Box 5. Structural developments in the banking sector in Romania

The Romanian banking sector further holds a prevailing position in the local financial system in terms of both assets (75 percent of total assets) and financing provided to the private sector (nearly 90 percent of total funds, December 2017) and to the general government (cumulating three quarters of the government securities held system-wide). The development of financial technological innovation favoured the emergence of a fairly large number of competitors on the credit and financial services markets; however, these competitors[1] did not succeed in gaining a significant share of these markets.

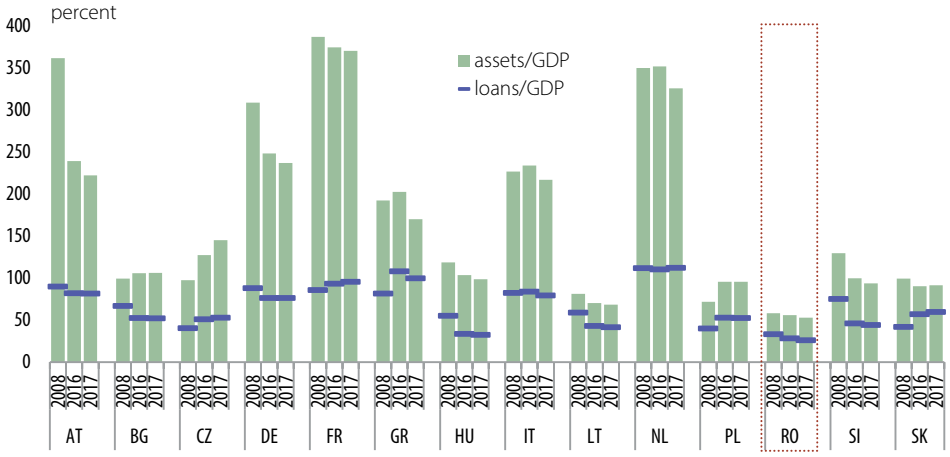


Chart A
Financial intermediation, international comparisons

Source: NBR, ECB

The Romanian banking sector is small as compared to those of the other Member States, recording the lowest shares in GDP of bank assets (53.6 percent, December 2017) and loans (27.1 percent) at EU level (Chart A). The gap has widened over the recent years, as the economic growth pace steadily exceeded that of banking activity, and the convergence process appears to be a lasting one.

In Romania, the degree of banking market concentration is relatively low, a stronger increase being visible on the deposits side. In terms of assets, the values of the Herfindahl-Hirschman (HHI) index and the market share of the top five credit institutions (Table A) are below the EU median[2].

The swift increase in credit institutions' balance sheets in the pre-crisis period (2006-2008) was not accompanied by corresponding rises in efficiency. The subsequent development of those institutions was severely affected by the economic corrections that occurred starting with 2008 Q4. Given the sharp contraction in consumption amid the halt in capital inflows, the change in market liquidity conditions, the increase in global risk aversion and the additional

1 These institutions are included in the following categories: (i) NBFIs; (ii) payment institutions; (iii) electronic money institutions; (iv) entities that notify directly, according to the European passport, their intention to provide services in the territory of Romania; and (v) FinTech companies.

2 In EU countries, the HHI is of approximately 1,000 and the market share of the top five banks stands at 63 percent.

pressures generated by the domestic currency depreciation, credit institutions accumulated considerable stocks of non-performing loans in their balance sheets, which weighed on their capital level and their capacity to continue financing the real sector. The shift in lending towards low risk items (in the period from 2009 to 2014) as well as the increase in operational efficiency helped them preserve their level of capital in a period marked by the rise in credit risk provisions to levels that largely eroded the operating profit. In order to prevent any repercussions on financial stability, the NBR recommended credit institutions to adopt proactive measures on the recognition of losses through the adequate coverage of non-performing loans by provisions. In addition, the implementation of macroprudential measures that resulted in higher capital requirements contributed to enhancing credit institutions' capacity to withstand adverse macroeconomic developments, as shown by stress tests.

Table A
Structural indicators of the Romanian banking system

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
No. of credit institutions	43	42	42	41	40	40	40	36	37	35
No. of credit institutions with majority private capital	41	40	40	39	38	38	38	34	35	33
No. of credit institutions with majority foreign capital, *of which*:	37	35	35	34	34	34	34	30	32	29
foreign bank branches	10	10	9	8	8	9	9	7	8	7
Share of top five banks in total assets (%)	56.2	54.3	54.1	54.3	54.8	54.9	54.8	58.1	59.1	58.8
Share of top five banks in total loans to the private sector (%)	55.0	55.8	54.7	54.6	55.5	55.6	55.1	58.3	58.4	57.9
Share of top five banks in total deposits from the private sector (%)	63.2	61.3	62.0	63.2	61.7	60.9	60.1	62.4	60.7	61.6
HHI, assets (points)	994	928	931	861	849	831	811	876	904	915
HHI, loans (points)	902	901	870	864	863	827	789	860	866	874
HHI, deposits (points)	1,080	1,006	999	1,001	944	912	911	959	949	964
Number of employees (thou.)	71.6	67.9	66.8	65.8	61.8	58.6	57.7	55.9	55.4	55.0
Number of units (thou.)	7.3	7.1	6.9	6.8	6.5	6.2	6.0	5.7	5.5	5.3

In addition, credit institutions had to resize both their branch network (down by 2 thousand units over the last 10 years to 5.3 thousand units at end-2017) and the number of employees (down from 71.6 thousand in 2008 to 55.0 thousand in 2017, Table A), in line with the new dimension of the banking activity, as well as for reasons related to cost reduction and the expansion of the distribution channel through digitalisation. The pace of adjustment was more moderate over the past two years. The contraction trend of the two structural components (number of units and number of employees) has been in line with international developments.

With regard to mergers and acquisitions, the post-2008 events caused a drop in the number of credit institutions, i.e. down from 43 in 2008 to 35 in 2017, and produced shifts in the ranking of credit institutions by market share and the country of origin of the majority capital. This process is likely to step up, considering the stronger competition, the high costs of staying in the market, as well as the group-level decisions to exit from certain markets.

The Romanian banking sector has several major structural features, namely:

(i) There is high diversity as concerns the country of origin of the majority capital. In addition to banks with domestic capital, credit institutions from other 12 countries (as at December 2017) operate in the Romanian market, of which eight are from the euro area, three are from non-euro area European countries and one is from a third country. Credit institutions with foreign capital hold nearly 78 percent of total bank assets (gross). Banks with Austrian capital come in first, with 25 percent of aggregate assets, ahead of banks with French and Dutch capital (with a share of 13 percent each) and banks with Italian capital (10 percent). Banks with Greek capital further hold a significant share, i.e. 9 percent (December 2017), but the prospects point to a reduction, as three out of the four institutions in this group are currently undergoing different takeover stages. The five euro area countries account for almost 60 percent of the total number of credit institutions, thus making the local banking sector highly sensitive to developments in these countries. In December 2017, the group of banks with fully or majority Romanian capital held a market share of 22 percent (calculated based on gross assets).

(ii) The degree of fragmentation is high, nearly half of credit institutions being small[3], with a cumulative market share of 5 percent of aggregate assets. The weaknesses in the balance sheets of these banks and the high costs associated with accommodating legislative changes and staying in the market, on the one hand, and the strong correlation between the market share of credit institutions and the measures of banking performance, on the other hand, suggest that there is significant room for banking sector consolidation. The share of large banks remained higher than 66 percent of assets over the past two years and is seen to head upwards.

(iii) Credit institutions are universal, except a small number of specialised banks that account for less than 2 percent of aggregate assets and are involved in housing-related activities, provide SME financing, support exports, grant auto loans.

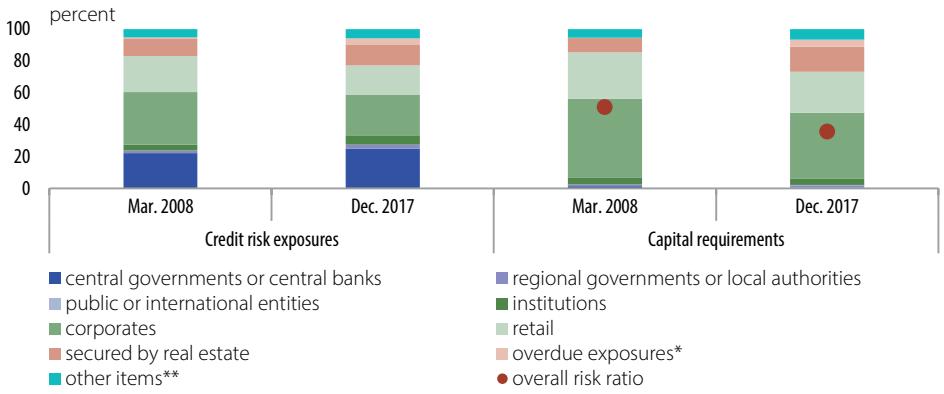
(iv) Financing is mainly ensured by taking retail deposits. After the financial crisis, credit institutions' reliance on foreign funding (particularly on medium- and long-term loans from parent banks) saw a decline, inter alia as a result of the change in lending strategy and the shift to leu-denominated loans.

(v) Banks shifted their focus to classes of exposures generating lower prudential requirements. The changes in banks' balance sheets seen starting with 2008 also influenced the structure of capital requirements, favouring high solvency and, implicitly, the release of resources for lending purposes. Credit risk further had a prevailing contribution to capital requirements (81.5 percent, December 2017), due to banks' traditional business models focused on lending and deposit-taking. The last 10 years witnessed an increase particularly in the class of exposures to central governments and central banks (up 68 percent in the period from March 2008 to December 2017). The rise in exposures to the central government offset the drop in the minimum reserve requirements

[3] Small banks have a share below 1 percent of total assets, medium-sized banks a share between 1 and 5 percent and large banks a share of over 5 percent.

(exposures to the central bank), allowing credit institutions to increase their assets without the need for capital allocation and also ensuring appropriate liquidity ratios. Despite the significant role of these exposures in maintaining adequate bank prudential indicators, the excessive reliance on such assets poses a notable concentration risk, given that a potentially higher sovereign risk also mirrored by the funding costs of credit institutions could not feed through to fixed-income assets until they matured. Assuming that credit institutions held these instruments in their trading book, potential losses would have an accelerated impact on the capital of credit institutions. The global interest rate normalisation trend will put pressure on credit institutions' capacity to generate profit through holdings of such instruments.

Moreover, credit institutions focused on granting housing loans, due to the low capital costs associated with this type of portfolio, also a result of the "First Home" government programme. Therefore, the share of exposures to this segment went up, while that of exposures to corporates dropped to a larger extent as compared with the retail exposures (Chart B). As a result of the change in lending strategies, the overall risk ratio[4] shrank over the past decade from 50.7 percent in 2008 to 35.7 percent in 2017. As for the share in the structure of capital requirements, exposures to corporates made the largest contribution, i.e. 50 percent in 2008 and 41.4 percent in 2017.



*) in the standardised approach to credit risk

**) they include exposures such as: (i) items associated to an extremely high risk; (ii) covered bonds; (iii) short-term claims on institutions and companies; (iv) claims in the form of UCITS; (v) exposures from capital securities; (vi) other items (holding the largest share in this sub-category)

Chart B
Composition of credit risk exposures and of capital requirements

The structure of own funds is a positive feature of the Romanian banking sector. Total own funds consist mostly of Tier 1 capital (89.3 percent in December 2017 versus 92.3 percent in December 2012), whereas the contribution of subordinate debt has remained relatively low. In addition, after the implementation of prudential filters in 2014, once the IFRS standards were introduced as an accounting basis, solvency indicators witnessed a gradual increase, the effects of filters being fully phased out at end-2017.

4 Defined as the ratio of risk-weighted assets to exposures.

(vi) The issue of non-performing loans has been addressed. Started in 2014, the resolution of non-performing loans helped reduce the NPL ratio from 21.5 percent in September 2014 to 6.4 percent in December 2017. Balance sheet clean-up should continue, given the need for alignment to the lower values specific to EU countries. This is a priority for banks in Romania and at EU level. To this end, the NCMO recommended that a systemic risk buffer should be implemented starting with mid-2018, using the non-performing loan ratio and the coverage ratio as differentiating criteria. On the other hand, the European institutions (the European Commission, the European Central Bank and the European Banking Authority) initiated a number of measures concerning non-performing loans, such as issuing guidelines on non-performing loan management, putting in place trading platforms for non-performing loans to help develop a secondary market, issuing guidelines for the setting-up of national asset management companies, comparing the efficiency of the national regimes for loan foreclosure and for the higher NPL coverage by provisions, respectively.