epidemiological situation expected in 2022 and 2023 leads to a major contribution of loans to the real sector during these years. For 2021, all banks expected substantial rises in the portfolio of loans to the real sector, above the 2020 average. It is worth mentioning that, for 2022, most banks anticipate the dynamics of the loan portfolio to slow down as compared with 2021, before gaining momentum in 2023.

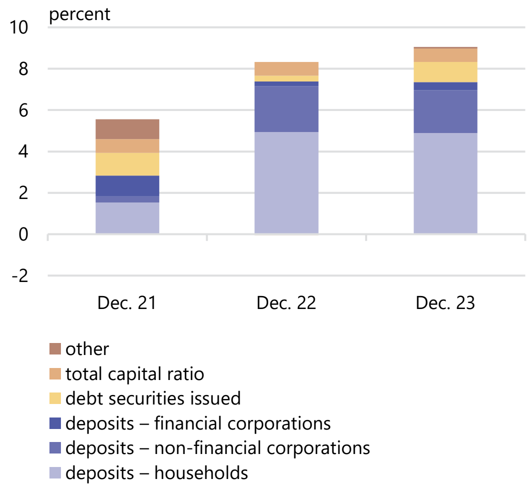
As far as the projected annual growth of liabilities is concerned, the most important contributors are deposits of households and non-financial corporations (Chart 3.28). Thus, in the period between 2020 and 2023, deposits will further be the main source of funding, their share in liabilities remaining unchanged at approximately 81 percent. Turning to the share of deposits covered by a guarantee scheme, this will widen by 1.2 percentage points, to 67.2 percent of total deposits in 2023.

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

From the perspective of the profit and loss account, banks' expectations may be summarised as follows: (i) the profit of banks will grow in the period under review against the backdrop of a faster-paced rise in operating income than in operating expenses, (ii) over the next years, ROA and ROE will post levels similar to those recorded before the COVID-19 pandemic and (iii) the cost-to-income ratio (indicator of operational efficiency) will stay at around 50 percent for this group of banks.

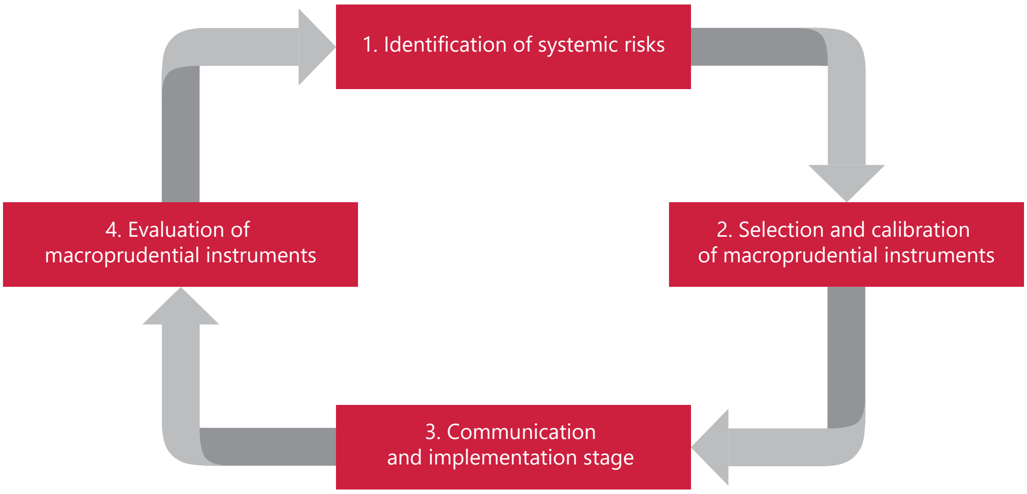
3.3. Evaluation of macroprudential instruments

The National Bank of Romania informed the NCMO General Board, in its meeting of 15 December 2021, of the outcome of assessing macroprudential instruments since their implementation in the national legislation until the end of 2021, as part of the macroprudential policy decision-making process in Romania.

Macroprudential policy decision-making is a four-step process, as follows: (i) identification of systemic risks, where relevant indicators support the detection and assessment of vulnerabilities by defining and using indicative thresholds, (ii) selection and calibration of macroprudential instruments that can be used to mitigate the identified risks, (iii) the communication and implementation stage (application of instruments at the level of financial entities), and (iv) assessment of macroprudential instruments, in which the effectiveness and efficiency of an instrument are determined in view of possible adjustments. In fact, selecting a certain step from those mentioned above is inappropriate as they are interconnected and are part of an ongoing process.

The importance of regular re-evaluation of macroprudential instruments is stipulated in both EU and national legislation. Specifically, according to *The ESRB handbook on operationalising macroprudential policy in the banking sector*, once a macroprudential instrument has been activated, the authorities should monitor and assess its effects. Such evaluations should include the extent to which the intermediate macroprudential objective is sufficiently

Figure 3.2. The decision-making process of macroprudential policy



Source: NBR, ESRB

addressed and whether there are undesirable spillovers domestically or cross-border. At the same time, the evaluation should allow sufficient time for the effects of an instrument to play out. Moreover, Recommendation D – Periodical evaluation of intermediate objectives and instruments under Recommendation ESRB/2013/1[62] specifies that macroprudential authorities are recommended to: (i) periodically assess the appropriateness of the intermediate objectives in view of the experience gained in operating the macroprudential policy framework, structural developments in the financial system and the emergence of new types of systemic risks and (ii) periodically review the effectiveness and efficiency of the macroprudential instruments in achieving the ultimate and intermediate objectives of macroprudential policy.

Domestically, the NCMO General Board approved, in its meeting on 21 May 2018, the Overall Macroprudential Strategy Framework of the National Committee for Macroprudential Oversight[63]. The chapter on taking macroprudential policy decisions sets forth that the following will be considered in the assessment of macroprudential instruments:

"The NCMO will regularly reassess the appropriateness of the intermediate objectives, in view of the experience gained in operating the macroprudential policy framework, structural developments in the financial system and the emergence of new types of systemic risks. The NCMO will also periodically review the effectiveness and efficiency of the macroprudential instruments in achieving the ultimate and intermediate objectives of macroprudential policy. In the event of identifying new risks to financial stability that cannot be satisfactorily managed by using the existing set of macroprudential instruments, the replacement or introduction of adequate instruments or, when appropriate, the activation/deactivation or recalibration of existing instruments will be decided accordingly".

[62] Recommendation of the European Systemic Risk Board of 4 April 2013 on intermediate objectives and instruments of macroprudential policy (ESRB/2013/1).

[63] A summary of the Overall Macroprudential Strategy Framework of the National Committee for Macroprudential Oversight is published on the NCMO website (http://www.cnsmro.ro/en/politica-macroprudentiala/cadrul-de-ansamblu-privind-strategia-politicii-macroprudentiale/).

Two key features were pursued in assessing the macroprudential policy conduct implemented at national level, namely the effectiveness and efficiency of each of the three buffers (the countercyclical capital buffer – CCyB, the capital buffer for other systemically important institutions – O-SII buffer and the systemic risk buffer – SyRB)[64] within the scope and responsibility of the NCMO, in its capacity as the designated national authority for the banking sector. At the same time, the analyses were made in a European context by taking into account the experience of other Member States and the best practices in the field recommended by the EU institutions.

As regards the CCyB buffer, the NCMO's decision to keep it at zero percent in the pre-pandemic period was substantiated by the absence of excessive credit growth that could have entailed cyclical risks, along with the lowest financial intermediation across the EU.

The outbreak of the COVID-19 pandemic brought a host of uncertainties about economic developments. With a view to preventing a pro-cyclical behaviour of the banking sector, European and national authorities chose to ease or increase the flexibility of prudential requirements in order to allow banks to carry on lending in support of the real sector. Most of the Member States that previously activated the CCyB buffer at rates above zero took immediate measures to release it partially or totally, while other Member States cancelled the buffer increase scheduled for 2020. In line with the European approach, the NCMO maintained the buffer rate at zero percent.

Given the increasingly strong signals on the resumption of economic growth and bank developments, steps towards macroprudential policy normalisation were taken in late 2021. The announced increase in the CCyB buffer rate to 0.5 percent as of 17 October 2022[65] takes into account the instrument's two objectives, i.e. to slow down the fast-paced credit growth seen in the past year and to build up additional capital buffers in a period of upturn for the banking sector, which could be released if adverse effects materialise.

The effectiveness and efficiency of a measure can also be judged in terms of arbitrage opportunities, by gearing the activity towards sectors outside the scope of the measure. From the perspective of the CCyB analyses, the dynamics of NBFIs' activity is important in terms of both their contribution to total indebtedness of the real sector and the risk of arbitraging on the regulations in force. As regards the latter aspect, although the buffer applies to credit institutions, it is noteworthy that the NBFIs' activity is concentrated in bank affiliates. In this case, the NBFIs are included in the prudential consolidation scope and are thus indirectly subject to the CCyB-related capital requirements. Consistent with the latest data available at the time of the analysis, loans granted by the NBFIs account for approximately 12.3 percent of total bank loans. As regards cross-border effects, another component that the ESRB recommends to be monitored and analysed in terms of policy

64 The capital conservation buffer was not independently included in the assessment since, according to the EU's regulatory framework CRD IV, it applies evenly in the EU at a rate of 2.5 percent as from 1 January 2019.

65 NCMO Recommendation No. R/7/2021 on the countercyclical capital buffer in Romania.

assessment, the EU's regulatory framework sets forth provisions on mandatory recognition of the CCyB rate[66] adopted by the designated authority in a given Member State, which thus applies to all exposures in a certain jurisdiction irrespective of the country of origin of the creditor. As for the macroprudential policy, given the breakdown of Romania's banking sector, this has a positive contribution to fulfilling the objective under the scope of the measure.

Table 3.9. Indicators on the financial and prudential performance of O-SIIs and their classification in EBA-defined prudential ranges

Criterion	Name	O-SII/ Sector	Dec.17	Dec.18	Dec.19	Dec.20	Dec.21	EBA-defined prudential range
Solvency	Tier 1 capital ratio	O-SII average	19.52%	20.35%	21.91%	25.47%	22.44%	>15%
		Banking sector	17.95%	18.64%	20.05%	23.22%	19.79%	[12%-15%] <12%
	CET1 capital ratio	O-SII average	17.64%	18.27%	19.83%	23.38%	19.64%	>14%
		Banking sector	17.95%	18.64%	19.95%	23.11%	19.70%	[11%-14%] <11%
Credit risk and asset quality	Non-performing loan ratio	O-SII average	6.26%	4.79%	3.96%	3.81%	3.36%	<3%
		Banking sector	6.41%	4.96%	4.09%	3.83%	3.35%	[3%-8%] >8%
	Non-performing loan coverage by provisions	O-SII average	60.00%	60.73%	62.72%	64.48%	66.62%	>55%
		Banking sector	57.68%	58.51%	60.75%	63.31%	66.07%	[40%-55%] <40%
	Ratio of restructured loans and advances	O-SII average	3.48%	2.48%	1.96%	1.65%	1.48%	<1.5%
		Banking sector	8.29%	6.25%	5.19%	5.05%	4.21%	[1.5%-4%] >4%
Profitability	ROE	O-SII average	13.33%	15.46%	12.24%	9.79%	13.12%	>10%
		Banking sector	12.52%	14.59%	12.21%	8.66%	13.45%	[6%-10%] <6%
	Cost-to-income ratio	O-SII average	51.79%	50.34%	51.81%	51.15%	52.31%	<50%
		Banking sector	55.06%	53.17%	54.32%	53.84%	53.80%	[50%-60%] >60%
Financing and liquidity	Loan-to-deposit ratio for households and non-financial corporations	O-SII average	70.88%	69.86%	67.24%	60.22%	61.74%	<100%
		Banking sector	73.21%	71.89%	69.48%	63.61%	63.99%	[100%-150%] >150%

Source: NBR, prudential data

66 When the CCyB rate is lower than 2.5 percent.

The analysis of the effectiveness and efficiency of the O-SII buffer, which covers the risk associated with the systemic size of institutions, is difficult to quantify over a short time horizon and without stress episodes so as to validate the buffer's additional resilience. Nonetheless, the designation of banks as O-SIIs may exert indirect effects on elements such as increased attention in the process of microprudential supervision and the establishment of resolution framework requirements, improved perception of the general public, but also of other international institutions or bodies, with potential effects on business conduct, etc. Thus, in order to assess the extent to which macroprudential policy objectives were achieved so far, a number of relevant indicators were evaluated in line with the following criteria: (i) solvency, (ii) credit risk and asset quality, (iii) profitability and (iv) financing and liquidity. The indicators relevant for each of the above criteria were compared to the average for Romania's banking sector and the EBA-defined prudential ranges. The analysis of key criteria for the banking sector and institutions identified as systemically important over time shows that the selected performance indicators tended, generally, to improve and converge towards the green zone of the EBA-defined prudential ranges, hinting at the effectiveness and efficiency of the current macroprudential policies (Table 3.9).

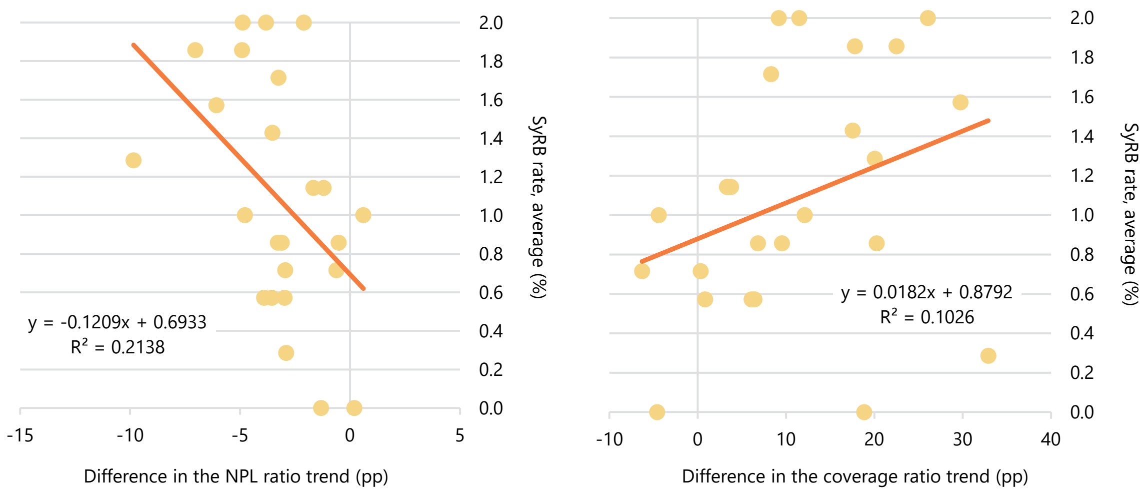
The effectiveness of the SyRB buffer for non-performing loans (NPL) can be gauged via the degree of fulfilment of the objectives envisaged in its calibration, through the approach to non-performance from the perspective of the balance sheet of credit institutions in Romania and by strengthening the resilience of the domestic banking sector, as a result of the build-up of additional capital reserves likely to support further financial intermediation should the identified risks and vulnerability materialise.

The systemic risk buffer was introduced into the EU legislation as a flexible instrument, capable of covering a risk dimension non-targeted by other capital buffers. The setting of a systemic risk buffer that approaches the financial stability risk stemming from non-performing loans was a one-off event in the Romanian financial system and in a European context.

The systemic risk buffer is a coercive factor for the Romanian banks as it establishes a higher capital requirement for the banks with a large share of non-performing loans or a low coverage ratio. After four years of its application, a natural question that arises is whether the instrument has been efficient in achieving its specific objective. Has the setting of a SyRB buffer influenced banks' decision to clean up their balance sheets and/or move to a higher coverage ratio?

The first evidence from the banking sector in this regard is encouraging. The NPL ratio decreased by 3.1 percentage points in December 2021 versus December 2017, whereas non-performing loan coverage by provisions increased by 8.4 percentage points during the same period. The number of banks applying an additional capital requirement for the SyRB has steadily declined: in early 2022, out of 21 institutions, only three banks applied a 2 percent SyRB requirement and seven other banks a 1 percent requirement (Chart 3.22).

Chart 3.29. Relationship between the trend of the NPL ratio and of the coverage ratio, respectively, and the applicable SyRB rate



Source: NBR

In studying the impact of the systemic risk buffer, a major difficulty arises from the endogeneity problems stemming from the manner of calibration by directly linking the capital requirement to the values of the two indicators. Thus, the values with greater differences from the optimal threshold of indicators will always be associated with a higher SyRB rate, giving rise to a correlation between their evolution.

The endogeneity problem can be partly solved if it is accepted that the SyRB, being a structural buffer, mainly affects the trend in the relevant variables. A decomposition using a monthly Hodrick-Prescott filter for the period from January 2015 to December 2021[67] shows, for each credit institution, a reverse relationship between the SyRB average applicable over the past four years and the difference in the NPL ratio trend in December 2017 and December 2021 (Chart 3.29, left panel). There is also a positive relationship between the SyRB average and the difference in the trend of the coverage ratio before and after applying the SyRB (Chart 3.29, right panel). Therefore, banks with a higher capital buffer tend to reduce their NPL ratio trend to a greater extent and to positively adjust their coverage ratio trend.

The direct relationship becomes significantly stronger if the banks that were systemically important during the period of application of the buffer are removed from the calculation[68]. This indicates lower SyRB effectiveness for banks that have also been subject to an O-SII buffer, as in the former European CRD IV framework the two structural capital buffers were implemented by applying the higher of the O-SII or the SyRB buffer rate. Thus, the Romanian systemic banks had no additional motivation to improve the indicators that are the basis for determining the SyRB level, as they had to apply an O-SII requirement that was, in many

[67] Individual bank data have been used for decomposition purposes. In order to approximate the composition of the banking groups, the savings and loan banks were aggregated with the banks of the group to which they belong. In order to avoid artificial breaks in the data series, banks that were absorbed into other domestic banking groups were added to the respective group for the pre-transaction data as well.

[68] The R^2 indicator increases to 40.31 percent from 21.38 percent for the NPL ratio and to 41.66 percent from 10.26 percent for the coverage ratio.

cases, at least equal to the SyRB rate. With the transition to the CRD V legislative framework and the cumulative application of the two buffers, this shortcoming will be addressed, and the effectiveness of the systemic risk buffer is expected to increase.

In order to analyse in depth the causal relationship between the two variables of interest and the macroprudential instrument, it is necessary to quantify the extent to which the SyRB has led banks to improve their non-performing loan ratios and to which the evolution of variables has been driven by an overall improving trend amid a more favourable economic environment. The proposed topic could be clarified by using more advanced econometric techniques that capture the developments in the causal relationship over a longer period and allow solving the aforementioned endogeneity problems.

4. Implementation of macroprudential policy

In accordance with the provisions of Art. 1 para. (2) of Law No. 12/2017 on macroprudential oversight of the national financial system, the National Committee for Macroprudential Oversight is mandated to ensure coordination in the field of macroprudential oversight of the national financial system by setting the macroprudential policy and the appropriate instruments for its implementation. 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 2021, the NCMO issued nine recommendations, as follows:

- in its meeting of 30 March 2021 – NCMO Recommendation No. R/1/2021 on the countercyclical capital buffer in Romania; NCMO Recommendation No. R/2/2021 on the extension of the period to refrain from dividend distribution; NCMO Recommendation No. R/3/2021 on compliance with the provisions of EBA Guidelines on the specification and disclosure of systemic importance indicators – EBA/GL/2020/14;
- in its meeting of 3 June 2021 – NCMO Recommendation No. R/4/2021 on the countercyclical capital buffer in Romania; NCMO Recommendation No. R/5/2021 on implementing Recommendation ESRB/2020/12 on identifying legal entities; NCMO Recommendation No. R/6/2021 on the analysis of the Working Group on supporting green finance;
- in its meeting of 14 October 2021 – NCMO Recommendation No. R/7/2021 on the countercyclical capital buffer in Romania; NCMO Recommendation No. R/8/2021 on the capital buffer for other systemically important institutions in Romania;
- in its meeting of 15 December 2021 – NCMO Recommendation No. R/9/2021 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 2021 were implemented, based on the information received from the addressees.

The results 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 2021, as well as of the recommendations issued in the previous period, which were not completed or which are applicable on a permanent basis are presented below:

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

(ii) five recommendations are currently being implemented:

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 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 availability of indicators. Thus, the national macroprudential authorities are requested to deliver their final reports regarding subrecommendations C and D by 31 December 2021 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;

c) NCMO Recommendation No. R/6/2020 on addressing vulnerabilities from the widening of the agri-food trade deficit – most of the measures which are the Government's responsibility, namely those dedicated to implementing the strategy in the field of agriculture have an implementation period of 1-3 years, whereas the measure regarding the implementation of an industrial policy for the food sector that should lead to a better fulfilment of the government's role in underpinning the agri-food sector has an 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 for improving agri-food firms' access to finance. These responsibilities have a regular implementation period, starting December 2020;

d) Recommendation NCMO No. R/5/2021 for the implementation of Recommendation ESRB/2020/12 on identifying legal entities – some of the measures adopted by the national authorities are to be implemented in 2022;

e) NCMO Recommendation No. R/6/2021 on supporting green finance – some of the recommendations made to the addressees have an implementation period from 2022 to 2023.

(iii) three recommendations are applicable on a permanent basis, requiring addressees to carry out analyses on a regular basis. The addressees implemented all three recommendations via the analyses made in 2017, 2018, 2019, 2020 and 2021, which were reviewed by the NCMO General Board.

The details concerning the developments in the implementation by the addressees of the recommendations issued by the National Committee for Macroprudential Oversight from January to December 2021, as well as of the recommendations issued in the previous period, which were not completed or which are applicable on a permanent basis are disclosed in the Annex.

Annex

The situation regarding the manner of implementation of the recommendations issued by the National Committee for Macroprudential Oversight in 2021, and of the recommendations issued in the previous period, which were not completed or which are applicable on a permanent basis

NCMO recommendation	Addressee	Manner of implementation of the recommendation*
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; (iv) NCMO Decision No. D/5/2021 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, in 2018, 2019, 2020 and 2021, 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 editions of the *Financial Stability Report* (published on the NBR website http://www.bnr.ro/Publicatii-periodice-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 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 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,

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NCMO recommendation	Addressee	Manner of implementation of the recommendation*
		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. 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. During the meeting of 15 December 2021, held by written procedure, NCMO Note No. 41/2021 on reporting to the ESRB on the availability of commercial real estate statistics was examined, which took into account the provisions of Recommendation ESRB/2016/14 on closing real estate data gaps, amended and supplemented by Recommendation ESRB/2019/3 amending Recommendation ESRB/2016/14 on closing real estate data gaps. The above-mentioned Note states that Romania complied with the provisions of the ESRB Recommendation on the residential real estate market (subrecommendations A and B), while the NBR submitted the interim report on the implementation of the Recommendation by 31 December 2019 and the final report on subrecommendations A and B by 31 December 2020, in accordance with the established deadlines. Based on these reports, the ESRB assessed Romania as being fully compliant. In order to comply with the provisions of the Recommendation on real estate lending, the NBR has extended the list of indicators reported via the Central Credit Register (CCR) by adding those recommended by the ESRB. In order to comply with the provisions of subrecommendations C and D (whose reporting deadline is 31 December 2021), except those on the physical market (subrecommendation C, point 1, letters a-e and subrecommendation D, point 2, letter a – whose deadline may be extended until 31 December 2025), the NBR submitted the template to the ESRB, according to the requirements of 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.
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 made in 2018 (based on the reports with the reference date of 31 December 2017), in 2019 (based on the reports with the reference date of 31 December 2018), in 2020 (based on the reports with the reference date of 31 December 2019) and in 2021 (based on the reports with the reference date of 31 December 2020) 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 presented during the meetings of 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.

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NCMO recommendation	Addressee	Manner of implementation of the recommendation*
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, the Insured Guarantee Fund; (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; (v) for all entities under its supervision, the FSA applies requirements on IT system security.
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 and NBFI sectors (by conducting solvency and liquidity stress tests, 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	Manner of implementation of the recommendation*
		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. On the Government/MF side, in order to mitigate the negative economic effects generated by the COVID-19 pandemic, a number of government support programmes have been approved to uphold the activity of SMEs and of large companies and small- and medium-sized enterprises with a turnover of above lei 20 million via state guarantees. The guarantees granted in 2020 and 2021 amounted to lei 12,48 billion (1.20 percent of GDP) and lei 14,85 billion respectively. The NCMO General Board was informed on a quarterly basis of the fiscal measures adopted by Romania, according to the template submitted to the ESRB in this regard, using the following indicators: type of support, beneficiaries and eligibility criteria, duration and other information (volume of the measure), while the potential implications of fiscal measures on financial stability were also analysed. The implications were assessed based on a series of indicators meant to capture the dynamics of the real sector and the financial sector during the 2020-2021 period. 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 quarterly established deadlines.
NCMO Recommendation No. R/6/2020 on addressing vulnerabilities from the widening of the agri-food trade deficit	Government, NBR	**An overview of the measures adopted by the National Bank of Romania (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 potential champion firms in the agri-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. The NBR updated the statistical data on lending to agri-food firms by credit institutions and NBFIs, based on the NACE code, with data as at December 2021. The updated statistics were published in March 2022 on the NCMO website, in the section dedicated to the NCMO Working Group analysis on addressing vulnerabilities stemming from the widening of the agri-food trade deficit (http://www.cnsmro.ro/en/publicatii/studii-si-analize/grupul-de-lucru-cnsm-privind-diminuarea-vulnerabilitatilor-provenind-din-cresterea-deficitului-balantei-comerciale-cu-produse-agroalimentare/).

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NCMO recommendation	Addressee	Manner of implementation of the recommendation*
		The NBR also updated the statistics on lending to companies in the agri-food sector by credit institutions and NBFIs, according to the NACE code, for the reference date of 31 March 2022. These statistics were published in May 2022 on the NCMO website in the section dedicated to the NCMO Working Group analysis on addressing vulnerabilities stemming from the widening of the agri-food trade deficit (http://www.cnsmro.ro/publicatii/studii-si-analize/grupul-de-lucru-cnsm-privind-diminuarea-vulnerabilitatilor-provenind-din-cresterea-deficitului-balantei-comerciale-cu-produse-agroalimentare/). **An overview of the measures adopted by the Government** **According to point 1:** The existence of the European Green Deal and in particular of its Farm to Fork strategy provides an appropriate framework for the development of production models based on enhancing added value throughout the entire food chain. For the next programming period related to the National Strategic Plan (NSP) 2023-2027, Romania will distribute to farmers, under the European Agricultural Guarantee Fund (EAGF), the amount of EUR 9,783,148 thousand through direct payments to a number of support schemes, as follows: - EUR 978,314 thousand through redistributive payments for income support, dedicated to small farms (1-50 hectares) according to the structure of farms in Romania, and where farming activities or livestock breeding are carried out on arable land, meadow and/or permanent grassland; - EUR 2,837,903 thousand for Eco schemes, dedicated to the majority of farms in Romania, where farming activities are carried out on arable land and/or permanent grassland. In particular, these support schemes address the European Union's higher environmental ambition, bringing additional benefits to natural resources (soil, water, biodiversity), as well as to the livestock in national agriculture; - EUR 4,398,692 thousand for basic income support payments dedicated to all farms registered under the management and control system operated by APIA (Agency for Payments and Interventions in Agriculture), and where agricultural activities or livestock breeding are carried out on arable land, meadow and/or permanent grassland; - EUR 100,766 thousand for income support payments for young farmers, dedicated to all farms registered under the management and control system managed by APIA, who carry out an agricultural activity and meet the eligibility age criteria (being no more than 40 years of age when becoming head of the agricultural holding). All farmers who will receive the above-mentioned direct payments in the programming period 2023-2027, as well as those from the current programming period, are required to adhere to the good agricultural and environmental conditions, provided for in the EU and national legislation.

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NCMO recommendation	Addressee	Manner of implementation of the recommendation*
		At the same time, the interventions financed by the European Agricultural Fund for Rural Development via the National Strategic Plan 2023-2027 will focus on achieving the following objectives: foster a smart, resilient and diversified agricultural sector ensuring food security; enhance market orientation and increase competitiveness; improve farmers' position in the value chain and develop rural areas through small-scale infrastructure investments, while taking into consideration the aims of the European Green Deal. **According to point 2:** Under the 2014-2020 National Rural Development Programme, innovation and development projects were supported via measure 16 – Cooperation under the 2014-2020 NRDP, in particular sub-measure 16.1 and sub-measure 16.1a – Support for the establishment and operation of operational groups, development of pilot projects, new products and processes in the agricultural and fruit sector, thus contributing to the achievement of the objectives under the European Innovation Partnership, namely to increase the degree of innovation and digitalisation in the agricultural sector. Under the 2014-2020 NRDP, precision agriculture was supported through measure 4, sub-measures 4.1 – Investments in agricultural holdings and 4.1a – Investments in fruit-growing holdings. Under these sub-measures (4.1-4.1a) precision agriculture was supported through the purchase of innovative equipment and machinery that help increase the competitiveness of Romanian farms and their sustainability. They include modern irrigation and fertilisation equipment, machinery and equipment using GPS technology, weather stations, real-time warning systems, modern systems for frost and hail protection, computer systems for managing production processes, etc. In the light of the National Strategic Plan 2021-2027, and given the importance of innovation in the agricultural sector, precision farming will play a significant role in the future. Given the need to produce more with less, precision farming could become a key tool for the sustainability of the agricultural sector and for the increase in competitiveness. Thus, under the National Strategic Plan 2021-2027, the financing of innovative projects in the agri-food sector will continue, especially since the future rural development programme will have an important objective, namely the cross-cutting objective – Promoting knowledge, innovation and digitalisation in agriculture. The future lines of action will focus on the (economic and technological) modernisation of the entities in the agricultural research sector, and also on stepping-up the dissemination of research results in order to support both agricultural producers (e.g. by creating drought-tolerant crops or adopting more efficient water and soil management techniques) and other actors in the agri-food chain. The role of innovation will therefore be crucial in the coming period to increasing the economic performance of farms, finding new forms of collaboration between farmers and other actors (short chains) and helping communities to better adapt to climate change effects.

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NCMO recommendation	Addressee	Manner of implementation of the recommendation*
		According to point 3: Once with the Government's approval of the legal act on the implementation of the "Agro IMM Invest" sub-programme, the legislative framework was created for the beneficiaries operating in agriculture, fishery, aquaculture and the food sector to access the support measures provided by the Ministry of Finance, which consist in state guarantees and mechanisms for subsidising interest rates on loans and some fees; 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 2022. At the same time, the information provided by guarantee funds shows the following developments in terms of guarantees granted to agricultural and agri-food businesses: **National Credit Guarantee Fund for Small and Medium Enterprises (FNGCIMM)** As at 31 December 2021, the statement of guarantees provided by FNGCIMM on loans granted by creditors to firms in agriculture and food industry was as follows:

Source of guarantee funding	No. of beneficiaries	Guarantees (lei)	Loans (lei)
FNGCIMM own funds	146	45,728,593	85,922,437
Sources under management (Ministry of Agriculture and Rural Development)	1	150,320	187,900
State guarantees (IMM Invest)	2,686	1,595,716,171	1,925,031,610
State guarantees (Agro)	1,917	1,984,512,242	2,454,395,751
State guarantees (Leasing)	1	2,065,987	3,443,312
Total	**4,751**	**3,628,173,313**	**4,468,981,010**

Romanian Rural Credit Guarantee Fund (FGCR)
In over 25 years of activity since its establishment, the fund has provided access to financing exclusively for agriculture, fishery, aquaculture and the food sector, guaranteeing over 119.3 thousand loans, which amounted to approximately lei 16,644,613.2 thousand, and which benefited from total guarantees granted by the FGCR of more than lei 11,245,166.0 thousand (as at 31 December 2021).
A summary of the guarantees granted by source as at 31 December 2021 is presented below:
- Under Law No. 218/2005, 2,024 guarantees amounting to lei 1,727,321.85 thousand were granted for a volume of loans of lei 2,430,924.38 thousand;
- Under Law No. 329/2009, 12,564 guarantees amounting to lei 2,256,692.78 thousand were granted for a volume of loans of lei 3,566,753.79 thousand;
- Under GEO No. 79/2009, 1,851 letters of guarantee were granted to AFIR in order to secure the advance mentioned in the grant agreements /additional

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NCMO recommendation	Addressee	Manner of implementation of the recommendation*
		acts concluded by the beneficiaries with AFIR, in amount of lei 2,894,051.79 thousand; - Under Government Ordinance No. 20/2013, 180 guarantees amounting to lei 88,814.83 thousand were granted for a volume of loans of lei 127,449.69 thousand; - Under GEO No. 43/2013, 2,730 guarantees amounting to lei 781,004.23 thousand were granted for a volume of loans of lei 1,362,302.87 thousand; - Out of the amounts allocated to the guarantee schemes financed under the 2007-2013 NRDP, 1,295 guarantees amounting to lei 1,359,300.63 thousand were granted, corresponding to a volume of loans of lei 2,088,842.80 thousand; - From the funds made available by the European Commission in 1994 via the PHARE programme, 98,634 guarantees amounting to lei 2,137,979.89 thousand were granted for a volume of loans of lei 4,174,287.94 thousand. On 30 December 2021, Government Emergency Ordinance No. 142/2021 was published, extending the implementation period of the "Agro IMM Invest" support sub-programme for small- and medium-sized enterprises and for small enterprises with medium market capitalisation in the fields of agriculture, fishery, aquaculture and the food sector, as well as including FGCR in the scheme management. For 2022, the total ceiling of guarantees that may be granted under the "Agro IMM Invest" sub-programme is lei 5 billion, equally distributed between the two guarantee funds running this sub-programme. Thus, 19 credit institutions submitted their applications for registering in the "Agro IMM Invest" sub-programme, requesting guarantee ceilings of lei 3,185,530,000 against a total guarantee ceiling of lei 2,500,000,000 allocated to FGCR by the Ministry of Finance. The sub-programme has started and is currently being implemented. Moreover, throughout 2022 the FGCR was involved in drafting the legal act that put forward the establishment of a new guarantee programme in the agricultural and food sectors, the "Rural Invest" programme, which aims to ensure liquidity and financing for investments made by eligible beneficiaries who locate their production in rural and small urban areas, in order to foster the development of businesses in these particular areas. For 2022, the total ceiling of guarantees proposed under the "Rural Invest" programme is lei 2.5 billion. **Romanian Counter-Guarantee Fund (FRC)** As regards the concrete action taken to increase access to guarantees by actually cutting guarantee fees, the Romanian Counter-Guarantee Fund is in the process of implementing a counter-guarantee scheme to support access to finance for SMEs in the agricultural sector, applicable in the 2021-2027 period, requiring an agreement on the de minimis aid ceiling from the Ministry of Agriculture and Rural Development. So far, no requests have been made to facilitate access to finance for companies in the agricultural and food sectors. **According to point 4:** The effective legislation stipulates regulatory measures for establishing a guarantee scheme for funds granted by credit institutions and/or non-bank financial institutions

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NCMO recommendation	Addressee	Manner of implementation of the recommendation*
		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 Ministry of Agriculture and Rural Development (MARD) aims to implement specific measures on the attestation of Romanian agri-food products, as an eligibility component for market-oriented actions: promotion, public procurement and fiscal incentives. With regard to the quality position of the Romanian agri-food products in the European context, and in line with the specific European policies, steps have been further taken for the recognition/attestation of new agri-food products, leading to an increase in their number within national and European quality schemes. Quality schemes were developed within the MARD and notified to the European Commission. The correspondence between Romanian institutions and the European Commission during the 2020-2021 period had as result the need to withdraw the draft legal act meant to regulate the products marked as "Premium Quality". As for the "Guaranteed Quality" national scheme, the text of the legal act will be amended and the regulation will then be approved via a higher-level legal act that will also change its title. After being adopted, technical quality specifications will be developed pursuant to this regulation in order to highlight Romanian agri-food products, with the aim of fostering the local or regional potential. At the same time, in the 2022 MARD Action Plan, specific objectives were defined in line with the recommendations of the NCMO Report, namely the implementation of the European legislation regulating the development of quality systems such as "geographical indication" for spirit drinks, high value-added goods which may contribute to a better exploitation of agricultural products, as well as obtaining additional income sources for the state budget. MARD also takes specific steps for the recognition of aromatised wine products as geographical indications at European level. **According to point 6:** In the preparation of the 2021-2027 programming period, the MARD conducted a number of consultations with public and private entities involved in the elaboration of the National Strategic Plan (NSP). Thus, the NSP aims to invest in processing units, mainly developed by farmers' associations, with a level of investment sufficient to cover raw material processing capacities that will result in a higher supply of value-added products, stabilising the trade balance and eliminating the existing shortages in certain sectors. Using specific policies, the MARD aims to increase the coverage of food consumption from domestic production. The actions will focus on promoting qualitative and value-added products from Romania,

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NCMO recommendation	Addressee	Manner of implementation of the recommendation*
		with an emphasis on supporting producers' associations. The MARD also encourages and supports the development and strengthening of short supply chains, which channels domestic production directly to consumers. In Romania, the organic farming sector is continuously developing, with possibilities for expansion, especially as a result of financial incentives introduced through direct payments and through the National Rural Development Programme. Under the wine promotion measure of the National Support Programme in the Wine Sector 2019-2023, two programmes for the promotion of wines in third countries were selected during the financial year 2021, the objective of which is to improve the competitiveness of Romanian wines with a controlled designation of origin (DOC), geographical indication (GI) or wines for which the grape variety is indicated. **According to point 7:** According to the 2014-2020 NRDP, including for the transition period 2021-2022, the development of associations, local chains, the uptake of digital technologies were stimulated either through dedicated allocations under the different sub-measures or by further scoring applicants proposing projects that are helpful in achieving these objectives. The National Strategic Plan 2023-2027 will also focus on achieving the following objectives: - Foster a smart, resilient and diversified agricultural sector ensuring food security, increase the viability of farms by stabilising farmers' incomes and eliminating discrepancies and disparities between farm categories; - Enhance market orientation and increase competitiveness in the agri-food sector by enhancing cooperation, encouraging collective investment, modernising and restructuring farms, based on investments that improve productivity while also developing and modernising the food industry. The NSP aims to foster cooperation and strengthen farmers' associations in order to steer them towards performance, with a view to obtaining more competitive products, which will improve the farmers' position in the value chain, stabilise the trade balance and integrate them vertically into the value chain (processing, distribution, sales). In the context of the CAP 2023-2027, cooperation between operational groups of various farmers' associations or between LAGs (local action group) is the key element defining the actions related to bioeconomy projects, further efforts being focused on applying bioeconomy principles for rural development, for using the biomass as a renewable biological resource, for the large-scale implementation of circular economy, for strengthening horizontal and vertical partnerships in order to develop short supply chains and local markets. **The National Committee for Macroprudential Oversight (NCMO)** During the NCMO General Board meeting of 30 March 2021, NCMO Note No. 11/2021 on monitoring the implementation by the authorities of the NCMO recommendations on addressing vulnerabilities

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		from the widening of the agri-food trade deficit was analysed. It highlighted the further widening of the agri-food trade deficit due to recent developments exacerbated by the COVID-19 pandemic crisis, such as the shift in consumption to essential goods, as well as the weak grain crops in that agricultural year. In this context, the NCMO approved the proposal to change the approach to monitoring the implementation of NCMO recommendations on addressing vulnerabilities from the widening of the agri-food trade deficit, by increasing the seniority level of the person coordinating the follow-up on these recommendations, namely at the level of an NCMO General Board member, with a view to finding new solutions to facilitate the implementation of the policy proposals included in that NCMO Recommendation.
NCMO Recommendation No. R/1/2021 on the countercyclical capital buffer in Romania	NBR	The NBR implemented the NCMO recommendation on maintaining the countercyclical capital buffer rate at 0 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/2/2021 for the implementation of Recommendation ESRB/2020/15 amending Recommendation ESRB/2020/7 on restriction of distributions during the COVID-19 pandemic	NBR, FSA	Taking into account the European Banking Authority's statement of 15 December 2020 (https://www.eba.europa.eu/eba-continues-call-banks-apply-conservative-approach-dividends-and-other-distributions-light-covid) and the Recommendation of the European Systemic Risk Committee of 15 December 2020 – ESRB/2020/15 (https://www.esrb.europa.eu/pub/pdf/recommendations/esrb.recommendation201215_on_restriction_of_distributions_during_the_COVID-19_pandemic~2502cd1d1c.en.pdf?248563cbdc12f1a0e29b3494e2398bc2), the National Bank of Romania sent to credit institutions, Romanian legal entities, Letter No. FG/788/31 December 2020, recommending the adoption of necessary measures to maintain own funds at an adequate level relative to the risk profile of the credit institution, namely to refrain from dividend distribution and from buying-back ordinary shares by 30 September 2021, without prior consultation of the National Bank of Romania. Thus, the NBR recommended that credit institutions with an adequate financial and prudential position may notify the National Bank of Romania of their intention to distribute dividends or buy-back ordinary shares within the limit of 15 percent of total profit for 2019 and 2020, but no higher than 20 basis points of the Common Equity Tier 1 capital ratio as at 31 December 2020. In addition, the NBR recommended that credit institutions review their remuneration policy in order to ensure it is in line with the current situation and contributes to the promotion of prudent risk management; this means that the NBR recommended credit institutions to postpone the variable remuneration for a longer period and to set a substantial part of variable remuneration that can be paid in share-linked instruments or equivalent non-cash instruments. In this context, the letter highlighted that the supervisory authority would monitor the remuneration policies of credit institutions to ensure that they contribute to maintaining a proper risk management framework.

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		Moreover, the NBR sent to credit institutions Letter No. FG/245/20 April 2021 which notified the issue of Recommendation NCMO 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 in the NCMO General Board meeting of 30 March 2021, requesting banks to refrain at least until 30 September 2021 from undertaking any of the following actions, which may result in reducing the quantity or quality of own funds at consolidated and/or individual level: a) make a dividend distribution or give an irrevocable commitment to make a dividend distribution; b) buy-back ordinary shares; 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 above-mentioned letter stated that exception to this are financial institutions that apply heightened caution in carrying out any of those actions and the resulting reduction does not exceed the conservative threshold set by their competent authority. To this end, the NBR required credit institutions to engage in bilateral discussions with the Supervision Department prior to taking any actions that could reduce the amount or quality of own funds at consolidated and/or individual level, such as: (i) make a dividend distribution or give an irrevocable commitment to make a dividend distribution; (ii) buy-back ordinary shares. For the insurance market (https://www.asfromania.ro/uploads/articole/attachments/602e473ba61c0365303023.pdf), the FSA applied Recommendation ESRB 2020/15 setting a conservative threshold at a minimum of 130 percent of solvency determined as the minimum ratio of own funds eligible to cover the SCR and the SCR ratio and the ratio of own funds eligible to cover the MCR and the MCR ratio, after deducting the amounts planned to be distributed from own funds. For financial investment companies (https://www.asfromania.ro/uploads/articole/attachments/6087fba1d3401784027763.pdf), the FSA applied Recommendation ESRB 2020/15 setting a conservative threshold at a minimum of 14 percent of total capital ratio. At the same time, the Financial Supervisory Authority issued, in turn, a number of recommendations applicable to insurance companies and investment firms. In total, 85 percent of insurance companies and 80 percent of financial investment companies notified the FSA that they complied with the recommendations issued on restriction of distributions during the COVID-19 pandemic. In the NCMO meeting of 14 October 2021, the NCMO General Board was informed of the expiry of Recommendation ESRB/2020/15 amending Recommendation ESRB/2020/7 on restriction of distributions during the COVID-19 pandemic and their implications for the banking sector in Romania, and in this context the following were decided: (i) approval of expiry of NCMO Recommendation No. R/2/2021, without an extension of the legal provisions on the restriction/limitation of distributions beyond 30 September 2021; (ii) approval of publication on the NCMO website, within the press release of the NCMO meeting, of an informing

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NCMO recommendation	Addressee	Manner of implementation of the recommendation*
		note regarding NCMO decision approving the expiry of NCMO Recommendation No. R/2/2021, without an extension of the legal provisions on the restriction/limitation of distributions beyond 30 September 2021. (http://www.cnsmro.ro/en/sedinta-cnsm-din-14-octombrie-2021/)
NCMO Recommendation No. R/3/2021 on compliance with the provisions of EBA Guidelines on the specification and disclosure of systemic importance indicators – EBA/GL/2020/14	NBR, FSA	The National Bank of Romania Board decided as follows: (i) to approve of the NBR's intention, in its capacity as sectoral supervisory authority (competent authority), to comply with the provisions of Guidelines EBA/GL/2020/14, subject to the adoption of a final decision by the NCMO General Board; (ii) based on the recommendation issued by the NCMO to the NBR to comply with the provisions of Guidelines EBA/GL/2020/14, from the date when there is a G-SII institution, Romanian legal entity, the NBR will ensure its enforceability against the relevant credit institutions subject to the provisions of these Guidelines, by conducting an analysis for the purpose of identifying the optimal solution to supplement the regulatory framework. Currently, no global systemically important institutions (G-SII) were identified within the NBR jurisdiction. The notification regarding the NBR's intention to comply with the provisions of Guidelines EBA/GL/2020/14, subject to the adoption of a final decision by the NCMO General Board during its next meeting, was submitted to the ESRB on 8 March 2021. This procedure was supplemented by submitting to the ESRB, on 6 April 2021, the notification regarding the NCMO's intention to comply with the provisions of Guidelines EBA/GL/2020/14. In addition, no global systemically important institutions (G-SII) exist within the FSA jurisdiction at present.
NCMO Recommendation No. R/4/2021 on the countercyclical capital buffer in Romania	NBR	The NBR implemented the NCMO recommendation on maintaining the countercyclical capital buffer rate at 0 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/5/2021 for the implementation of Recommendation ESRB/2020/12 on identifying legal entities	NBR, FSA	To date, the NBR adopted the following measures: 1) a press release on NCMO Recommendation No. R/5/2021 for the implementation of Recommendation ESRB/2020/12 on identifying legal entities (https://www.bnr.ro/page.aspx?prid=19817) was published on the NBR website on 30 August 2021, stating that the NBR recommends institutions under its supervisory remit (credit institutions, electronic money institutions, payment institutions and non-bank financial institutions) to have a legal entity identifier (LEI). 2) two regulations are currently being drafted to amend some legal acts issued by the NBR, in order to include in their provisions/in the reporting templates the LEI of the reporting entity that has an LEI, or the LEI of any other legal entity about which information must be reported and which has an LEI, as follows: (i) the draft NBR Regulation amending and supplementing some regulatory acts issued by the National Bank of Romania by including the LEI code among the identification data of entities, which amends the following: NBR Order No. 18/2007; NBR Regulation

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NCMO recommendation	Addressee	Manner of implementation of the recommendation*
		No. 20/2009; NBR Regulation No. 17/2012; NBR Regulation No. 5/2013; NBR Order No. 2/2014; NBR Order No. 8/2014; NBR Order No. 9/2014; NBR Order No. 9/2017; NBR Order No. 10/2017; NBR Regulation No. 2/2019; NBR Regulation No. 4/2019; NBR Regulation No. 5/2019 and NBR Regulation No. 12/2020; (ii) the draft NBR Order amending and supplementing some regulatory acts issued by the National Bank of Romania by including the LEI code among the identification data of entities, which amends the following: NBR Order No. 27/2010; NBR Order No. 6/2015; NBR Order No. 10/2012 and NBR Order No. 2/2020; 3) steps were taken to include the LEI code in the templates of reporting entities to the Central Credit Register (CCR); 4) steps were taken to amend the public registers (Credit Institutions Register, Payment Institutions Register, Register of Electronic Money Institutions, Register of Non-Bank Financial Institutions – General Register and Special Register), highlighting financial institutions which are monitored or prudentially supervised by the central bank, by adding information on the LEI (if this information exists and is available). The NBR submitted to the ESRB, within the requested deadline, the Template on the implementation of Recommendation B – Use of Legal Entity Identifier until the EU legislation under Recommendation ESRB/2020/12 on identifying legal entities is implemented. Ever since the emergence of these standardised codes, the Financial Supervisory Authority has been in favour of their being extensively used by the entities under its supervisory remit: (i) on the capital market, all European legislative packages imposing mandatory reporting obligations (MAR, MiFID II, MiFIR, EMIR, SFTR, MMFR, AIFMD, UCITS etc.) to entities require that they use the LEI as an identifier; (ii) on the insurance market, all insurance companies have an LEI; (iii) in the private pension system, both managers and private pension funds are registered with LEI codes. The Romanian entity issuing LEI codes is the Central Depository.
NCMO Recommendation No. R/6/2021 on supporting green finance	NBR, FSA, Government	The report of the Working Group on supporting green finance was published on the NCMO website (http://www.cnsmro.ro/res/ups/Raport-CNSM-pentru-sprijinirea-finantarii-verzi.pdf) and it was presented to the public during a press conference held on 8 June 2021 (http://www.cnsmro.ro/media/evenimente/raportul-cnsm-pentru-sprijinirea-finantarii-verzi/). **National Bank of Romania (NBR)** As regards prudential regulations, it is worth noting that the EBA published in 2020 the Guidelines on loan origination and monitoring (EBA/GL/2020/06), laying down the requirements for including in credit risk policies the environmental, social and governance (ESG) factors on the financial conditions of borrowers, and in particular the potential impact of environmental factors and climate change with a view to assessing the risks of climate change for the financial performance of borrowers. The Guidelines provisions, including those related to ESG factors, were transposed into the national regulatory framework via NBR Regulation No. 5 of 25 March 2022 amending and supplementing NBR Regulation No. 5/2013

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NCMO recommendation	Addressee	Manner of implementation of the recommendation*
		on prudential requirements for credit institutions and on repealing some legal acts (effective as at 30 March 2022), which was published in Monitorul Oficial al României, Part I, No. 314 of 30 March 2022. The stage of implementation of the four recommendations addressed to the NBR is as follows: 1. Recommendations made by national authorities to the entities in their area of competence regarding the prudent approach to climate risk. The recommendations will cover at least the following areas: (i) governance, (ii) strategy, (iii) risk management, (iv) scenario analysis and stress testing and (v) transparency – this recommendation was fulfilled by the letter the NBR sent to banks and NBFIs with regard to the expectations concerning climate risk management. 2. Conduct an analysis on the appropriateness of easing prudential requirements for green finance, in line with similar concerns at European level, with a view to stimulating this category of lending without affecting financial stability – the first draft of this analysis was published as a "Special Feature" in the December 2021 Financial Stability Report, published on the NBR's website (https://www.bnr.ro/PublicationDocuments.aspx?icid=19968). A study on this topic, which will be published as a working paper, is also currently in preparation. 3. Create a climate risk dashboard for the banking sector, which should be regularly updated and disseminated, conduct annual stress tests on climate risk-related issues and publish the results – recommendation fulfilled. The first edition of the climate risk dashboard was published and can be found at https://www.bnr.ro/PublicationDocuments.aspx?icid=31984. The NBR will resume the stress test in the first part of 2022. 4. Introduce in the NBR's Central Credit Register the information on green loans, starting with the European taxonomy – reporting specifications were completed also by discussions with the banks and the NBFIs. The first reports are expected in June 2022. **Financial Supervisory Authority (FSA)** Due to the complexity of the field of activity on sustainable finance, which involves legislative amendments and changes in business models across all categories of regulated entities in order to incorporate environmental, social and governance risks, the FSA has created a distinct modular structure, organised as a permanent working group (focused) on green transition. The FSA has also published a set of recommendations (https://www.asfromania.ro/uploads/articole/attachments/619e4da11a3a5272469852.pdf), the scope of which is to support entities supervised by the FSA by providing a first set of information on sustainable finance, in particular on the growing importance of sustainability risks, in a global, European and local context that endeavours to support the financing of environmentally sustainable activities in order to transform real economies into long-term sustainable ones. The FSA intends these recommendations to represent best practice principles to be applied by supervised entities in the area of sustainability risks in order to implement the legal requirements for organising business and setting

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		an adequate risk management system. The recommendations are addressed to entities supervised by the FSA, which are also covered by Article 2 of Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector: insurance companies, insurance intermediaries, manufacturers of pension products, investment fund managers, investment firms, providers, financial advisers. **Government** **Ministry of Finance (MF)** *Subrecommendation I-2* During the visits paid by the senior representatives of the three international financial institutions (IFIs) in July 2021, the Ministry of Finance opened the dialogue on stepping-up green finance for the implementation of the second subrecommendation. As a result, the World Bank Group (WBG) organised a virtual mission in November 2021 in order to: (i) identify key partners and all stakeholders expected to play a critical role in mobilising green finance in Romania; (ii) identify green finance in the public and private sectors and (iii) present an action plan for a potential involvement of the WBG. The mission's results were summarised in an *Aide Memoire* sent to the Romanian authorities in December 2021, the recommendations being structured on four levels: national financial institutions, capital market, financial stability, financial intermediaries. Concerns about green finance will also be reflected in other WB documents, for which the MF is consulted as main dialogue partner with the IFIs, such as: the Country Private Sector Diagnostic (CPSD) that will include an analysis of the opportunities and constraints regarding the development of the private sector in Romania and its contribution to the domestic economy, and the Systematic Country Diagnostic, based on which the next Country Partnership Framework 2024-2029 will be developed. The European Bank for Reconstruction and Development (EBRD) submitted its response on 21 December 2021, where it presented the EBRD's operational model, context and results in tackling climate change, with a focus on operations in Romania. In the context of the NRRP, the EBRD will implement the financial instrument for energy efficiency and renewable energy in the residential and buildings sector during the period 2022-2026. In its capacity as the "EU Climate Bank", the European Investment Bank (EIB) is following the roadmap approved in November 2020 on green financing in Member States, including Romania. In 2021, the EIB launched for consultation the Framework on the alignment of counterparties with the objectives of the Paris Agreement, and in this context it will provide technical assistance to borrowers and financial intermediaries on their pathways to align with these objectives. In 2021, the EIB also provided technical assistance to finance climate action in sectors such as transport, waste and wastewater management, rural and urban development. In Romania, between 2022 and 2026, under the NRRP, the EIB Group will implement financial instruments that will contribute to increasing green finance, both through the EIF with guarantee and venture capital instruments and through the EIB with guarantee and direct lending instruments.

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		Subrecommandation I-3 Currently, the Ministry of Finance is taking steps to obtain financing for the purchase of external advisory services regarding the development of the Green Bond Framework. The Ministry of Environment, Water and Forests will provide support, according to its tasks, for the promotion of the legal framework necessary for the establishment of the inter-ministerial collective that will have as main tasks the identification, selection and approval of green expenditures/projects. **General Secretariat of the Government (GSG) through the Department of Sustainable Development (DSD)** In order to increase the transparency and comparability of the data reported by entities falling under the provisions on non-financial reporting (Order No. 1938/2016 of 17 August 2016 on amending and supplementing some accounting regulations and Order No. 1239/2021 of 22 October 2021 amending and supplementing some accounting regulations applicable to economic agents), as well as by other entities which, on a voluntary basis, wish to publish non-financial information, the General Secretariat of the Government through its Department of Sustainable Development initiated the elaboration of the Romanian Sustainability Code (RSC) within the project "Sustainable Romania – Development of the strategic and institutional framework for the implementation of Romania's Sustainable Development Strategy 2030", SIPOCA code 613. The RSC is based on the German Sustainability Code (https://www.deutscher-nachhaltigkeitskodex.de/en-gb/). The reporting will be done via an online platform. So far, for the development of the RSC the following activities have been carried out: - a Memorandum of Understanding signed between the GSG (through its DSD) and the German Council for Sustainable Development in order to facilitate the elaboration of the RSC, following the model of the German Sustainability Code; - the contract for providing consulting services for the development of the RSC was signed; - the following documents were translated, The Sustainability Code and The Guide for the Sustainability Code of the German Council for Sustainable Development (GCSD), and also were the data from the online platform of the GCSD; - the Analysis of the national and EU legislative framework in the field of non-financial reporting was made; - the first draft of the document Methodology on adapting the Sustainability Code to national and/or European elements was drawn-up. The stages of development of the RSC will be published on the website www.romania-durabila.gov.ro. **Ministry of Transport and Infrastructure (MTI)** The MTI set up the MTI working group on supporting the financing of NCMO green projects. As for subrecommendation I.3 from Recommendation NCMO No. R/6/2021 on supporting green finance, it is aimed only at the National Company Administration of the Navigable Canals S.A. (C.N. ACN S.A.) from among all the companies under the MTI.

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NCMO recommendation	Addressee	Manner of implementation of the recommendation*
		Through Address no. 13675/12.07.2021, C.N. ACN S.A. submitted to the MTI the company's actions/projects/ green investment plans, and it also nominated the contact persons for each action/project. As one of the recommendations included in the 2021 NCMO report is the development of a Sovereign Green Bond Framework – which will be constituted as a tool for planning and using the funds made available, mostly by banking institutions, for the implementation of green projects – C.N. ACN S.A. informs that, for some of the green investments envisaged within the company, the financial resources for this purpose have been identified in order to meet the environmental objectives of the European Green Deal. For other matters (in particular those relating to increasing energy efficiency by reducing energy consumption and supplying electricity from renewable sources to the offices), no European funds were identified for which C.N. ACN S.A. could be considered an eligible beneficiary. Given that C.N. ACN S.A. falls into the category of large enterprises with a consumption of up to 1000 toe/year, it does not qualify among the eligible beneficiaries of the Sustainable Development Operational Programme (Programul Operațional pentru Dezvoltare Durabilă – PODD), nor among the eligible beneficiaries of the NRRP for the financing of a project for energy supply from renewable sources. In this context, the opinion of C.N. ACN S.A. is that the purpose of green bonds is to finance projects which contribute to environmental sustainability. Taking into account that the future Sovereign Green Bond Framework sets out the eligibility criteria to identify the projects for green bond financing, C.N. ACN S.A. considers it absolutely necessary for the framework to focus on those beneficiaries who do not fall under the categories of eligible beneficiaries of other non-repayable European financing programmes, in order for them to benefit from much more advantageous funding schemes offered by banking institutions compared to those provided for other types of investment projects. **Ministry of Energy (ME)** *Subrecommendation I-5 – in progress* In 2018, the Ministry of Energy/Directorate-General for Energy Policies conducted a study evaluating the options for implementing a State aid instrument "Contracts for Difference" (CfD), aimed at developing low-carbon investments in the electricity generation sector. The purpose of such a mechanism is to ensure the predictability of income for investors when making investments in low-carbon technologies, with the beneficiaries of the CfD support mechanism safe in the knowledge that they will obtain a certain level of income, which guarantees the recovery of their initial investment. Taking into account the positive impact of the CfD mechanism in EU Member States with a view to promoting investments in technologies using renewable energy sources (RES), the European Bank for Reconstruction and Development (EBRD) expressed its interest in supporting the Ministry of Energy in implementing that particular mechanism by contracting and financing a consultant. Thus, in January 2021, the Directorate-General for European Affairs – Directorate for Energy Policies, Energy Transition and Renewables started a study on the concrete implementation of the CfD mechanism. As part of this

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		project, the EBRD provides technical assistance to the Ministry of Energy through the consultant CMS Cameron McKenna, for the implementation of the Contracts for Difference (CfD) support mechanism, which will be applied in the energy market to low-carbon electricity producers, i.e. renewable sources, storage and nuclear technologies. The study's main objectives are: examining the model of the Romanian energy market which will allow the adoption of the CfD mechanism, preparing the primary and secondary legislation, as well as the rules and requirements necessary for the conduct of the tendering procedure, the counterparty monitoring the CfD and analysing the cost structure necessary for the functioning of the support and technical assistance mechanism required to notify the CfD mechanism to the European Commission. The duration of this project is estimated at approximately 24 months. An online briefing event for stakeholders took place in December 2021 on the topic of the Contracts for Difference (CfD) support mechanism, and it was organised by the Ministry of Energy in cooperation with the European Bank for Reconstruction and Development (EBRD) and the consultant CMS Cameron McKenna. In February 2022, the consultant CMS Cameron McKenna submitted to the CfD Working Group deliverables 5 and 6, namely, the CfD draft law and the CfD contract. In early March 2022, the consultant CMS organised a hybrid working meeting to discuss the comments received from the CfD Working Group. This project is currently in the final phase of its execution period, the last two deliverables being the development of the notification for the European Commission and the analysis of the economic impact. The implementation of the Contracts for Difference (CfD) support mechanism is an important milestone assumed by Romania in the National Recovery and Resilience Plan (NRRP) whereby contracts for difference must be signed for at least 1 500 MW by 2023 Q4, as a result of the first round of competitive procedures/tenders. *Subrecommendation I-6 – completed* Directive (EU) 2019/944 and Regulation (EU) 2019/943 include a number of new principles concerning the functioning of the electricity market, which are aimed at free price formation and increased competition in order to limit market distortions, at the removal of price caps, and at the definition of concepts such as active customers and citizen energy community. Thus, the consumers' active participation will play an essential role in achieving the flexibility necessary to adapt the electricity system to variable and distributed renewable electricity generation. Access to electricity contracts and derivatives, price formation based on demand and supply, as a result of competition, and interventions on energy prices only under the conditions expressly provided for in this Directive, subject to notification to the European Commission, are all elements that ensure a free, competitive market. The entry and the exit of producers and suppliers from the energy market shall be without prejudice to the public service obligation. Given that new European regulations include principles and concepts that are either not found at national legislation level in the field of electricity or are at odds

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		with national legislation provisions, it was deemed necessary to amend and supplement Law No. 123/2012 – The Electricity and Natural Gas Act, Title I – Electricity; this process was achieved by Government Emergency Ordinance No. 143 of 28 December 2021 amending and supplementing Law No. 123/2012 – The Electricity and Natural Gas Act and amending some legal acts. Thus, new provisions were introduced, whereby, in order to facilitate the financing of investments in capacities of electricity generation, a natural or legal person has the right to contract, as producer, under the regulations issued by the Romanian Energy Regulatory Authority, the electricity which will be produced by this new energy capacity, without having, at the time of concluding the contract, the respective license. Furthermore, the above-mentioned natural or legal person, with the exception of holders of electricity generation capacity or electricity and heat generation capacity in cogeneration power plants connected to the electricity grid, and/or of energy storage facilities, with a total power output of less than 1 MW, shall be required to obtain the licence at least 60 days before delivering the electricity produced by this new energy capacity. If the obligation is not fulfilled, the concluded contracts shall be terminated, by applying the contract terms regarding termination by fault of the party who did not comply with its obligation, therefore resulting in failure to produce their effects related to the supply of electricity. In addition, Commission Regulation (EU) 2015/1222 of 24 July 2015 establishing a guideline on capacity allocation and congestion management introduced the concept of nominated electricity market operator (NEMO) designated to perform tasks related to single day-ahead or single intraday coupling (Articles 23 and 43), and of multiple NEMOs (Article 23). *Subrecommendation II-11 – completed for operational support and near completion for investment support* Investment measure I.3 – Developing flexible and high-efficiency gas production capacities for the cogeneration of combined heat and power (CHP) in district heating, with a view to achieving deep decarbonisation, Component C.6 Energy of the National Recovery and Resilience Plan (NRRP). As part of the Investment Measure for the development of flexible and high-efficiency gas production capacities for the cogeneration of combined heat and power (CHP) in urban district heating, projects aimed at achieving/upgrading electricity and heat production units in high-efficiency cogeneration, in urban district heating, using natural gas, prepared for blending with renewable/low carbon gases, including green hydrogen, and hydrogen volume flexible, will be financed through a grant. Thus, on 16 February 2022, the Ministry of Energy launched for public consultation the following documents related to the procedure of call for projects under Investment measure I.3 – Developing flexible and high-efficiency gas production capacities for the cogeneration of combined heat and power (CHP) in district heating, with a view to achieving deep decarbonisation, Component C.6 Energy of the National Recovery and Resilience Plan (NRRP):

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1. The State aid scheme aimed at supporting the development of flexible gas generation capacities for the cogeneration of combined heat and power (CHP) in district heating, notifiable under the Guidelines on State aid for climate, environmental protection and energy 2022.
2. The specific guide to the call for projects which support investments in high-efficiency cogeneration in district heating, related to the notified State aid scheme.

Within this call for projects procedure, which will be launched for the above-mentioned scheme, projects aimed at achieving/upgrading electricity and heat production units in high-efficiency cogeneration, district heating, using natural gas, prepared for blending with renewable/low-carbon gases, including green hydrogen, and flexible in terms of hydrogen volume may be financed by a grant.

The public consultation took place over a period of 10 calendar days, on the website of the Ministry of Energy.

The total estimated budget of the scheme is the equivalent in lei of the amount of EUR 390,000,000, made up of EUR 300,000,000 non-repayable European funds provided via the Recovery and Resilience Mechanism within the National Recovery and Resilience Plan – Component 6 – Energy and EUR 90,000,000 national funds, by applying the 30 percent overcontracting percentage based on the provisions of Article 24 of Government Emergency Order No. 124/2021.

The budget is indicatively broken down per year, as follows:

Year	Budget (EUR)	Budget with overcontracting (EUR)*
2022	80,000,000	104,000,000
2023	110,000,000	143,000,000
2024	110,000,000	143,000,000
Total	**300,000,000**	**390,000,000**

* The budget allocation with overcontracting is indicative, as the Ministry of Energy may decide to limit it.

NOTE: The unused amounts from one year will be carried over to next year. If the submitted projects allow for the amounts of the following years to be used, the budget shall be used in advance. The budget reflects the amounts allocated via the NRRP to which a 30 percent overcontracting percentage is applied pursuant to Article 24 of Government Emergency Order No. 124/2021.

In terms of the allocated budget, the estimated number of State aid beneficiaries under this scheme is approximately six enterprises, and the maximum aid that may be granted for an investment project may not exceed EUR 50,000,000.

Moreover, with regard to the operational support scheme for high-efficiency cogeneration established by Government Decision No. 1215/2009 on setting the criteria and conditions necessary for implementing the support scheme for the promotion of high-efficiency cogeneration based on useful heating demand, in November 2021 Romania notified the amendments to the existing cogeneration scheme, which were approved by the European Commission through Decision C(2021) 9774 final – State aid SA. 57969 (2021/N) – Romania –

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NCMO recommendation	Addressee	Manner of implementation of the recommendation*
		Modification of State Aid N 437/2009 and SA 45976 for promoting high-efficiency cogeneration. Given the situation of electricity and heat producers in high efficiency cogeneration, the beneficiaries of the bonus support scheme - the Romanian authorities, following the approval received from the European Commission by Decision C(2021) 9774 final, decided to extend the period of validity of the bonus support scheme established by Government Decision No 1.215/2009 until 2033. The extension of the scheme was approved via Government Decision No. 409 of 25 March 2022 amending and supplementing Government Decision No. 1215/2009 on setting the criteria and conditions necessary for implementing the support scheme for the promotion of high-efficiency cogeneration based on useful heating demand, as it was published in Monitorul Oficial al României, No. 294 of 25 March 2022). **Ministry of Environment, Water and Forests (MEWF)** *Subrecommandation I-3* Currently, the Ministry of Finance is taking steps to obtain financing for the purchase of external advisory services regarding the development of the Green Bond Framework. The Ministry of Environment, Water and Forests will provide support, according to its tasks, for the promotion of the legal framework necessary for the establishment of the inter-ministerial collective that will have as main tasks the identification, selection and approval of green expenditures/projects. *Subrecommandation III-14 and III-15* The Ministry of Environment, Water and Forests will provide the necessary support within the non-financial reporting mechanism, which will be achieved via an online platform for environmental information, within the project implemented by the GSG through DSD – SIPOCA 613: "Sustainable Romania – Development of the strategic and institutional framework for the implementation of Romania's Sustainable Development Strategy 2030 (SNDDR 2030)" that spans until July 2023, and one of its specific objectives is to establish the Romanian Sustainability Code (RSC). So far, the DSD has covered several project activities concerning the RSC objective. *Subrecommandation III-16* The Ministry of Environment, Water and Forests provided support to the General Secretariat of the Government in developing the draft Government Decision on the establishment, organisation and functioning of the Interinstitutional Committee on Climate Change, which is currently under external approval procedure. The main objectives of this Committee are the strategic coordination of policy-making in the sectors that have an impact on climate change, in line with the commitments made at national level to the European Union, the United Nations and other international organisations of which Romania is a member, as well as the monitoring of the progress made by the Romanian institutions in implementing said policies. Furthermore, the Ministry of Environment, Water and Forests (MEWF) is reviewing the Climate Change Strategy in terms of both its adaptation and mitigation components. As for the adaptation component, the revision of the Strategy and the development of a new National Action Plan to implement the former

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NCMO recommendation	Addressee	Manner of implementation of the recommendation*
		during 2021-2030 are carried out under the project "Strengthening institutional capacity to improve climate change policies and adapt to climate change effects". This project is implemented by MEWF as leading ministry, in partnership with the National Environmental Protection Agency (NEPA), the National Environmental Guard (NEG), the National Agency for Protected Natural Areas (NAPNA) and the University of Bucharest. The project has included consultation activities with all stakeholders, and over the next period various briefing and consultation activities will be carried out both at the level of public and private institutions, of non-governmental organisations, as well as at civil society level. At the same time, in October 2021, the Ministry of Energy and the Ministry of Environment, Water and Forests, with the support of the European Commission via the Directorate-General for Structural Reform Support (DG Reform) completed the contracting procedure to update the Integrated National Energy and Climate Change Plan (INECCP) and to develop "Romania's long-term strategy for reducing greenhouse gas emissions" (LTS), in line with the provisions of Regulation (EU) 2018/1999 on the Governance of the Energy Union. The goal achieved by updating and preparing the above-mentioned strategic documents is to reflect the EU's climate ambition of achieving climate-neutrality by 2050, with an intermediate target of reducing emissions by 55 percent by 2030 as compared to 1990. Following the developments in work and consultations under the above -mentioned process, the MEWF will provide strategic guidelines for the most pressing environmental and climate issues. **Ministry of Investments and European Projects (MIEP)** *Subrecommendation II-8* Achieving the climate objectives is essential in the successful implementation of the programmes for Cohesion Policy in the financial period 2021 – 2027. Thus, pursuant to Regulation (EU) 2021/1060 laying down common provisions, which governs cohesion policy funds, Member States and the European Commission ensure that environmental protection, resource efficiency, climate change mitigation and adaptation, disaster resilience, risk prevention and management requirements are promoted both in the development and in the implementation of specific programming documents, and also in the actual implementation of this policy. To this end, at least 30 percent of the national ERDF allocation (approximately 5.4 billion) and 37 percent (around 1.3 billion) of the national CF allocation is dedicated to goals focused on climate change. Support for climate change objectives shall be established on the basis of a specific methodology set at European level, which shall in turn be based on categories of intervention, on areas of concentration or on measures, where applicable, for each of the Cohesion Funds. The operational programmes containing investments which target climate change objectives are the following: Sustainable Development Operational Programme (Programul Operațional Dezvoltare Durabilă - PODD), Transport Operational Programme (Programul Operațional Transport - POT), Just Transition Operational Programme (Programul Operațional Tranziție Justă – POTJ), Inclusion

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NCMO recommendation	Addressee	Manner of implementation of the recommendation*
		and Social Dignity Operational Programme (Programul Operațional Incluziune și Demnitate Socială – POIDS), Intelligent Growth Operational Programme, Digitalisation and Financial Instruments (Programul Operațional Creștere Inteligentă, Digitalizare și Instrumente Financiare – POCIDIF) and the eight Regional Operational Programmes (ROP). The European Green Deal presented in December 2019 set the way for a new sustainable growth policy for Europe. In line with the EU's objective of achieving climate neutrality by 2050 in an efficient and fair manner, the European Green Deal proposed the Just Transition Mechanism (JTM). It will be focused on supporting the most affected regions and sectors, taking into account their dependence on fossil fuels. One of the three pillars of the Just Transition Mechanism is the Just Transition Fund (JTF), presented in January 2020. Through selected interventions, the POTJ shall promote the economic diversification of the most affected territories, along with retraining measures and the active inclusion of workers and job seekers, and it will also support the industrial processes' transformation which is necessary for the transition to a neutral economy and for maintaining or increasing the number of jobs in these fields. At NRRP level, the green transition is supported through reforms and investments in green technologies and capacities, including biodiversity, energy efficiency, building renovation and the circular economy, while contributing to the Union's climate goals, promoting sustainable growth and maintaining energy security. Regarding the launch of calls for projects, the managing authorities are starting the procedure in compliance with the provisions of European regulations, respectively the management and control procedures approved by the Audit Authority. Specifically, the managing authorities are publishing in consultation the draft guides for the applicant, the launch calendar, the lists of approved projects/signed contracts, the lists of payments made and methodologies, etc. **Ministry of Economy (Industrial Policy and Competitiveness Department)** *Subrecommendation II.7 – in progress* Within the Industrial Policy and Competitiveness Department of the Ministry of Economy, the 2021-2027 National Competitiveness Strategy (NCS) is being developed under the SIPOCA 605 project – "Increase in the administrative capacity of the Ministry of Economy for monitoring, assessing and coordinating public policies in the field of economic competitiveness". Following NCMO Recommendation No. R/6/2021 on supporting green finance, Measure II.7 – "Develop an industrial policy focusing on the climate change agenda, phased in annually until 2025, in correlation with the European Commission's A New Industrial Strategy for Europe, which targets two areas: green transition and digitalisation. The industrial policy should also include solutions for the relocation of global production chains linked to climate change, from abroad to Romania", the new *National Competitiveness Strategy* (2021-2027 NCS), currently under development, takes into account the climate change agenda and Europe's New Industrial Strategy focusing on the two areas: green transition and digitalisation. It is also envisaged to introduce references

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NCMO recommendation	Addressee	Manner of implementation of the recommendation*
		regarding solutions for the relocation of global production chains linked to climate change, from abroad to Romania. The deadline for the completion of the 2021-2027 NCS is November 2022, when Measure II. 7 of NCMO Recommendation No. R/6/2021 on supporting green finance is fulfilled as well. **Ministry of Entrepreneurship and Tourism (MET)** At end-December 2021, the Ministry of Entrepreneurship and Tourism (MET) and the Ministry of Economy were set up. Based on the powers set forth in Government Decision No. 1327/2021 on the establishment of the MET, the Ministry took over only measures 8, 9, 15 of NCMO Recommendation No. R/6/2021 on supporting green finance. *Subrecommendation II-8* As for subrecommendation 8 to "assign markedly higher scores in any support scheme provided by the authorities (state aid, guarantees from loan guarantee funds, financing through EU funds, promotion of investment, exports, etc.) to firms that make an important contribution to the climate change agenda", in preparing new financial support schemes from government budget of local SMEs (such as StartUp Nation Romania), the MET envisages providing higher scores for SMEs' contribution to achieving climate change objectives, consistent with the 2015 Paris Agreement. *Subrecommendation II-9* With a view to implementing subrecommendation 9 to "elaborate and publish a methodology for identifying companies with domestic capital that competitively produce goods and services related to green sectors; prepare, regularly update and publish the list of the companies identified using that methodology; engage Romania's diplomatic and commercial representatives from abroad in promoting the companies on this list", the MET has so far carried out preliminary research work in the field of green economy: • Since there is no unanimously accepted definition at international level, according to MET, the concept of "green economy" usually translates into a sustainable economy where environmental risks and constraints are mitigated (low-carbon emissions, resource efficiency, social inclusion, etc.). • The Ministry of Environment, Water and Forests (MEWF) specified in the "National Strategy on Climate Change and Low Carbon Growth for 2016-2020" the so-called "green sectors" of the national economy. The MET covers the SMEs that are active in the following green sectors: industry, waste and wastewater management. • In developing a methodology for identifying companies producing goods/services in the above-mentioned sectors, the MET considers that all firms, regardless of the form of equity ownership, not only domestic ones, should be taken into consideration. • Therefore, as well as in relation to the implementation of subrecommendation 15, the MET envisages to set up a working group encompassing relevant public institutions and private organisations (e.g. the Ministry of Economy, the MEWF, the National Trade Register Office, sectoral employers' organisations, environmental NGOs, SMEs).

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NCMO recommendation	Addressee	Manner of implementation of the recommendation*
		• After establishing the methodology, the MET will publish on its website and regularly update the list of identified firms. *Subrecommendation III-15* As regards subrecommendation 15 to "encourage non-financial reporting by the SMEs via: (i) the publication of a simplified reporting template, (ii) the digitalisation of reports and (iii) the allocation of funds to increase the reporting capacity of SMEs, including by compiling guidelines; set up an automated framework for monitoring the reporting of the non-financial statements", the MET specifies that: • Strictly in light of the powers provided by the law, the Ministry considers that the measure of non-financial reporting by SMEs of environmental aspects could have a negative impact (currently non-quantifiable but potentially significant especially in the current context of the COVID-19 pandemic and the global turmoil) particularly on micro- and small-sized enterprises, as it would be a new administrative burden reflected by higher compliance costs and more bureaucracy in the SMEs sector. Therefore, the Think Small First principle set out in the *Small Business Act* would be completely ignored. • Hence, the Ministry proposes the above-mentioned working group to investigate the position of SMEs' officials (e.g. the SMEs National Council in Romania, sectoral employers' organisations, professional associations) and make a preliminary regulatory impact assessment (as the EU's Regulatory Impact Assessment) on extending to SMEs the obligation of non-financial reporting.
NCMO Recommendation No. R/7/2021 on the countercyclical capital buffer in Romania	NBR	The NBR implemented the NCMO recommendation on maintaining the countercyclical capital buffer rate at 0.5 percent by issuing NBR Order No. 6/2022 amending NBR Order No. 12/2015 on the capital conservation buffer and the countercyclical capital buffer (published in *Monitorul Oficial al României*, Part I, No. 1130 of 26 November 2021).
NCMO Recommendation No. R/8/2021 on the capital buffer for other systemically important institutions in Romania	NBR	The NBR implemented the NCMO recommendation by issuing NBR Order No. 7 of 26 November 2021 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. 1174 of 13 December 2021.
NCMO Recommendation No. R/9/2021 on the countercyclical capital buffer in Romania	NBR	The NBR implemented the NCMO recommendation on maintaining the countercyclical capital buffer rate at 0.5 percent by issuing NBR Order No. 6/2022 amending NBR Order No. 12/2015 on the capital conservation buffer and the countercyclical capital buffer (published in Monitorul Oficial al României, Part I, No. 1130 of 26 November 2021).

*) The section "Manner of implementation of the recommendation" includes the full contributions submitted by the addressees of the NCMO recommendations.

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
EAGF	European Agricultural Guarantee Fund
EBA	European Banking Authority
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECB	European Central Bank
EEA	European Economic Area
EIB	European Investment Bank
EIOPA	European Insurance and Occupational Pensions Authority
ESRB	European Systemic Risk Board
EU	European Union
Eurostat	Statistical Office of the European Communities
FDI	Foreign direct investment
FSA	Financial Supervisory Authority
GDP	Gross domestic product
GEO	Government Emergency Ordinance
G-SII	Global Systemically Important Institutions
IFRS	International Financial Reporting Standards
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
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
O-SII	Other Systemically Important Institutions
ROA	Return on assets
ROBOR	Romanian Interbank Offered Rate
ROE	Return on equity
SEK	Swedish krona
SMEs	Small and medium-sized enterprises
SyRB	Systemic Risk Buffer
VAT	Value Added Tax

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