Box 7. New trends in banking activity in a pandemic context – outlook and risk implications

The COVID-19 pandemic affected people's day-to-day activities fundamentally and, in some cases, irreversibly. The banking sector had to adapt and quickly respond to new challenges through (i) the fast implementation of remote working for the employees who could perform their tasks without being physically present at the bank branches; (ii) the limitation of contact with the customers at the bank branches, the reorganisation of activity in order to comply with the public health rules in force; (iii) the notable digital transformation of bank products and services, which was also accelerated amid the competition from the FinTech/BigTech sector. Despite the temporary nature of some of these measures, a series of changes became permanent, and banks thus had to change their business strategy or make faster adjustments in the working environment, in order to adapt to the new customer needs and to the market conditions altered by the COVID-19 pandemic. The progress in digitalisation may be spurred further, *inter alia* through the EU parent banks' efforts to improve efficiency, the subsidiaries of which are the main banking players in Romania. However, digital transformation in Romania will most likely be less visible than in other European countries, as Romania features a large disparity between urban and rural areas, a low level of financial literacy, a trend of population ageing, and the lowest degree of digital society development[1] in the EU. Specifically, banks in Romania are expected to maintain, in the near future, an adequate mix of digital services and the face-to-face advisory services in the territorial units, in order to best accommodate customer demand and expectations.

Digital payments, digital fingerprint authentication and online banking services for granting new products (loans included) are only some of the changes that have gained ground in the recent period, aiming to improve the banking experience of customers and better meet their needs, as well as to increase the efficiency of banking activity based on careful cost management. Significant investments were necessary to run these adaptation and improvement processes from a digital perspective. According to an NBR survey[2], digitalisation expenses in 2017-2020 amounted to approximately lei 2.44 billion at the aggregate level of respondent banks, being particularly related to technological innovation projects, almost three quarters of which focused on customer relations. The budgeted digitalisation expenses accounted for around 50 percent of total such expenses recorded in the previous four years, confirming the significant pick-up in digital transformation, *inter alia* in terms of internal reorganisation of work and staff retraining. The NBR also took these developments into consideration, via the recent amendments to the legislative framework[3], which focus on the need to ensure the use of technological innovation and the adequate management of risks inherent to the lending activity.

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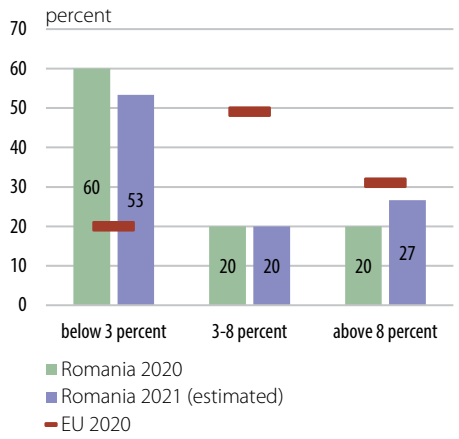
1 According to the *Digital Economy and Society Index* (DESI) 2021, published on the European Commission's website, Romania comes in last of all EU countries as regards the level of digitalisation.

2 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).

3 Amendments to NBR Regulation No. 5/2013 on prudential requirements for credit institutions, based on EBA Guidelines on loan origination and monitoring (EBA/GL/2020/06).



Source: NBR Survey, ESRB (*Reports of the Advisory Scientific Committee*, No. 12, 2022)

Chart A
Bank distribution by ratio of IT costs to total operating income – Romania versus EU

The gap between Romania and the EU as regards the digital potential and investment is confirmed by the differences in the ratio of IT costs to total operating income (Chart A). Most respondent banks in Romania (60 percent of total in 2020 and 53 percent in 2021) invested in digitalisation less than 3 percent of their operating income. Conversely, at European level, only 20 percent of banks reported IT costs below 3 percent. In Europe, the stronger propensity for digitalisation translates into a higher share of EU banks that allocate over 3 percent of their operating income to cover digitalisation expenses.

As regards the anticipated effects of digitalisation expenses, the respondent banks in Romania expect increases in assets and the number of customers (individuals, in particular), as well as an improvement in operational efficiency, with small externalities related to operational risk losses. Specifically: (i) three quarters of respondent banks estimated an annual growth of up to 10 percent in the number of customers (both individuals and legal entities) in the year after investments in digitalisation were made; (ii) all banks expect asset increases; (iii) around 70 percent of respondents consider the volume of operational risk losses will decline by up to 10 percent.

In the EU, the large-scale digital transition is a key priority for economic recovery, the European Commission establishing the Union's digital targets for 2030 in several areas. From an economic perspective, the objective is to foster EU innovation and competitiveness in the financial sector, while also ensuring consumer protection and financial stability, similar aspects being presented in the digital finance package[4], adopted by the European Commission in September 2020. Moreover, in July 2021, the ECB decided to launch a digital euro investigation project and carry out further analysis in 2022 to establish the implications of this initiative and take a decision.

All European initiatives can produce significant digital changes in the financial markets. The fact that banking sectors need to adapt to the new realities (*inter alia* by acknowledging the increased competition) shows their digital transformation will continue in the period ahead as well, also at the level of local markets.

There are also concerns about the way in which digitalisation can change future bank services, the risks associated with this transformation (operational risk, especially in terms of cyber risk) evolving continuously. These concerns are manifest at national and European level. Specifically, since the outbreak of the war in Ukraine, cyber risk has been assessed as very high, while at European level, there are concerns over how to increase the cyber resilience of the financial system and to develop related stress tests. In this context, the banking sector needs to make efforts to achieve resilient digital development with regard to the operational risk, in order to prevent the rise in risks to financial stability.

[4] Source: https://www.consilium.europa.eu/en/policies/digital-finance/