

FINANCIAL SECTOR ASSESSMENT PROGRAM

ROMANIA

FINANCIAL INTERMEDIATION

TECHNICAL NOTE

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This Technical Note was prepared in the context of a joint IMF-World Bank Financial Sector Assessment Program (FSAP) mission in Romania during October 31–November 21, 2017, and January 11–23, 2018 led by Erlend Nier, IMF and Laurent Gonnet, World Bank, and overseen by the Monetary and Capital Markets Department, IMF, and the Finance, Competitiveness and Innovation Global Practice, World Bank. The note contains the technical analysis and detailed information underpinning the FSAP assessment’s findings and recommendations. Further information on the FSAP program can be found at www.worldbank.org/fsap.



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FINANCE, COMPETITIVENESS & INNOVATION GLOBAL PRACTICE

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Glossary

Alternative Dispute Resolution	ADR
Bank for International Settlements	BIS
Cadastre and Real Estate Publicity Office	ANCPI
Capital Adequacy Ratio	CAR
Credit Bureau	CB
Central Credit Registry	CCR
Compound Annual Growth Rate	CAGR
Electronic Archive for Security Interests in Movable Property	AEGRM
European Commission	EC
European Investment Bank	EIB
European Investment Fund	EIF
European Structural and Investment Funds	ESIF
European Union	EU
Financial Sector Assessment Program	FSAP
Financial Supervisory Authority	ASF
Gross Domestic Product	GDP
Group for the Assessment of the Economic Impact of Normative Acts on SMEs	GEIEAN
Initial Public Offerings	IPO
International Monetary Fund	IMF
Micro, Small and Medium-sized Enterprise	MSME
Ministry for Agriculture and Rural Development	MoARD
Ministry of Business Environment, Trade, Industry and Entrepreneurship	MBETE
Ministry of Economy	MoE
Ministry of Justice	MoJ
Ministry of Public Finance	MoPF
National Bank of Romania	NBR
The National Agency for Cadastre and Real Estate Advertising	ANCPI
National Authority for Consumer Protection	ANPC
National Credit Guarantee Fund for SMEs	FNGCIMM
North Atlantic Treaty Organization	NATO
Non-banking Financial Institution	NBFI
Non-Financial Corporation	NFC
Non-Performing Loan	NPL
Posta Romana	PR
Purchasing Power Parity	PPP
Romanian Counter-Guarantee Fund	FRC
Romanian Leu	RON
Utilized Agricultural Area	UAA
World Trade Organization	WTO

I. Introduction

Financial intermediation is a dynamic equilibrium influenced by several structural and cyclical factors affecting supply and demand of financial products, in particular credits and deposits. The objective of the technical note is to analyze the factors at play explaining the relatively low and declining level of financial intermediation, both regarding the household and the corporate segment in Romania and offer policy recommendations to support sustainable enhancement of financial intermediation.

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The information in the note is based on interviews with stakeholders held during two missions (November 2017, January 2018), data provided by the National Bank of Romania and other sources, publicly available information, relevant laws and regulations, World Bank research, and 2 bank questionnaires. Where possible, comparisons are made with regional peers and income peers. The 4 peer countries consistently used throughout the analysis are: Bulgaria, Croatia, Hungary, and Poland.

The note explores the determinants of financial intermediation under five lenses: a) contextual factors, b) demand for credit by the real economy, c) supply of credit by intermediaries, mostly through banks as the main financial intermediary, d) public intervention schemes, and e) financial infrastructure. Each one of these factors can fundamentally shift the dynamics on financial intermediation.

II. Executive Summary

1. Banking financial intermediation relative to the economy is low and declining. The depth of the Romanian banking sector is lagging both in terms of deposit and loan penetration. Cross-cutting factors such as poverty, rurality and informality form a set of constraints that still persist affecting both financial inclusion and intermediation. On the demand side, credit needs remain limited due to low enterprise density, poor health of enterprises, especially micro-enterprises, relatively high number of foreign owned firms, and increasing use of other forms of financing. Furthermore, while economic growth had a positive spillover, this did not translate into a commensurate increase in corporate investment activity. On the supply side, banks have been adversely affected by high Non-Performing Loans (NPLs) and deleveraging pressures. Gaps in access to finance persist, especially for micro, small and medium-sized enterprises (MSMEs), start-ups, and in rural areas. The emergence of banks with niche market positioning could reverse the disintermediation trend, but should be aided by measures to improve the health, performance, and skills of enterprises. Macroprudential measures to protect against excessive sovereign exposures could also, at the margin, support financial intermediation.

2. Financial inclusion is lagging. Low intermediation is also the result of low and decreasing financial inclusion, exacerbated by a thin and declining bank branch network, especially in rural areas. Although the recent law introducing zero fee accounts for about 50 percent of the population is expected to enhance inclusion, it may also have adverse effects such as higher costs for other consumers, and/or the acceleration of banks' retrenchment from rural areas. Improving financial inclusion requires a strategic approach including broader solutions such as i) a better use of the Posta Romana network of branches, ii) enhanced role of credit unions but within a stronger supervisory framework, iii) the adoption of incentive mechanisms to accelerate the expansion of digital finance solutions and iii) the promotion of financial literacy and effective consumer protection mechanisms.

3. While financial infrastructure supporting credit intermediation is generally effective, there are some needed improvements. The legal framework for insolvency and secured collateral registry is considered best practice although enforcement of secured claims could be streamlined and the regulatory framework for commodity collateralized lending should be strengthened. The credit information system, based on the Central Credit Registry and a private Credit Bureau is effective but there are significant gaps in the coverage. A multi-stakeholder committee tasked with enhancing the reach and quality of credit reporting should be formed to address the deficiencies identified to support both access to finance for enterprises and financial inclusion for underserved segments.

4. Closing these financial sector development gaps would require clear development policies and an efficient coordination mechanism. Many public initiatives support access to finance for enterprises and financial inclusion but are too fragmented and lack efficiency. It is necessary to adopt a holistic view by encompassing all state institutions and initiatives, eliminating duplications, identifying all market gaps and leveraging commercial finance. The authorities should consider establishing a Financial Sector Development Committee with a clear development mandate, an effective monitoring and evaluation system and accountability mechanism.

III. Table of Recommendations

	Recommendations	Agency	Time
1	Introduce a capital buffer to mitigate excessive exposure of banks on sovereign	NBR	NT
2	Develop a greater range of available financial services under the banking agent statute through Posta Romana. This would also necessitate a restructuring strategy for PR to achieve financial sustainability	MoCIS, MoPF, NBR	NT
3	Provide incentives for the usage of digital payment solutions e.g. by awards to buyers and merchants (through lottery), or merchants' tax cuts based on the volume of card and mobile phone transactions	NBR, MoPF	I
4	Undertake a cost-benefit analysis related to the further development of the credit union sector including reviewing the regulatory and supervisory framework	NBR	NT
5	Strengthen the monitoring of bank agents (e.g. via a register), which would also highlight areas of regulatory focus for the future	NBR	I
6	Catalogue the financial education initiatives undertaken by all stakeholders	NBR	I
7	Prepare a national strategy for financial inclusion, which is well-coordinated, robustly monitored, and evaluated and reflecting all stake-holders to address lagging financial inclusion, especially in rural areas. The strategy should reflect a digital approach ¹ and include a financial education component, which is targeted and informed by a baseline household financial capability survey	NBR, MoPF	NT
8	Adopt national legislation corresponding to Regulation No 924/2009	MoE, MoPF	I
9	Investigate potential reforms of government policies to improve access to finance for rural areas and agriculture particularly focusing on small holders and also longer-term investments that could transform agriculture towards higher tech and higher value add.	MoARD, MoPF, NBR	I
10	Enforce Law 72/2013;	MoPF	NT
11	Increase the predictability of business environment through a more systematic approach to proposing regulatory changes through conducting and publishing the SME test (as part of a regulatory impact assessment) for any initiative which impacts the private sector;	MBETE	I
12	Increase financial and business education programs (e.g. by linking grants to technical assistance, as well as considering a one-stop-shop for SMEs);	MBETE	NT
13	Incentivize firms to perform audits by recognized firms and improve corporate governance (especially medium and large firms)	MBETE	NT
14	Undertake an assessment of undercapitalized firms (including how many of them are actively operating; qualify as insolvent; have been declared insolvent; are viable and should be encouraged to continue operating; how many are non-viable and should be	NBR	I

¹ Common elements typically include: Basic low-cost bank account with simplified account opening procedures; e-money is available as an option, agent based models, financial literacy campaigns, digitization of government payments; remittances and agriculture related payments reaching the rural areas, some regulatory requirements / subventions for expanding in rural areas: no permission needed for opening branches in rural areas; matching requirement of opening one branch in rural area for every new one opened in urban areas etc., fund established to compensate for expanding in rural areas, Other financial services products: credit, insurance and pensions designed for rural customers.

	liquidated; have insufficient assets to cover cost of liquidation proceedings) to develop appropriate recommendations		
15	Establish a steering committee with a clear financial sector development mandate, an effective monitoring and evaluation system and accountability mechanism.	MoPF	I
16	Implement regulations that ensure effective out-of-court enforcement of security rights, including expedited judicial review process	MoJ	NT
17	Facilitate faster judicial enforcement times by reducing opportunities for appeals;	MoJ	I
18	Digitalize the real estate registry, completing the cadastral registration process and allowing on-line registration and searches	ANCPI	NT
19	Strengthen the legal framework applicable to movable assets in line with best practices in order to further encourage use of movables as security;	MoJ	NT
20	Upgrade the technological aspects of the AEGRM, streamlining the electronic registration and search capabilities and ensuring effective registration of security rights over all movable assets	MoJ	NT
21	Review the regulatory framework and oversight mechanisms for commodity-collateralized lending.	MoARD, MoPF, NBR	NT
22	Strengthen the provisions related to determining viability of insolvent companies to ensure that non-viable companies are not being reorganized;	MoJ	NT
23	Reduce opportunities for appeals and streamlining the procedural steps during the insolvency process to avoid unnecessary delays;	MoJ	NT
24	Promote timely insolvency filings to increase chances of successful reorganization;	MoJ	C
25	Review internal regulations of state agencies that often act as creditors in insolvency proceedings to ensure effective participation of state authorities;	MoJ, MoPF	I
26	Facilitate multi-creditor out-of-court workouts;	NBR	C
27	Update the insolvency administrators' regime to ensure sufficient administrator qualifications, to reward administrators who facilitate business continuation and speedy case resolution, and to increase accountability of administrators.	MoJ	I
28	Establish a multi-stakeholder committee tasked with improving the quality of credit reporting and enhancing its reach to improve access to finance	NBR, DPA	I
29	Expedite certification of CSLAB and SAL-FIN to the EC under the EU ADR Directive; and	MoPF	I
30	Amend CSALB's rule so that providers can no longer opt out (and without introducing any new restrictive conditions). ²	CSALB	I

Agencies: ASF = Financial Services Authority; CSALB = Alternative Dispute Resolution Center for Banking; DPA = National Supervisory Authority For Personal Data Processing; MoARD = Ministry of Agriculture and Rural Development; MoCIS = Ministry of Communications and Information Society; MBETE = Ministry of Business Environment, Trade, Industry and Entrepreneurship; MoE = Ministry of Economy; MoPF = Ministry of Public Finance; MoJ = Ministry of Justice; NBR = National Bank of Romania.

Time Frame: C = continuous; I = immediate (within one year); NT = near term (1-3 years); MT = medium term (3-5 years).

² Additional recommendations on improvements on the ADR framework are included in Annex 5.

IV. Country Context

Macroeconomic Performance

5. While economic growth has been restored after the global financial crisis, this has been largely consumption driven. Romania's economy shrunk by some 8 percent during 2009–10. Since then, in the context of successive European Union (EU) and International Monetary Fund (IMF)-supported programs in the period to 2015, macroeconomic stability has been restored and the fiscal and current account deficits have improved markedly. Economic growth accelerated in the last two years, driven by a sharp increase in private consumption on the back of resumed fiscal expansion and increases in minimum wages. Real GDP grew by 4.8 percent in 2016 and 6.9 percent in 2017. However, investment contributed negatively to growth in 2016 but turned positive in 2017. Investment as a percentage of GDP has been declining since 2008, reaching 22.6 in 2017, of which the contribution of the private sector was 87.6 percent. As consumption remained strong, inflation reached 4.9 percent in March 2018. High imports (up 11.3 percent in 2017) contributed to a deterioration of the current account deficit (3.4 percent of GDP in 2017).

6. Costly procyclical fiscal policies and weak structural reform efforts are expected to moderate growth. Fiscal policy became expansionary in 2016 with large cuts in tax rates and increases in the minimum wage, public wages and pensions, significantly boosting disposable incomes. While government debt according to EU methodology remains low at 35 percent of GDP in 2017, the fiscal deficit reached 2.8 percent of GDP. Pro-cyclical fiscal policy is expected to continue in 2018, and Romania risks re-entering the EU's Excessive Deficit Procedure in 2019 if the deficit exceeds 3 percent of GDP in 2018. The perception of weakening fiscal prudence could adversely affect market confidence, leading to a sharp drop in consumption and investment, while increasing the cost of government borrowing, and putting pressure on the exchange rate which would affect banks through their exposures to foreign exchange. Against these developments, the Romanian sovereign is rated BBB- by Standard and Poor and Baa3 by Moody's.

7. Monetary policy has long been accommodative, but is beginning to tighten. Low imported inflation and indirect tax cuts kept inflation subdued, but inflationary pressures are increasing. In response, the National Bank of Romania (NBR) recently narrowed the interest rate corridor (in line with IMF advice to manage excess liquidity in the banking system) and gradually raised the policy rate to 2.5 percent. This was the first effective increases in rates since the 2008 global financial crisis. It is expected that the tightening cycle will continue.

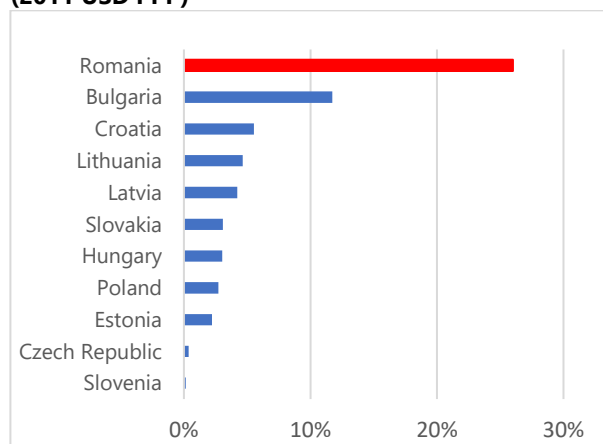
Cross-Cutting Themes

8. Both supply of and demand for financial products including deposits, loans, and payment services, are constrained by a set of contextual factors. These cross-cutting factors include: lagging physical infrastructure, high poverty rate, high share of rural population, high degree of informality and low financial literacy. These factors affect the ability of enterprises to grow and expand, which would in turn affect their propensity to invest and use external financing. These factors also affect households' ability to accumulate savings, gain access to credit, and manage risks.

9. Business activity is severely hampered by poor infrastructure. According to the Global Competitiveness Report 2017-2018, Romania ranks 102nd (out of 137) in the quality of transport infrastructure, which constitutes one of the weakest areas of its business environment. Similarly, the country has the second lowest ranking in the EU in the World Bank’s Logistics Performance Index. In the EIB Investment Survey for 2016, availability of adequate transport infrastructure is listed as a major obstacle for long-term investment by 45 percent of Romanian firms compared to the peer average of 15.5 percent and is the second top rated investment constraint.

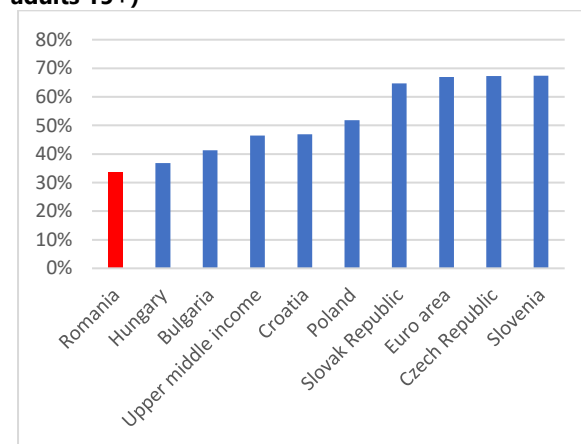
10. The poverty rate in Romania remains distinctively high for its income level. Poverty remains distinctively high for Romania’s income level with 38.8 percent of the population at risk of poverty or social exclusion in 2016.³ With more than a quarter of its population living on less than \$5.50 per day measured in 2011 PPP terms, Romania has the highest share of population living in moderate poverty, faring significantly worse than its peers. Disposable income in Romania amounted to 62.1 percent of the EU average in purchasing power standard. As a result, Romanian households are less likely to save. In the Global Findex 2017, only 33.5 percent of households saved any money at all in the preceding year vs, an EU average of 66.9 percent and 46.4 for upper middle-income countries.

Figure 1: Population living under \$5.50/day in 2015 (2011 USD PPP)



Source: Eurostat

Figure 2: Saved any money in the last year (% of adults 15+)



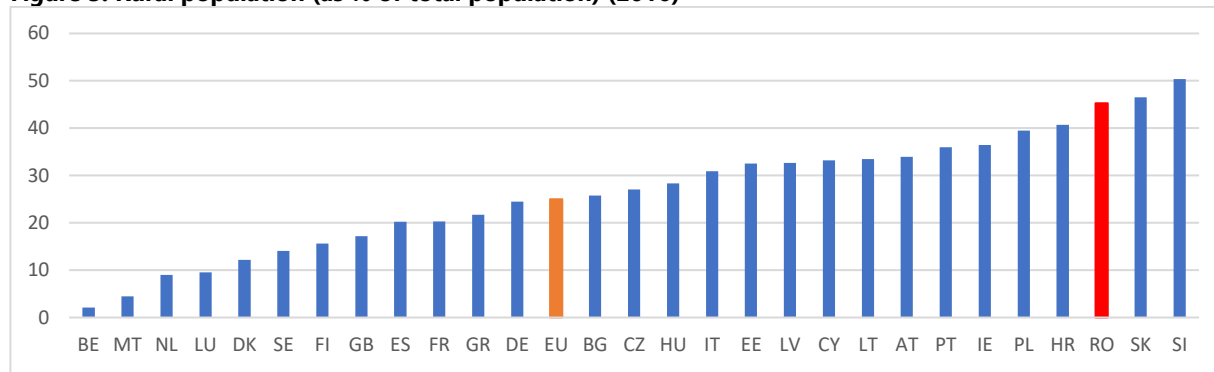
Source: Global Findex 2017

11. Financial intermediation is also adversely affected by the high share of rural population. Romania has one the highest share of rural populations in Europe at 45.3 percent. While the rural space is richly endowed with natural resources, it is marked by lower incomes, limited job opportunities and higher rates of poverty, and an ensuing urban-rural divide in social and living standards. The majority

³ This indicator corresponds to the sum of persons who are: at risk of poverty or severely materially deprived or living in households with very low work intensity. At risk-of-poverty are persons with disposable income below the risk-of-poverty threshold (60 percent of the national median disposable income after social transfers). Severely materially deprived persons experience at least 4 out of 9 following deprivations items: cannot afford i) to pay rent or utility bills, ii) keep home adequately warm, iii) face unexpected expenses, iv) eat meat, fish or a protein equivalent every second day, v) a week holiday away from home, vi) a car, vii) a washing machine, viii) a color TV, or ix) a telephone. People living in households with very low work intensity are those aged 0-59 living in households where the adults (aged 18-59) work 20 percent or less of their total work potential during the past year.

of the rural population is at risk of poverty or social exclusion. Public consultations conducted by the World Bank⁴ have concluded that the main constraints limiting rural development are: (i) insufficient access to finance, (ii) land fragmentation, (iii) ageing population, and (iv) lack of skills.

Figure 3: Rural population (as % of total population) (2016)



Source: World Development Indicators

12. Informal employment and the shadow economy are sizeable in Romania. Two main groups of informality may be identified: individuals who work informally because they have no real alternative and for whom informal employment is a survival strategy, and those who deliberately evade taxes and social security contributions. The first group includes informal work in agriculture and contributing family workers. The second comprises non-registered firms, or firms which do not register their workers and hire them without contracts, firms that under-report their sales and workers who under-declare their earnings and receive so-called “envelope payments” (payments in cash). Informal employment represents about 20-50 percent of employment in Romania depending on the definition used while the shadow economy was 27.6 percent of GDP in 2016, the second highest in the EU after Bulgaria.⁵ Informality may impose significant costs both on firms as well as individuals. Informal behavior is associated with weaker performance and many informal businesses with the potential to grow and create jobs often lack access to credit. Access to finance is exacerbated by the lack of transparency inherent in informal practices, which makes it difficult for banks to evaluate companies’ and individuals’ creditworthiness. In the bank survey (see Annex 1), 56.5 percent of the respondent banks rated the importance of informality / shadow economy either 4 (Important) or 5 (Very Important) in terms of adversely impacting financial intermediation.

13. Financial Literacy in Romania is low, both among firms and individuals. Firms have low financial skills, with only 47 percent of the Romanian firms reporting confidence to talk to banks compared to 65 percent firms on average in peer countries.⁶ Interviews suggest this is related to weak corporate governance, including the fact that many firms do not have audits performed by recognized auditors, which further hampers the ability to negotiate with banks and get access to bank credit. In

⁴ Information on the agricultural sector is provided through the World Bank Advisory Services to the Romanian Ministry of Agriculture and Rural Development (MoARD) for Strengthening the Agri-Food Sector Strategy Formulation

⁵ Schneider, Friedrich (2016)

⁶ 2017 SAFE survey

the bank survey conducted for the FSAP, low financial literacy was ranked “very important” in terms of its adverse impact on financial intermediation by one third of the respondents, and one of the top three factors that negatively affect financial intermediation. Similarly, only 22 percent of adults in Romania are financially literate,⁷ significantly lower than in peer countries and the lowest in the EU (average is 53 percent). While the relationship between financial literacy and income holds for the richest 50 percent of the countries (more than GDP per capita of USD 12,000), it does not for the poorer half. This suggests that national-level policies related to education and consumer protection shape financial literacy more than any other factor. Recognizing this issue, the financial education agenda has been promoted by multiple stakeholders including NBR, the Financial Supervisory Authority (ASF), the Ministry of Education, as well as the Romanian Banking Association and through commercial banks initiatives. NBR has recently established a Financial Education department and plans to prepare a National Economic Education Strategy.

V. The Real Economy

14. Financial intermediation is driven by low financial inclusion for households and poor demand for bank credit by the enterprise sector. Financial inclusion is lagging, exacerbated by low financial literacy, mistrust in financial institutions, and preference for cash holdings. While supply of credit was constrained in the context of the crisis (see Section VI), the demand for bank credit by enterprises is weak, affected by: a) the size and composition of the Romanian enterprise sector, including the dominance of agriculture, b) the constraints businesses face, and c) alternative corporate financing.

Households

15. Financial inclusion is lacking and even more pronounced for the poorest 40 percent of the population and the Roma. According to the Global Findex Survey of 2017, only 57.8 percent of adults in Romania have an account in a financial institution, below the peer average of 80.0 percent and the upper-middle income country average of 73.1 percent. Furthermore, financial inclusion seems to be increasing since 2014, when 60.8 percent of adults had an account. Disaggregating into rural and urban populations does not alter the picture much although there is a difference of 9 percentage points in account ownership between males and females. There is also a significant 33.2 percentage point gap between the richest 60 percent and the poorest 40 percent of the population, higher than in its peer countries and income group. According to the UNDP/World Bank/EC Regional Roma 2011 survey, less than 5 percent of the Roma households in Romania have a current account.

⁷ According to the S&P Global FinLit Survey in 2014. Current literacy levels are likely higher than in the 2014 due to recent measures.

Table 1: Financial Inclusion

Indicator Name (data for 2017)	Bulgaria	Croatia	Hungary	Poland	Romania	Euro area	Upper middle income
Account at a financial institution (% age 15+)	72%	86%	75%	87%	58%	95%	73.1%
Account at a financial institution, male (% age 15+)	71%	90%	78%	85%	62%	97%	77.0%
Account at a financial institution, female (% ages 15+)	74%	83%	72%	88%	54%	94%	69.3%
Account at a financial institution, rural (% age 15+)	66%	88%	69%	87%	54%	96%	73%
Account at a financial institution, income, poorest 40% (% ages 15+)	55%	81%	68%	84%	38%	94%	62%
Account at a financial institution, income, richest 60% (% ages 15+)	84%	90%	80%	88%	71%	96%	80%
Account at a financial institution, older adults (% ages 25+)	75%	93%	77%	91%	59%	98%	75%
Account at a financial institution, young adults (% ages 15-24)	43%	47%	60%	63%	51%	79%	66%

Source: Global Findex 2017

16. While recent legislation on bank account fees may enhance inclusion, it could also have adverse effects. EU Directive 92/2014 on payment accounts aims at improving the transparency and comparability of fees on payment accounts, facilitating switching accounts, and ensuring access to a basic bank account for EU residents at no or reasonable fee. Romania transposed the directive by means of Law on Comparability of Payment Account Fees, Change of Payments Accounts and Access to Basic Payments Accounts of 2017. The law introduced zero fee accounts for vulnerable consumers, which was defined as those with under 60 percent of national average salary; a definition which affects about 50 percent of consumers. The legislation is expected to enhance financial inclusion as vulnerable consumers will gain access to basic accounts including deposits, withdrawals, direct debt transactions, online payments and credit transfers. However, the law may also have adverse effects such as higher interest / fees for other clients, or the acceleration of banks' retrenchment from rural areas, especially given the broad definition of vulnerability and the fact that these accounts are free. Other countries in the region have either narrowed the applicability of the law or introduced small or capped fees.⁸

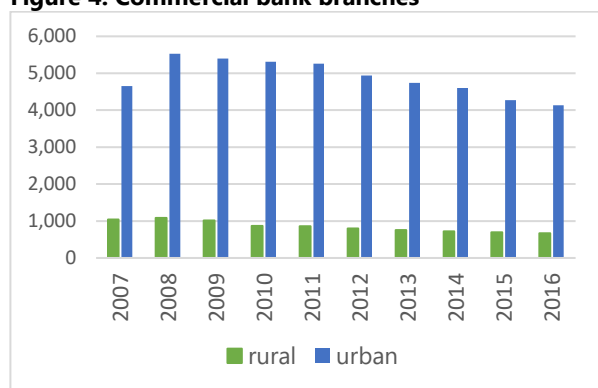
17. Commercial banks have lower branch coverage in Romania compared to peer countries and are beginning to implement alternative service delivery mechanisms. As of end 2016, there were 4,804 bank branches in Romania, equivalent to 27.9 branches per 100,000 adults. This network penetration is 12.0 percent lower than that of peers (31.8 branches per 100,000 adults on average). The commercial branch network has been declining since the crisis, in line with the region. In Romania, the CAGR 2008-2016 for branches has been -3.9 percent, although the decline has been faster in rural areas (-5.9 percent). New banking delivery mechanisms are being offered, thanks to the expansion of agent networks. While no information is currently available through the NBR on the number of bank agents, 40 percent of the banks surveyed are already using bank agents. In addition, the majority of banks plans to invest substantially in branchless services in the medium-term, including agents, mobile banking vehicles, and virtual branches. Internet banking is still in its infancy with only 5 percent of the population using such services. While there is a potential for growth in light of increasing internet use in Romania (66 percent of the population in 2016), however only a small portion use the internet for paying bills or making purchases (19.2 percent of adults versus 51.0 percent peer average in 2017).⁹

⁸ In Hungary the monthly account fee cannot exceed 1.5 percent of gross minimum salary (about 300 EUR in 2016). In Czech Republic, fees must not exceed usual market fees. In Slovakia, basic accounts are available to consumers with net income lower than minimum wage (400 EUR) with monthly fee up to 3 EUR. In Bulgaria basic accounts are offered free of charge or for a reasonable fee which shall be below average fee. In Poland, free basic accounts are offered only to consumers who don't have existing bank accounts. In Slovenia, the fee has to be no more than 1.6 percent of minimum income or 0.8 percent for beneficiaries of social welfare.

⁹ Global Findex 2017

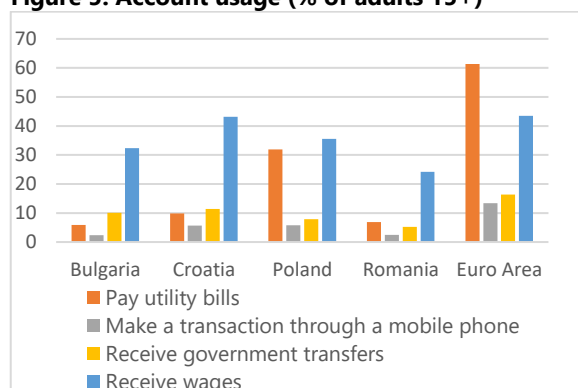
18. Accounts are predominantly used for receiving wages, albeit at a lower rate than in peer countries and the euro area. The most frequent use of an account is to receive wages (24.2 percent of adults). This is one of the lowest portion of adults for receiving wages among peer countries (36.7 percent average) and the euro-area (43.5 percent). This suggests there is a higher tendency to receive wages as cash in Romania. The country also lags on the account usage to pay utility bills (6.9 percent of adults compared to a peer average of 19.9 percent) and euro-area average of 61.3 percent.

Figure 4: Commercial bank branches



Source: NBR

Figure 5: Account usage (% of adults 15+)



Source: Global Findex 2014

19. Despite its large physical presence, Posta Romana plays only a marginal financial inclusion role. Posta Romana (PR) is the 75 percent state-owned postal service operator and is mandated by law to be present in every commune with more than 1,500 inhabitants. PR currently has approximately 5,100 outlets throughout the country. PR distributes pension payments, which generates approximately 55 percent of its revenues (the remaining 45 percent coming from mail and package distribution activities). Additional financial services are minimal and include: money transfers (through postal mandates and Western Union for international transfers) and location rent for banks' ATMs. While the banking law does not allow PR to take deposits or grant credit, it could become a bank agent for established licensed banks. PR tried several times to establish a partnership in this domain. The last attempt allowed PR to collect 4 bids. However, the process was stopped recently, when a new board was appointed by the Ministry of Communications and Information Society.

20. PR has the potential to play a bigger role in financial inclusion but this would entail significant operational and financial restructuring. The development of a greater range of financial services under the banking agent statute could be a promising avenue and would also help enhance financial inclusion. However, this would necessitate restructuring of PR, supported by a clear strategy, taking into account current and expected markets transformations¹⁰ and aiming to achieve financial sustainability. Heavily indebted, PR has an obsolete and largely inefficient operational structure which makes difficult to contemplate any privatization (as envisaged by the government a few years ago). With a decline in the postal business, fierce competition (licensed operators have captured 50 percent

¹⁰ It is likely that the pension payment activity would decrease with the expansion of digital finance. On a more positive side, parcel distribution activity should continue booming.

market share), and high personnel expenses (over 24,000 staff), PR has suffered significant losses since 2010. At the same time, the operator has significant investment needs to upgrade its IT and infrastructure. PR was recapitalized by the government in May 2018 with a RON 170 million injection.

21. The usage of digital payments is increasing but some critical gaps remain. The total number of payment cards issued in Romania from 2010 to 2016 has increased by 24 percent (from 12.8 million to approximately 15.9 million). This is significantly faster than in the EU, where the number of payment cards increased from 726 million to 804 million (11 percent), allowing Romania to partially close the gap (there are 0.65 payment card per inhabitant versus 1.57 payment cards per inhabitant in the EU). The banking infrastructure also includes 11,124 ATMs, equivalent to 66.7 per 100,000 adults, about 25.0 percent lower than that of the four peer countries. The ATM network has been growing, albeit at a lower rate than in peers. Meanwhile, the usage of point-of-sale (POS) systems has been increasing in recent years with the number of POS terminals growing with a 9.0 CAGR in the period 2009-2016, reaching 967 per 100,000 adults. Since 2014, two e-wallet initiatives were launched (only one succeeded as of today) which has contributed to the diversification of the digital finance offer.

22. The government has supported the usage of digital payments, through various measures, which has an additional advantage in discouraging tax evasion. Government Emergency Ordinance no. 193/2003 on introduction of modern payment systems was amended in 2016 in order to increase the usage of cards as a payment method, by introducing the obligation for public utility companies and public institutions collecting taxes or legal persons that operate retail commercial activities and have an annual turnover of over EUR 10,000 to accept payment by debit or credit card. In addition, the Fiscal Receipt Lottery was introduced by MoPF in 2015 as a measure to discourage tax evasion by increasing the awareness and involvement of the consumers in the taxation of traders' revenues. The lottery type awarding mechanism rewards in cash up to 100 physical persons (residents or non-residents) holding tax receipts attesting the purchase of goods or services in Romania. Since the introduction of the Lottery 18,737 prizes have been awarded.

23. The expansion of digital payments instruments could be further supported through transposition of PSD2. EU Directive 2015/2366 (PSD2) on EU-wide payment services provides the foundation for the further development of an integrated internal market for electronic payments within the EU, puts in place comprehensive rules for payment services, and aims to open up payment markets to new entrants. The transposition process of the directive in Romania is ongoing. As PSD2 opens access of Fintechs to banks' Application Programming Interfaces (APIs), its transposition would further facilitate the development of fintechs such as payment initiators and payment aggregators, and would further encourage competition in the market, benefitting the expansion of digital payments instruments.

24. A reduction in the cost of cross-border transfers in lei in the EU could also be facilitated by the adoption of national legislation in Romania consistent with the country's decision to voluntarily apply the equal charges rule of EU Regulation No 924/2009 to cross-border payments in lei as of January 2012. Regulation No 924/2009 on cross-border payments in euro aims to equalize charges for corresponding national and cross-border electronic payments in euro offered by any

payment service provider in the EU. The adoption of corresponding national legislation would ensure that, effectively, cross-border payments in lei should be charged the same as national payments in lei.

25. Credit unions play an important financial inclusion role, especially in rural areas. Access to financial services is supported by 3,000 credit unions serving employees¹¹ (about 1.2 million members out of a total estimated of 4-5 million) and pensioners (about 1.4 million members out of a total estimated 5 million). The largest federation for employee credit unions (UNCARSR) estimates that about 20 percent of its affiliated entities are in rural areas. Credit unions are non-deposit taking institutions funded through the members' social funds (which cannot be withdrawn in the case of the employees' credit unions) and mainly provide short-term small loans to individuals. In contrast to other countries in the region (e.g. Poland), in which credit unions are allowed to mobilize deposits from their members, credit unions in Romania are not supervised by the NBR (in fact, supervision does not seem to be exercised by any external authority). Legal limitations on funding sources, scope of financial services and type of members reduce significantly their operations. While removing these constraints could significantly expand their outreach, this would entail the mobilization of significant additional resources and would also necessitate stronger supervision, ideally exerted by NBR. (see Annex 2).

26. Trust in financial institutions in Romania was affected by the crisis but has started to improve. According to the Life in Transition Survey conducted in 2016, 48.0 percent of surveyed adults in Romania have some or complete mistrust of the banks and financial system compared to 38.1 percent across the region.¹² Trust in the system was shaken during the financial crisis even though no bank needed a bail out in Romania and depositor did not lose any money. Of all European countries included in the survey, Romania expressed the biggest drop in the trust indicator between 2006 and 2010. Similar results are borne by the OeNB Euro Survey.¹³ However, trust has since improved, as evidenced by the growth in bank deposits (4.7 percent CAGR in 2008-2016).

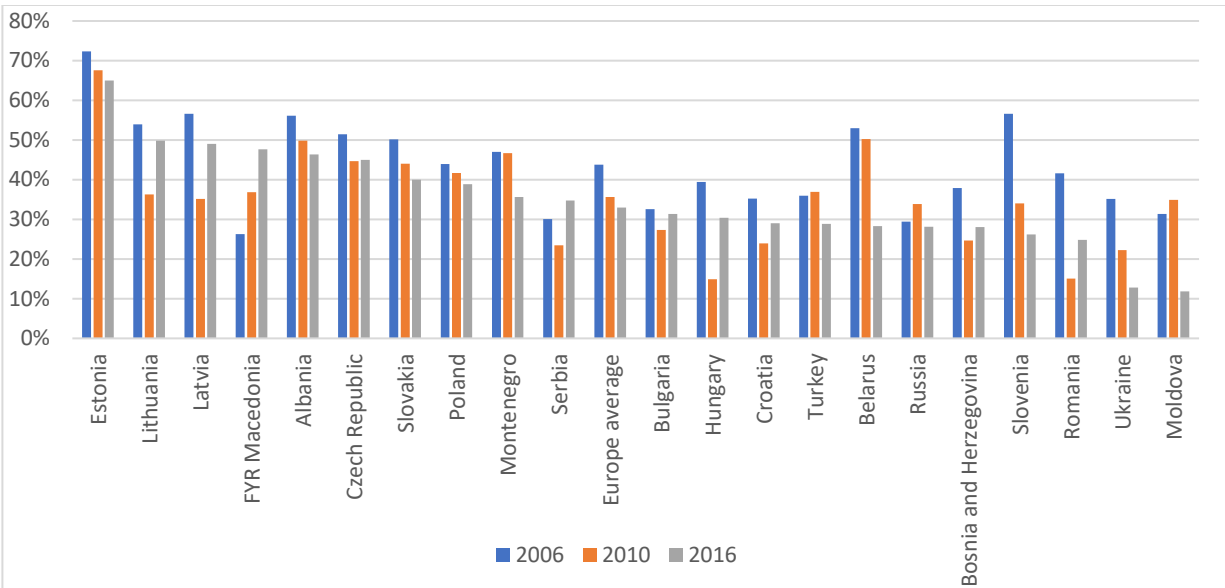
Figure 6: Trust in banks and the financial system¹⁴ (% of respondents)

¹¹ Defined as any person receiving salaries / other types of regular incomes, including from independent activities – such as attorneys, doctors, farmers, etc.

¹² The following countries participated in the survey: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, the Czech Republic, Estonia, FYR Macedonia, Georgia, Greece, Hungary, Kazakhstan, Kosovo, the Kyrgyz Republic, Latvia, Lithuania, Moldova, Mongolia, Montenegro, Poland, Romania, Russia, Serbia, the Slovak Republic, Slovenia, Tajikistan, Turkey, Ukraine and Uzbekistan.

¹³ The OeNB regularly conducts a survey of households in Central, Eastern and Southeastern Europe, the OeNB Euro Survey, which collects unique information about (euro) cash holdings, saving behavior and debt, and looks into respondents' economic opinions, expectations and experiences.

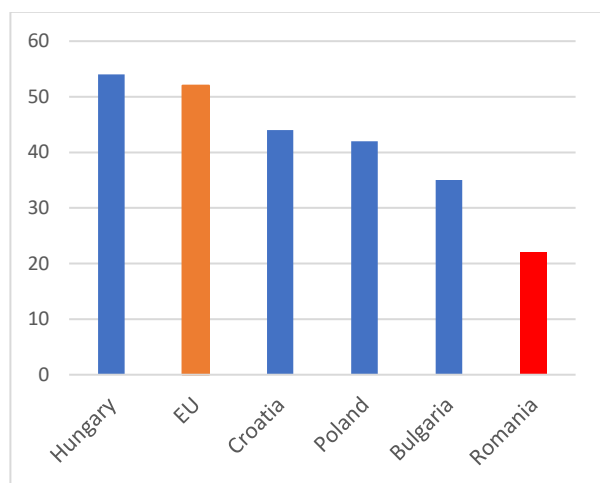
¹⁴ Respondents who select "complete trust" or "some trust"



Source: Life in Transition Survey (LiTS)

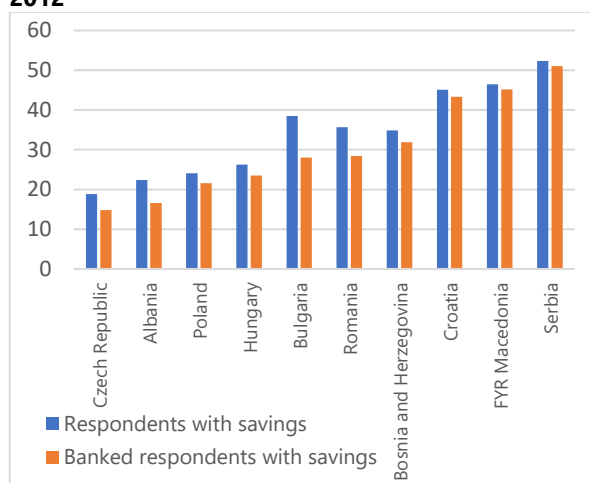
27. A significant portion of Romanians has a strong preference for cash. In the OeNB Euro Survey, 35.7 percent of Romanians prefer to hold cash rather than a savings account. Even among individuals who have savings account, this portion is still high at 28.4 percent, in line with countries in the region. Stix (2013) explains households' strong preference to hold cash at home rather than with banks with lack of confidence; an effect which is aggravated by the recollection of past banking crises. Furthermore, weak institutional frameworks, e.g. the poor quality of legal enforceability or tax collection, as well as a low bank penetration, also contribute to the strong preference for cash. Notably, the per capita monetary base and cash in circulation in Romania grew much faster than in peer countries, registering a 10.8 percent CAGR in the period 2008-2016, higher than GDP. This growth is partly explained by the preference for cash and financial illiteracy, as well as certain fiscal measures focusing on consumption and the prevailing low interest rate environment, combined with high bank fees for maintaining accounts.

Figure 7: Adults who are financially literate (% 2014)



Source: S&P Global FinLit Survey

Figure 8: Cash Preference¹⁵ (% of respondents) 2010-2012



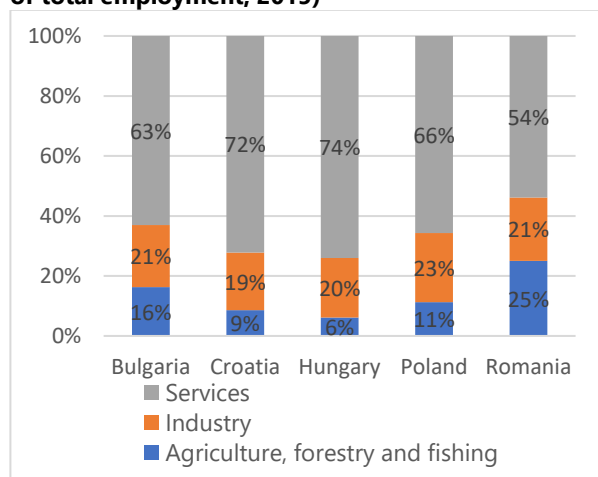
Source: OeNB Euro survey

Agriculture sector

28. The agriculture sector is inefficient, has not realized its full potential, and is for the most part unbanked. The rural population is mostly active in agriculture, which accounted for 47.3 percent of total rural employment and 23.1 percent of total employment in the country in 2016. However, the sector is inefficient, accounting for only 4.3 percent of gross-value added. Agricultural production is characterized by a strongly polarized farm structure: 98 percent (3.6 million) of all farm operators are small and managing 44.9 percent of the total Utilized Agricultural Area (UAA) while 0.5 percent of all farm operators (around 16,400) are medium/large and managing 46.3 percent of total UAA. Unlike Poland or Bulgaria, Romania has not yet been able to establish a viable, commercially-oriented middle-sized family farming sector after 10 years of EU membership. Smallholders' access to finance is limited by the small farm size, low management capacity, and lagging infrastructure, especially in transportation that reduces the economic viability of agriculture in remote areas. Farms are also not registered as firms, limiting their ability to access finance for business purposes. Lending to farms is further constrained by problems with the land cadaster which limit the capacity of farms to provide collateral. Furthermore, while commodity collateralized lending exists, the regulatory framework and oversight mechanisms are deficient, significantly limiting the use of this form of financing.

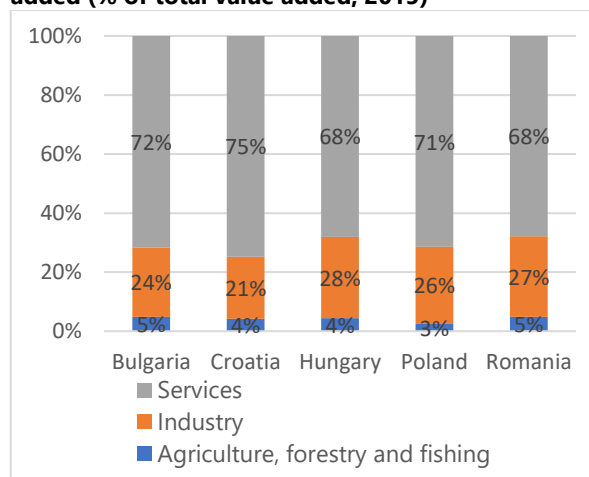
¹⁵ Extent of Agreement with the Statement: I prefer to hold cash rather than a savings account.

Figure 9: Contribution of sectors to employment (% of total employment, 2015)



Source: Eurostat

Figure 10: Contribution of sectors to total value added (% of total value added, 2015)



Source: Eurostat

Enterprise Sector

Size and composition

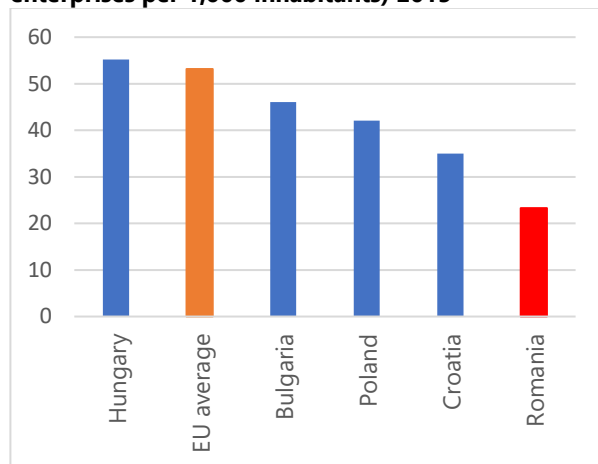
29. Demand for credit is capped by the relatively small size of the Romanian enterprise sector. About 460,000 enterprises are operating in the secondary and tertiary sectors in Romania.¹⁶ Of these, 88.5 percent are microenterprises, 11.1 percent SMEs and 0.4 percent large firms¹⁷ (1,642 large firms) (see Box 1). With a density of 23 enterprises over 1,000 people, Romania appears to be lagging behind the rest of Europe in terms of entrepreneurial activity, for all firm sizes. In fact, while the gap is larger for microenterprises, it also exists for SMEs and large firms. This divergence points to a potential deficit in entrepreneurial activity. Interviews with stakeholders point to historical factors for this deficit, including an absolute suppression of private enterprise in Romania in the communist era, more severe than the experience of peer countries. The smaller size of the Romanian non-financial business sector is further confirmed by the smaller employment in NFCs (29.1 percent of persons employed in working age population¹⁸ compared to 36.7 percent on average for peer countries) and highest percent of working age population residing abroad in Europe (22.3 percent).

¹⁶ As of December 31, 2015, data from EUROSTAT

¹⁷ Using Eurostat definition: micro enterprises: fewer than 10 persons employed; small enterprises: 10 to 49 persons employed; medium-sized enterprises: 50 to 249 persons employed; large enterprises: 250 or more persons employed. This is different from the EU definition which also includes turnover and balance sheet characteristics: SMEs is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro.

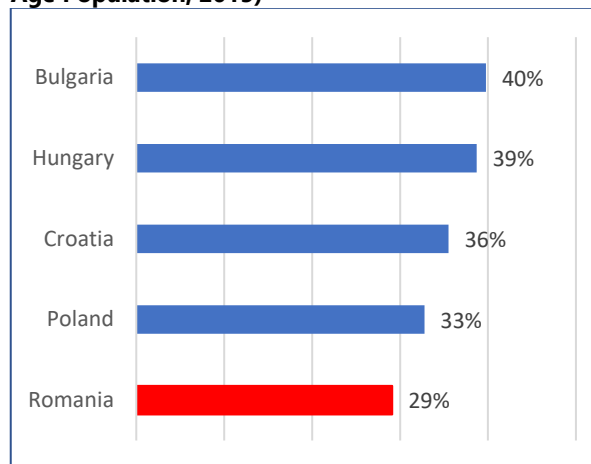
¹⁸ As per Eurostat 2015 data for Bulgaria, Croatia, Hungary and Poland for persons employed in the non-financial business economy and working age population

Figure 11: Business density (total number of enterprises per 1,000 inhabitants) 2015



Source: Eurostat

Figure 12: Persons Employed by NFCs (% of Working Age Population, 2015)



Source: Eurostat

Box 1. Composition of Romanian enterprise sector by firm size and sector

Microenterprises are firms with little organizational structure, often operating informally. A micro firm is defined as a company with less than 10 employees, representing the smallest size that a firm can have. In 2015 the micro enterprise sector employed 22.2 percent of the non-financial business economy, lower than in peer countries (employing 33 percent¹⁹ on average). Four out of 10 persons working in micro firms are active in wholesale and retail trade, while the next 4 micro firm employees work either in construction, professional and technical activities, transport and storage or accommodation and food services. Micro-enterprises are often informal. Anecdotal evidence shows that the tendency of businesses to “stay small” is also related to the unpredictable behaviour of fiscal inspectors who face increasing pressure to collect taxes in order to support current pro-cyclical policies. Micro firms also tend to be under-capitalized, accounting for 69.7 percent of total negative equity among enterprises in 2016.

SMEs are a very heterogenous group. A small enterprise represents a firm that employs between 10 and 49 persons and a medium one employs between 50 and 250 persons. The SMEs sector was employing 43 percent of persons in total in Romania in 2015 and the average SME is preponderantly active in the manufacturing sector, followed by wholesale and retail trade, construction and transportation and storage. The SME segment is heterogeneous also as a result of the scope of activities and their affiliation to a foreign group. Some SMEs are atypical, meaning that they cannot be classified in any of the categories provided by the EU definition.²⁰

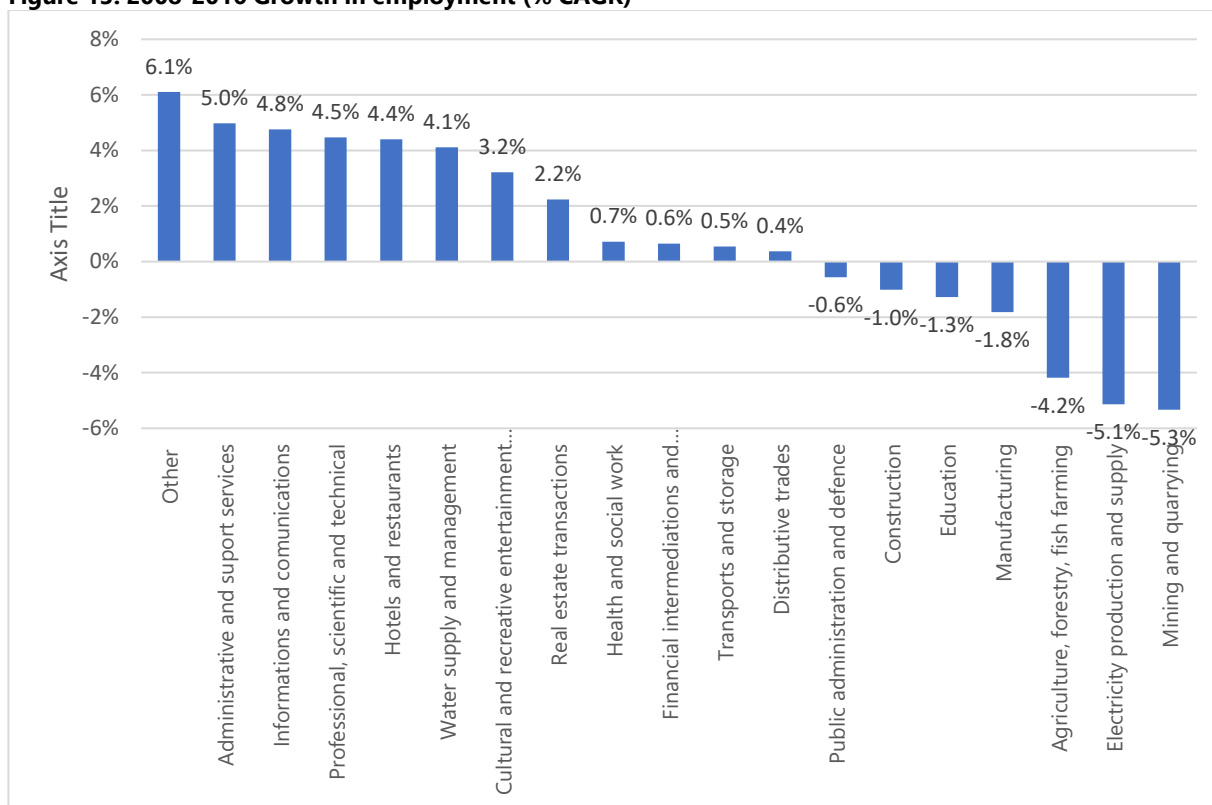
Large corporates are well established enterprises. A large firm is employing over 250 persons. Large firms employ 35 percent of the persons in Romania, a larger share than in peer countries. Four out of 10 people working in large firms are employed in the manufacturing sector and the next 3 in wholesale and retail trade, transport and storage or water supply or related activities. Less than 1,650 corporates are well established enterprises in Romania.

¹⁹ As per Eurostat 2015 data for Bulgaria, Croatia, Hungary and Poland for persons employed in the non-financial business economy

²⁰ The EU definition of an SME: enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro. By this definition, a firm which has less than 10 employees, but its turnover is larger than EUR 2 million and/or balance sheet exceeds EUR 2 million cannot be classified in any of the SME categories.

30. Demand for credit might have been reduced by a structural shift of the enterprise sector to less capital-intensive sectors after the crisis. Between 2008 and 2016, Romania experienced a structural change of the economy with employment moving from more traditional and capital-intensive sectors into more labor-intensive sectors. For example, while mining and quarrying, electricity production and supply and agriculture registered a decline of greater than 4 percent in compound terms, administrative support services, information and communications, professional, scientific and technical activities registered a positive CAGR of over 4.5 percent. The switch in economic activity towards less intensive capital sectors could have had a negative impact on credit demand, particularly for long-term bank loans.

Figure 13: 2008-2016 Growth in employment (% CAGR)



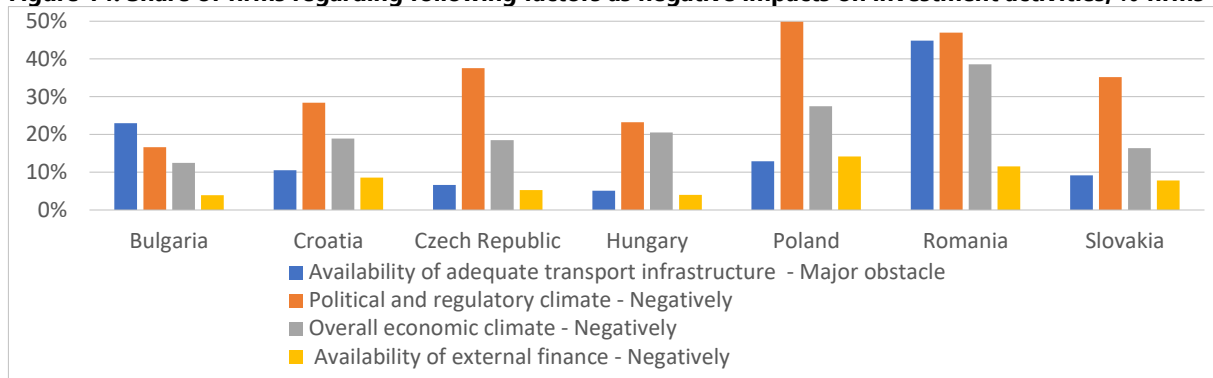
Source: Eurostat

Constraints to Firm Growth

31. The unpredictability of the business environment is a significant challenge to business operations including investment decisions. While a static analysis of the business environment does not portray a very negative picture (Romania is ranked 45th in Doing Business), over the past years businesses were faced with a number of fiscal measures introduced/reversed which severely impacted their ability to plan operations, including investments. While constraints to businesses activity vary depending on firm size, the unpredictability of the regulatory framework, in particular as far as fiscal predictability is concerned, was raised by all market participants. The high number of changes to the fiscal code (20 changes in the last 2 years only), the lack of consultation with the private sector, and

the short time given to businesses to adapt delay decisions to invest by firms. Due to their size and scarce resources, MSMEs can be affected by the costs of regulations more than their bigger competitors. According to the EIB investment survey 2016, “political and regulatory climate” was the top factor negatively impacting firms’ ability to carry out planned investment, reported by 47.0 percent of firms compared to only 29.5 percent of firms reporting the same problem in the four peer countries. The frequently changing legal environment is considered by banks the most significant factor negatively affecting financial intermediation, rated 4.2 on average.

Figure 14: Share of firms regarding following factors as negative impacts on investment activities, % firms



Source: EIB Investment Survey 2016

32. Although public authorities are required by law to assess the economic impact of regulatory initiatives expected on the private sector, this has not been enforced. According to Law 62/2014²¹ for amending and completing Law 346/2004 on stimulating the establishment and development of SMEs, public administration has the obligation to elaborate policies “meant to contribute to the protection of SMEs in their relations with the state” and draft laws with impact on the business environment be subjected to a “SME Test” in order to ascertain the effects of the proposed law on SMEs. The SME test’ procedure and methodology is outlined in Ministerial Order 698/2014 and its implementation is supported by a consultative body – the Group for the Assessment of the Economic Impact of Normative Acts on SMEs (GEIEAN). In 2015, according to a World Bank report reviewing the proposed legal and institutional regulatory impact assessment for Romania,²² only a handful of SME Tests have been conducted and only partly with the full involvement of GEIEAN and according to the established procedure.

Corporate Financing

33. While access to finance is not a significant constraint for many firms, significant financing gaps remain in segments without access to bank credit. In NBR’s Survey on the Access to Finance of Non-Financial Corporations in Romania, December 2017, the most pressing problems

²¹ See Law 62/2014, published in the Official Gazette of Romania no.328/06.05.2014. The Methodology for the elaboration of the SME Test was adopted by Ministerial Order no.698/04.06.2014, published in the Official Gazette of Romania no.438/16.06.2014.

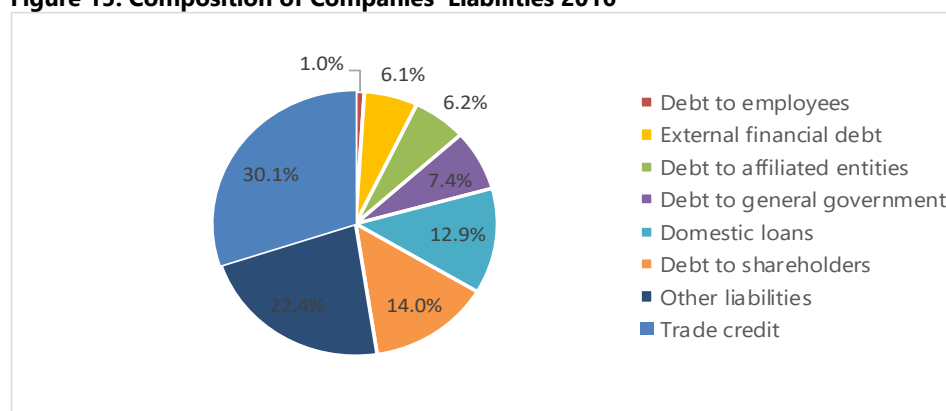
²² Source:

<http://sgg.gov.ro/docs/File/UPP/doc/evaluare/Methodological%20guidance%20for%20impact%20assessment.pdf>

faced by companies are: level of taxation, fiscal unpredictability, competition, finding customers and costs. Access to finance came in last, with 14 percent of firms stating that it was a problem with significant impact on the company's activity. However, in the predominantly bank-centric financing market in Romania, financing gaps remain for companies without access to bank credit, especially for start-ups, micro-enterprises, micro-credit, and rural areas. (See Box 2). According to the Romania Ex-ante assessment for financial instruments for SMEs in the 2014-2020 programming period,²³ the estimated financing gap is EUR 3.4 billion, including bank, microfinance and equity investments.

34. Romanian firms are primarily financed by trade credit and debt to shareholders, and to a lesser extent by banks. Romanian firms' liabilities (excluding equity, provisions, and accrued income) at the end of 2016 comprised trade credit (30.1 percent of total), debt to shareholders (14.0 percent) and domestic loans (12.9 percent).²⁴ Only 10.4 percent of NFC's had bank loans at the end 2017, close to the average value for the last 5 years. Corporate leverage, defined as total non-equity liabilities over capital, declined sharply between 2008-12. However, leverage has been rebounding between 2012-16, despite the decline in bank credit (see Section VI), with a more prominent role of trade credit between domestic corporates and external funds. A significant contribution to the elevated corporate leverage also comes from the common practice of corporate funding through "shareholders' loans." This instrument is preferred over equity for tax minimization and for owners to be able to extract a fixed amount of income from the corporate through interest.

Figure 15: Composition of Companies' Liabilities 2016



Source: NBR, MoPF

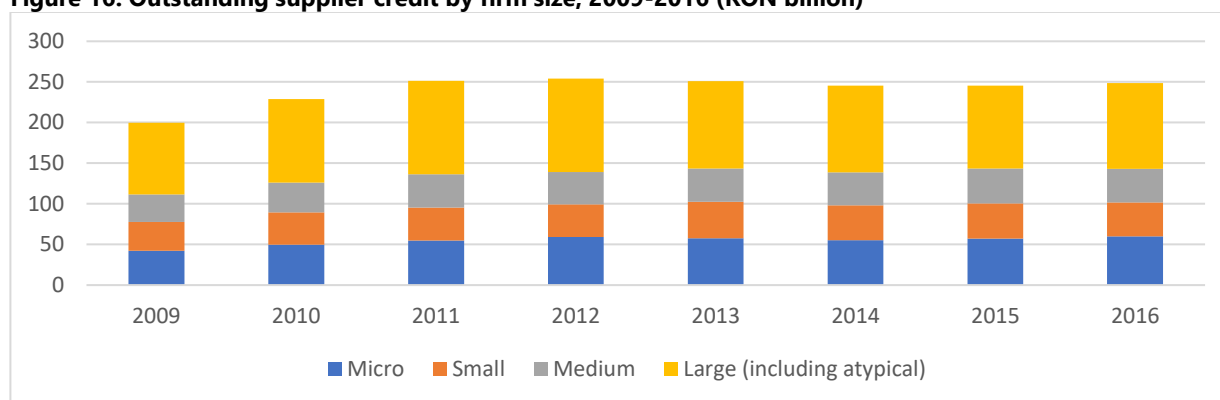
35. Trade finance has increasingly become a financing option for credit constrained firms. Although traditionally large firms are relying preponderantly on supplier credit, microenterprises in Romania, more credit-constrained than other segments, are increasingly relying on supplier credit. While the amount of outstanding supplier credit was quite stable in the SME segments between 2009

²³ <http://www.fonduri-ue.ro/images/files/documente-relevante/2016/Romania.Ex-ante.aprobat.pdf>

²⁴ "Other liabilities" comprise 22.4. percent of liabilities and include loans from other financial institutions; transactions with shareholders/associates related to capital; dividends payable; loans from other non-financial companies, transactions related to joint operations, sundry creditors and deferred income related to assets received by transfer from customers.

and 2016, supplier credit increasingly became an option of financing to micro firms, growing by 5.1 percent CAGR. Large firms still hold an important share of supplier credit (37.3 percent of all supplier credit to firms in Romania in 2016) and in the period 2009-2016 large firms had an average of RON 91.4 billion in outstanding supplier credit, possibly adding to the access to finance constraint of MSME suppliers. In 2016, 27.3 percent of SME firms reported delays in cashing in invoices from private firms. Although the Late Payment Directive (2011/7/EU), which sets a 60 day limit for payments for businesses, was transposed in Romania through Law 72/2013, businesses report that that the Directive did not impact payment practices in business to business transactions²⁵ and small companies in particular are less able to exercising their rights.²⁶

Figure 16: Outstanding supplier credit by firm size, 2009-2016 (RON billion)



Source: NBR, MoPF

36. A persistently high number of companies have negative equity, mostly within the micro-enterprise segment, which renders them non-bankable. A large portion of enterprises is in poor financial health with 42.3 percent of the total number of active enterprises having negative equity, 96.5 percent of which are microenterprises. While this seems to reflect structural characteristics of the Romanian economy, the share increased following the financial crisis, reaching a peak of 50.4 percent of firms in 2012. The total amount of negative equity amounts to RON 137.6 billion at the end of 2016, or 18.1 percent of GDP. As a result, banks only consider a fraction of Romanian enterprises to be within their minimum financial criteria: in the bank survey, on average 128,000 enterprises (about 20 percent of all active enterprises) are considered bankable. Part of the rise in trade credit could reflect claims on firms with negative equity with limited capacity to service their obligations. The NBR's National Committee for Macroprudential Oversight has set up a working group to assess the financial position of the corporate sector and develop measures to reign in the high share of technically insolvent firms.

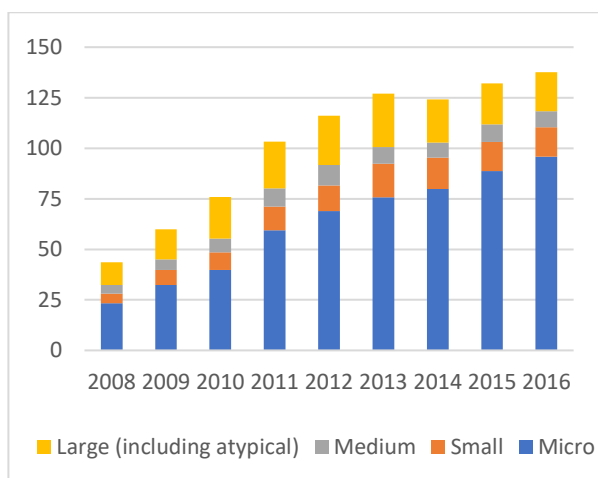
37. A large share of Romania's business sector is foreign-owned and (partially) financed from abroad. Romania was successful in attracting foreign investments in key sectors such as renewables, real estate, automotive, distributive trades, transportation, information technology &

²⁵ Dec 2015, EC, Ex-post evaluation of Late Payment Directive

²⁶ Idem

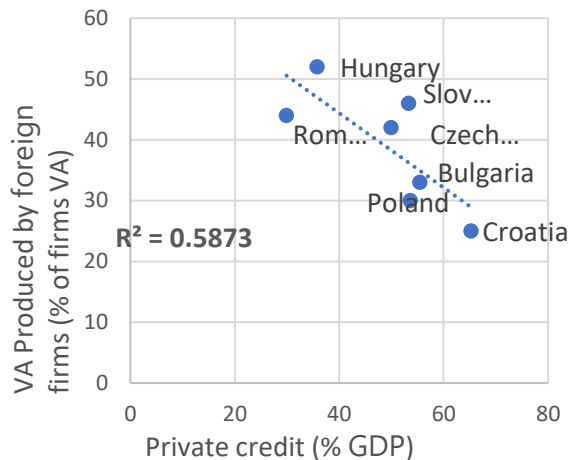
communications, oil and natural gas, financial services. These investments outsourced part of foreign companies' production process, attracted by a competitive labor market, the size of the consumer market, and the proximity to European markets. About 5.9 percent of Romanian enterprises in 2015 were foreign owned, a much larger share than the average of 2.6 percent for the peer countries.²⁷ Since foreign companies operate on average larger businesses, their turnover represents approximately half of the overall enterprise sector's turnover in Romania. There is an inverse correlation between the percentage of foreign-owned firms and domestic credit to GDP across countries, which may be explained by the fact that typically, large foreign-owned firms use external financing for CAPEX, either through parent companies (through bank loans or bonds issued abroad), or through foreign banks, and only a limited share of working capital is financed locally. In Romania, NFC debt financed through non-resident financial institutions amounted to 5.3 percent of GDP as of 2017.²⁸

Figure 17: Amount of negative equity (RON billion)



Source: NBR, MoPF

Figure 18: Domestic private credit to GDP and Value Added by foreign firms, 2015



Source: Eurostat

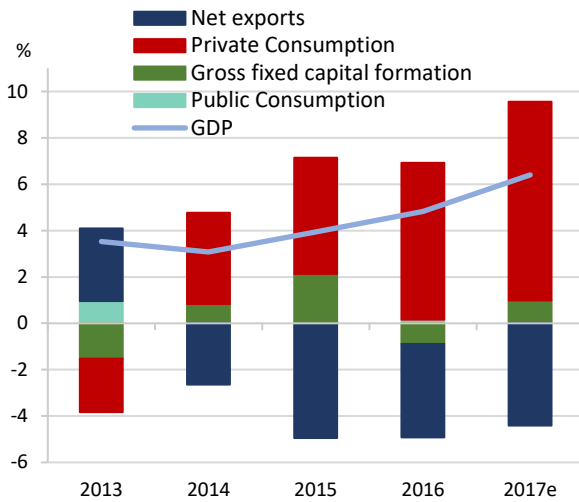
38. Demand for credit was subdued as firms' investment activity has been lagging, despite the recent impressive economic growth. After a contraction of cumulative 8 percent during the 2008-2010 crisis, Romania's economic growth was reinstated, GDP growth averaging 4.4 percent over the last 5 years. The growth was reflected in a positive spillover into the enterprise sector, with more than 31 percent of businesses reporting an increase in their turnover of more than 20 percent over the last 3 years, a share significantly higher than peer countries. Increased turnover has been accompanied by an increase in investment activity with the percentage of firms that invested rising from 60 percent in 2014 to 67.5 percent in 2015; however this share is lagging behind that of peers (75.5 percent).

Figure 19: Components of the real GDP growth, 2013-2017

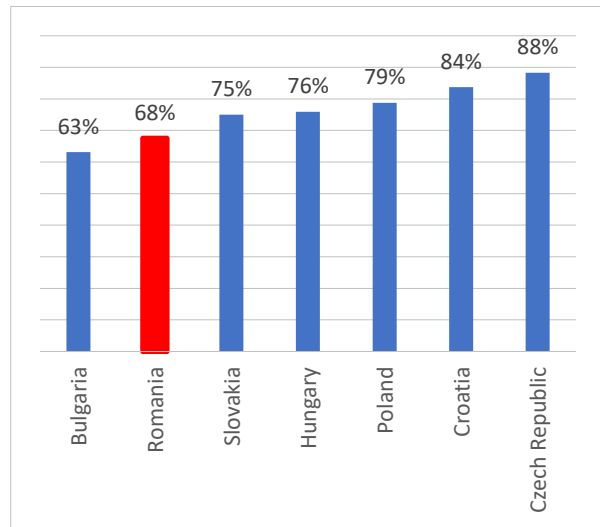
Figure 20: Share of companies that invested in the last financial year

²⁷ Source: EUROSTAT. According to MoPF and NTRO data, the percentage of foreign owned non-financial companies in Romania at 2016 was 7.1 of total

²⁸ NBR



Source: WB calculation based on NIS data

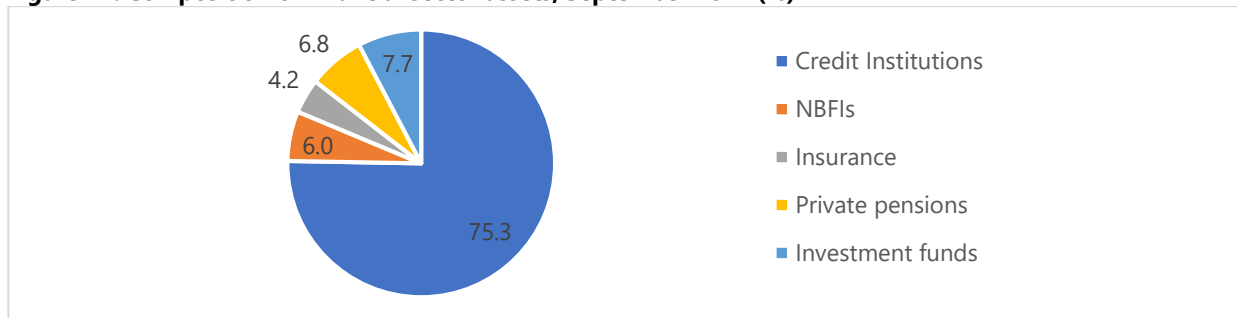


Source: EIB Investment Survey 2016

VI. The Financial Intermediaries

39. Romania has one of the lowest levels of financial intermediation across the EU. Financial sector intermediation, as measured by the share of financial sector assets relative to the country's GDP is small, amounting to 73.3 percent as of September 2017. The banking sector is the major intermediary, with credit institutions accounting for 75.3 percent of financial sector assets. Furthermore, financial intermediation has been declining, mostly driven by the evolution of the banking sector relative to GDP post crisis.

Figure 21: Composition of financial sector assets, September 2017 (%)



Source: NBR

Banking Sector

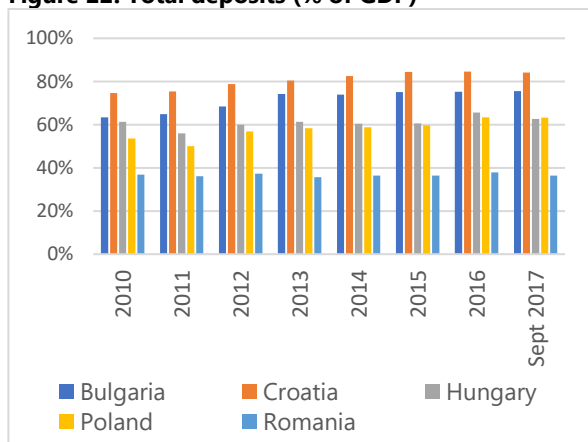
40. The banking sector in Romania is relatively shallow and has been declining relative to the economy. The banking sector in Romania is shallow with banking sector assets amounting to 52.7

percent of GDP as of September 2017, one of the lowest in the region (peer average²⁹: 104.9 percent) and significantly lagging the eurozone average (278.9 percent). This divergence is even more striking in the context of a growing economy in the post-crisis period. Between 2009-2016, Compound Annual Growth Rate (CAGR) of banking sector assets was 2.5 percent, lagging that of nominal GDP (6.2 percent).

41. The lagging banking intermediation is reflected in a low deposit and loan penetration.

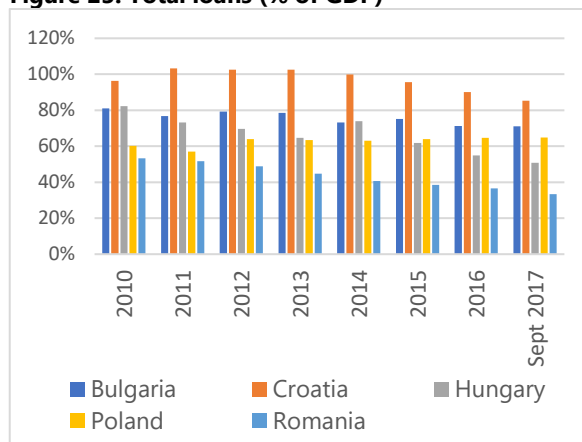
Romania is lagging both in terms of deposit and bank loan penetration. The deposit base as a share of GDP stood at 36.3 percent in September 2017 vs. peer average of 71.4 percent and eurozone average of 157.7 percent. Similarly, total banks loans relative to GDP reached 33.4 percent compared to a peer average of 68.0 percent and eurozone average of 164.7 percent of GDP in the same time period. This lagging depth is observed across both major segments of the market: households and enterprises. Household deposits, which form the majority of deposits (55.0 of total deposits), reached 20.5 percent of GDP, compared to 40.5 percent for peer countries. Loans to households amounted to 14.4 percent of GDP vs. peer average of 25.9 percent and loans to enterprises amounted to 12.7 percent of GDP vs. peer average of 22.5 percent.

Figure 22: Total deposits (% of GDP)



Source: ECB, Eurostat

Figure 23: Total loans (% of GDP)



Source: ECB, Eurostat

42. The low credit intermediation is rooted in a protracted period of transition in the 1990's and slower credit expansion in the period leading up to the global financial crisis.

Romania experienced intense financial disintermediation in the post-communist era, as a result of several bank failures, high inflation, and the weak financial performance of state-owned entities, among other factors. In the decade 1990-2000, private sector loans to GDP fell from 79.7 to 9.2 percent in Romania, similar to Bulgaria (from 118.5 to 12.0 percent in 2000.³⁰ While comparable time-series is not available,

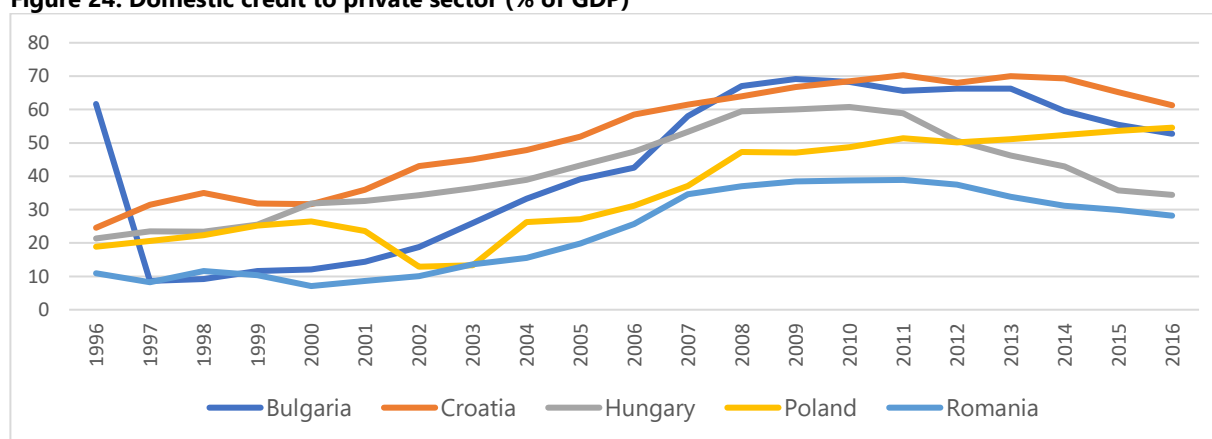
²⁹ Average for Bulgaria, Croatia, Hungary, Poland

³⁰ Source: NBR Study Book No. 48

other countries in the region seem to have experienced milder or less prolonged disintermediation.³¹ Credit intermediation picked up after 2000 across the region. In Romania, private credit reached a high of 39.2 percent of GDP in 2011, supported by positive economic and political developments, such as the NATO and EU accession process in 2004 and 2007 respectively. Other countries, however, experienced even faster growth in intermediation, e.g. in Hungary private credit increased from 21.3 (1996) to a high of 66.1 (2010) and Bulgaria from 8.6 (1997) to 69.9 percent in (2009).

43. The positive trend in intermediation was reversed in the context of the crisis, which has been linked to weaker and more protracted economic recoveries. Since 2012, private credit in Romania has been declining relative to GDP each year, despite resumption of economic growth. It seems that, as other countries in the region, Romania experienced a credit-less recovery after the financial crisis.³² Hence, while the crisis was not the cause for the initial lagging credit intermediation, it greatly contributed to its deceleration post crisis. Literature suggests that credit-less recoveries tend to be weaker and more protracted (i.e. takes longer for economic growth to return to trend) and that sectors more dependent on external finance grow less in such a recovery while more financially dependent activities (such as investment) are curtailed more.

Figure 24: Domestic credit to private sector (% of GDP)



Source: World Development Indicators

44. The composition of the loan portfolio is also more heavily tilted towards shorter-term loans, most likely driven by fewer investment loans. Long-term loans (defined as those with initial maturity over 5 years) amounted to 35.1 percent of total loans to NFCs in Romania, vs. 49.3 in peer countries.³³ While the medium and long-term loans have increased in volume in the last 5 years, the limited participation of the NFCs in the bank credit market (10.4 percent of NFCs) makes the overall

³¹ In Hungary, private sector loans to GDP fell from 31.2 percent in 1992 to 21.3 percent in 1996, in Czech Republic from 61.3 percent in 1993 to 27.1 in 2002.

³² There are several definitions of "credit-less recoveries," typically they are characterized by zero or negative credit growth in a certain period after economic recovery.

³³ Source: ECB. According to Central Credit Registry data at end 2017, 37.3 percent of loans were granted to nonfinancial companies with an original maturity higher than 5 years.

bank lending provided for investment needs is insignificant. Enterprise surveys suggest that in Romania most enterprises borrow for short-term working capital as opposed to investment³⁴ (see Section V). Furthermore, there do not seem to exist any meaningful differences in the maturity profile of the liability structure of banks in Romania. Long-term household deposits (defined as those over 2 years in maturity) amounted to 8.6 percent of total in 2017, not far from the EU average of 10.6 percent and Central and Eastern Europe average of 9.6 percent. Hence, it seems the gap in the divergence of the maturity profile of NFC loans in Romania may not be attributed to a limited availability of long-term household deposits. While the Net Stable Funding Requirement (NSFR)³⁵ is not calculated by the NBR, NSFR ratios were calculated for 12 banks within the context of the FSAP, and almost all banks meet an NSFR ratio of above one.

Banking Sector Structure and Performance

45. The banking sector is competitive for certain segments and the industry is set to continue a process of consolidation. As of September 2017, there are 36 banks operating in the country, 8 of which are foreign bank branches. There are 2 state-owned banks (CEC Bank, Banca de Export-Import a României – Eximbank) with combined share of assets of 8.4 percent. The market has been undergoing a process of consolidation with the number of banks gradually declining from 43 in 2008. This trend is expected to continue as there are 19 banks with market share below 1 percent. Large banks (more than 5 percent share in assets) currently hold 73.5 percent of assets. Competition indicators including the Herfindahl-Hirschman (895 vs around 1,000 in the EU) and asset concentration for the top five banks (58.1 percent vs 63 percent across the EU) point to sufficient room for competition given the size of the economy. However, while this competition is fierce, particularly for large corporates and bankable SMEs, banks are not serving other segments, such as micro-enterprises and rural areas. (see Box 2)

46. The banking market is majority foreign-owned and parent banks consider Romania a key market. Foreign-owned institutions represent 77.0 percent of total bank assets as of end 2017. In the EIB's CESEE Bank Lending Survey H2-2017,³⁶ 73 percent of the parent banks consider Romania a market with high potential; the highest score among all the countries included in the survey. Romanian operations are also more profitable than the rest of the group with 63 percent of respondents report higher Return on Assets (RoA) and 75 percent higher Return on Equity (RoE) compared to the overall group level. During the FSAP mission, market participants indicated a long-term view on the Romanian

³⁴ According to the SAFE survey conducted by the EC in September-October 2017, 42.4 percent of respondent firms in Romania used external financing for inventory and other working capital, vs. 38.4 percent for fixed investment. In the NBR's Survey on the access to finance for NFC's conducted October 2016 – March 2017, 73 percent of respondent firms accessed external financing for working capital vs. 44 percent for investment. It is noted that multiple answers were allowed in NBR's survey.

³⁵ NSFR (Net Stable Funding Requirement) = Available stable funding (ASF)/Required stable funding (RSF), where: ASF captures all funding sources, weighted by stability factors; and RSF captures all assets and off-balance-sheet commitments, weighted by illiquidity factors.

³⁶ Albania, Bosnia-Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Macedonia, Poland, Romania, Serbia, Slovakia, Slovenia and Ukraine1.

market. For two leading foreign-owned banks, not only is the local subsidiary a significant local market player, but Romanian operations are also important for the group as a whole.³⁷

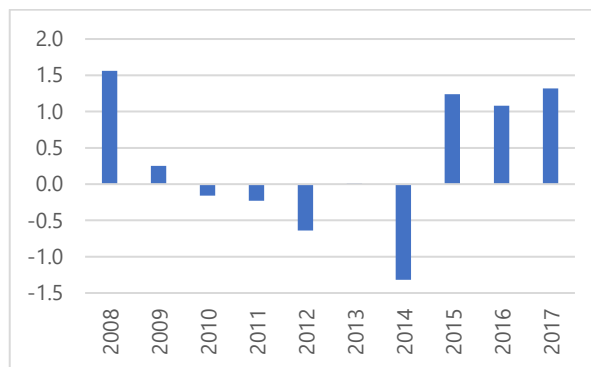
47. The sector is well capitalized and profitable. The Capital Adequacy Ratio (CAR) at system level stood at 19.0 percent as of September 2017, significantly higher than the NBR's minimum threshold of 8 percent. Profitability declined after 2008 and banks experienced losses in 2012-2014, driven to a large extent by measures to reduce Non-Performing Loans (NPL) in 2014. Profitability rebounded to positive territory in 2015 and further improved in 2016 and 2017, with average sector RoA and RoE growing to 1.4 percent and 12.9 percent respectively.

Figure 25: Capital Adequacy (%)



Source: NBR

Figure 26: Return on Assets (%)



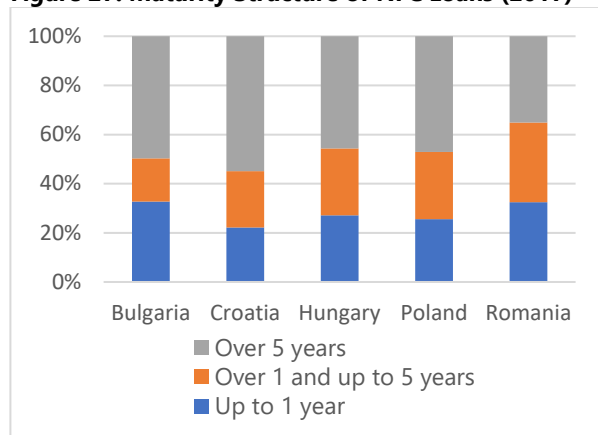
Source: NBR

48. Banks in Romania are highly liquid. The aggregate Liquidity Coverage Ratio³⁸ in Romania is above 200 percent both in EUR and RON, significantly above the 100 percent prescribed ratio under the Basel framework. Furthermore, the ratio of loans to deposits for Romania in 2017 amounted to 91.6 percent, compared to 94.4 percent average for the four peer countries and 104.3 percent for the euro area. As a result of stronger growth of deposits than loans in the period 2009-2016, the Loan-to-Deposit ratio has been declining since 2008. Banks' liquidity position is comfortable and, as stated by several banks during the interviews, attracting deposits is not a key business target. Hence, lagging intermediation is not the result of banks' liquidity pressures.

³⁷ BCR (Erste) has 16.3 percent share of assets as of 2016 and the Romanian subsidiary accounts for 6.8 percent of group assets, higher than Croatia and Hungary. Raiffeisen has 8.5 percent share of assets and the Romanian subsidiary accounts for 6.6 percent of the group's assets, higher than Bulgaria, Croatia, and Hungary.

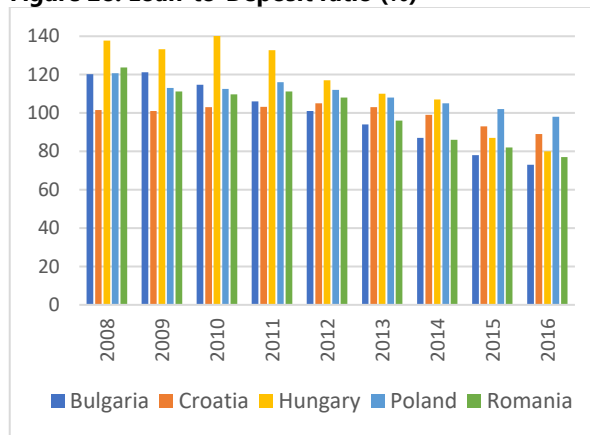
³⁸ The Liquidity Coverage Ratio is calculated by dividing High Quality Liquid Assets by Total Net Cash Outflows over a 30-day time period.

Figure 27: Maturity Structure of NFC Loans (2017)



Source: ECB

Figure 28: Loan-to-Deposit ratio (%)



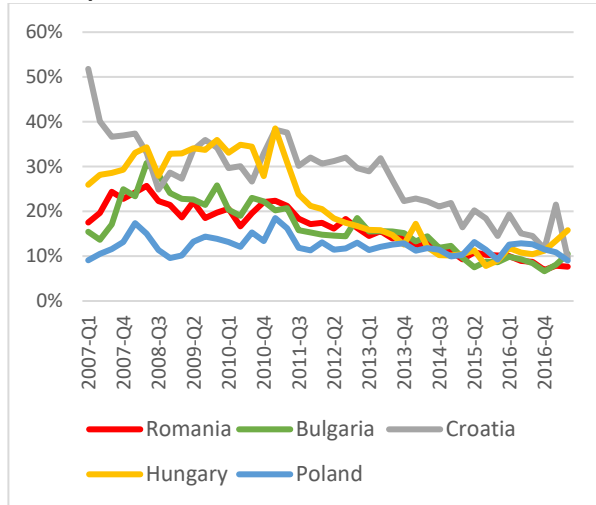
Source: Raiffeisen Research

49. Credit supply was partially negatively affected by foreign bank deleveraging. As the sector is mostly foreign-owned, it experienced persistent deleveraging after the crisis, similar to other countries in the region, particularly after the end of Vienna Initiative 1.0.³⁹ External exposures of BIS-reporting banks to Romanian banks declined from 21.4 percent of GDP at the end of 2008 to 7.7 percent of GDP in the second quarter of 2017. However, the decline in foreign bank funding took place in an orderly manner and was partially offset by the gradual shift towards local deposit funding, with deposits growing with 4.7 percent CAGR in 2008-2016. At the same time, the deleveraging process did not generate liquidity pressures for the banks, aided by a reduction in NBR’s minimum reserve requirement from 18 percent to 8 percent for RON denominated liabilities and from 40 percent to 8 percent on FX denominated liabilities. However, the deleveraging process led to a re-definition of banks’ business models.

50. Banks increased their exposure to the sovereign. As of December 2016, the sovereign debt exposure of banks was around 20 percent of assets, increasing from below 5 percent in 2008, and making the Romanian banking system one of the most exposed in the EU. The increasing exposure to sovereign is contrasted by the stagnant share of credit to enterprises and entails an important risk for individual banks and the system as a whole. This topic is explored in greater detail in the Technical Note on Macroprudential Policy Framework and Tools developed under the FSAP. NBR is planning to undertake an impact study of the introduction of a capital buffer in order to mitigate excessive exposure of banks on sovereign.

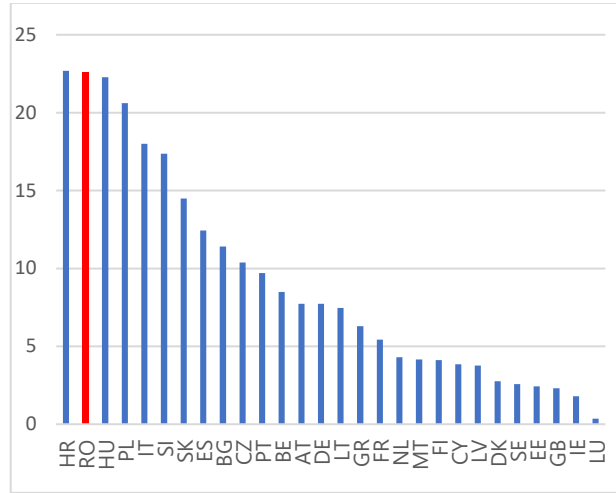
³⁹ The Vienna Initiative 1.0 was launched in January 2009 at the height of the global financial crisis. It comprised major international financial institutions as well as the most important European institutions, home and host country regulatory and fiscal authorities of large cross-border bank, and the largest banking groups operating in emerging Europe, and supported by international organizations. Key objectives were to prevent a large-scale and uncoordinated withdrawal of cross-border bank groups from the region, and ensure that parent bank groups maintain their exposures and recapitalize their subsidiaries in emerging Europe.

Figure 29: Bank's External positions, FX adjusted (% of GDP)



Source: BIS

Figure 30: Sovereign debt exposures (% of total assets, December 2016)

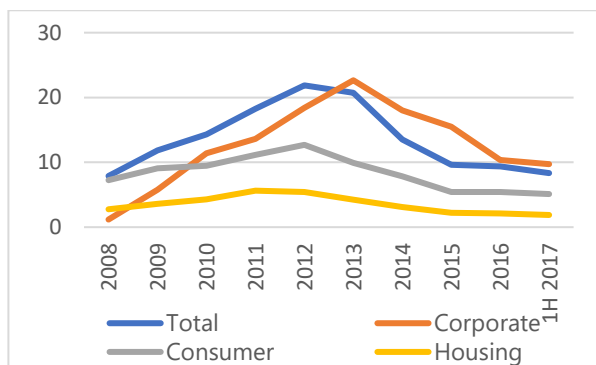


Source: NBR

51. The supply of credit was also affected by high NPLs, particularly for micro-enterprises.

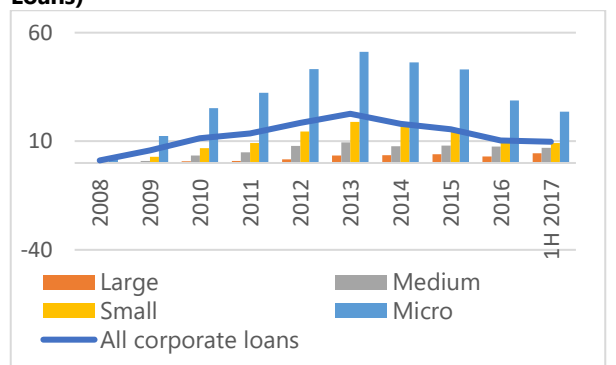
Asset quality rapidly deteriorated with the crisis with the ratio of NPLs to gross loans rising from 2.7 percent in 2008 to a high of 21.6 percent in 2013, led by the corporate segment. As a result of supervisory measures adopted by the NBR and implemented by banks, NPLs dropped sharply to 6.4 percent at the end of December 2017. The reduction in NPLs took place by sales of distressed assets by banks to debt collecting agencies (local and foreign), which resulted in a decline in the value for outstanding loans on the banks' balance sheets. However, while bank asset quality has improved overall, NPL levels remain elevated for certain sectors (20.8 percent in construction and 11.0 for real estate) and for micro-enterprises (23.6 percent) as of June 2017.

Figure 31: Non-Performing Loans (% of Gross loans)



Source: NBR

Figure 32: Corporate NPLs by firm size (% of Gross Loans)⁴⁰



Source: NBR

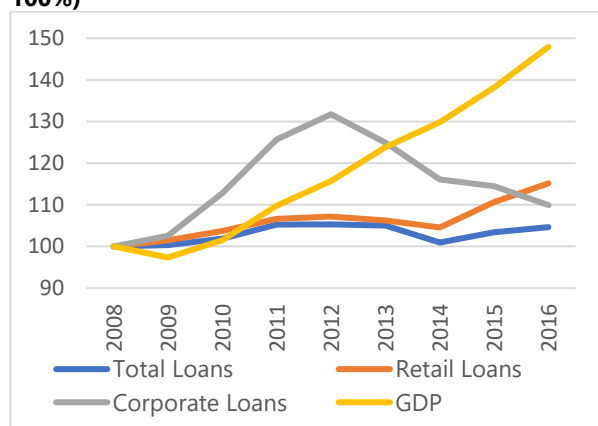
⁴⁰ Using EU definition of SME and excluding atypical firms. As of June 2017, NPL ratio in this segment was 4.5 percent

Lending to Corporates

52. Despite resumption of economic growth, credit to the real economy, especially to finance investment and MSMEs, has underperformed expectations. Growth of the banking sector has not kept pace with the economy, with bank assets and credits growing at a CAGR of 2.8 and 3.1 percent in the period 2008-2016 vs. 5.0 percent CAGR for nominal GDP. In particular, growth in the NFC segment remained marginal, with 0.9 percent CAGR in the same period. Banks have increasingly shifted their portfolios to large corporate clients and away from MSMEs since the crisis. By company size, loans to MSMEs registered a 0.6 percent decline in compound terms, driven by loans to the micro-enterprise segment, which registered a decline of 8.4 percent. By loan purpose, investment loans were most affected declining by 1.1 percent in compound terms. Meanwhile the household segment grew by 1.6 percent CAGR, driven by housing loans and the “Prima Casa” program.⁴¹

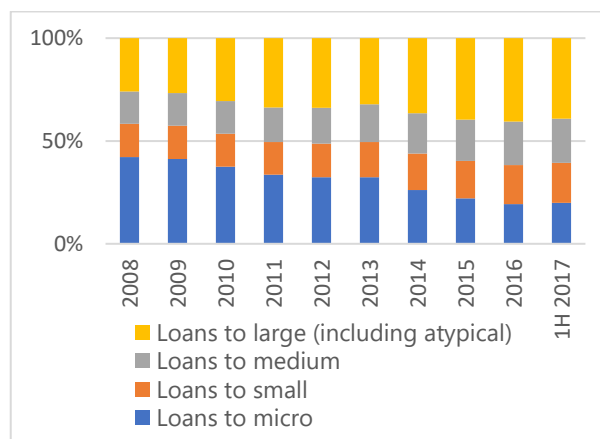
53. Banks loan portfolios are disproportionately geared towards larger companies and urban areas. The aggregate loan comprises loans to NFCs (42.9 percent) and households (50.4 percent), with the remainder attributable to government and financial corporations. Within corporates, the majority of outstanding loans are to SMEs (41.0 percent), while large corporates (including atypical firms) account for 39.1 percent and micro-enterprises the remaining 19.8 percent. In the survey, among 27 banks surveyed, 17 indicated that they use their own internal definition for MSMEs and 23 that they provide loans to MSMEs, with shares of MSME loans in the overall corporate portfolio averaging 44.8 percent. There are 8 banks which focus predominantly on the MSME market, with MSME loans accounting for the majority of their corporate portfolios. At the same time, banks are focusing most of their businesses in urban areas, and in particular Bucharest, which accounts for more than a third of SME loans on average. Only 5 banks have branches in rural areas, led by state-owned CEC Bank.

Figure 33: Loan and GDP evolution (2008 indexed to 100%)



Source: NBR

Figure 34: Composition of corporate loan portfolio⁴²



Source: NBR, MoPF, CCR

⁴¹ The Prima Casa program provides state guarantees for home purchase guaranteeing 50 percent of the loan amount. The program is explored in greater detail in the Technical Note on Macroprudential Policy Framework and Tools developed under the FSAP.

⁴² Using EU definition of SMEs

Box 2. Enterprise access to bank finance

Start-ups do not have access to traditional bank financing. Young firms rely less on bank financing and more on informal financing as they lack track record and strong balance sheets, which can be used for collateral. In addition, bank lending is not the best funding vehicle specifically for innovation in new firms, as banks cannot bear the inherent high risk. Banks prefer to use physical assets to secure loans and are reluctant to lend when the project involves substantial R&D investment rather than investment in plant and equipment. Also, banks typically do not have the necessary skills to evaluate projects with few collateralizable assets and significant uncertainty, and lack incentives to monitor firms closely (e.g. they do not share in the upside of the firm's success). Hence risk capital in the form of angel investment and venture capital is better suited for start-ups.⁴³ Nonetheless, venture capital requires the presence of investors, experienced, venture fund managers, and a market for Initial Public Offerings (IPOs) to enable exit of investors. In Romania, there is a significant under-supply of pre-seed and seed financing for start-ups.

The small size, informal practices, and poor financial condition, hampers banks' ability to adequately assess the risk of microenterprises. The majority of micro-enterprises are informal, operating on a cash basis and only a small share of their transactions channelled through the financial sector. The perceived and actual risks connected to lending to micro-firms resulted in banks retrenching from the segment almost fully after the crisis. The high NPLs in the micro sector in the context of the crisis resulted in more restrictive credit policies for the segment and the exit of some of the institutions. As of today, only a few financial institutions proactively pursue microenterprises, in a few cases through dedicated vehicles (BT Mic – a Non-Financial Institution created by Banca Transylvania) while the remaining ones only pursue the segment opportunistically. As of end 2016, only 7.6 percent of micro-enterprises had a bank loan compared to 12.1 percent in 2008.⁴⁴

SMEs are a very heterogenous group being served by banks in a differentiated manner. Banks define SME segments differently and do not serve them equally. One of the main problems in granting credit to SMEs is the high transaction costs of processing, monitoring, and enforcing small loans, which increase break-even interest rates for these loans. Furthermore, many small firms lack adequate documentation and records to successfully apply for a loan or are unregistered. According to the Romanian Council for SMEs (CNIMPMMR), pre-crisis, more than 50 percent of SMEs had access to financing from the banking sector. High NPLs during the crisis especially for small enterprises (which had a peak of 18.9 percent⁴⁵ in 2013) forced the banking sector to become much more selective in serving SMEs. Operational challenges faced by the National Credit Guarantee Fund for SMEs (FNGCIMM) (see Section VII) further increased the risk aversion of banks toward the segment. As a result, the share of those SMEs with access to bank credit more than halved (from 65 percent to less than 30 percent).⁴⁶

Large corporates remain a preferential target for the banking sector. Large corporates are well established enterprises with long standing relationships with banks. Banks compete to serve the segment, including through the provision of credit lines and/or overdraft facilities: 43.4 percent of large firms have domestic bank loans.⁴⁷ Only a small number of the remaining firms are credit constrained, as the majority of these firms report that they are not in need of credit, or are foreign firms that often prefer to receive funding by the parent company outside Romania, because of the lower cost of financing.

Non-banking Financial Institutions

54. The Non-Bank Financial Institution (NBFI) sector was even more severely affected by the crisis than the banking sector and has not fully recovered yet. The NBFI sector in Romania is small, amounting to 6.0 percent of financial sector assets and 4.3 percent of GDP as of September 2017,

⁴³ Hall, B and Lerner, J. (2009)

⁴⁴ Based on data received from the CCR. This does not capture loans below the reporting threshold of 20,000 RON.

⁴⁵ As per data provided by NBR

⁴⁶ Data received from NBR differs from the CNIMPMMR. According to NBR data, 41.5 percent of small firms and 53.8 percent of medium-sized firms had a bank loan in 2016.

⁴⁷ As per data provided by NBR

down from 8.6 percent of GDP in 2008. The sector was severely hit by the financial crisis with a decline of -3.6 percent in compound terms in the period 2008-2016, although assets began to gradually grow starting in 2014. The decline was primarily driven by financial leasing to NFCs, which experienced a reduction of -26.1 percent in compound terms in the same period. Leasing assets currently amount to 0.1 percent of GDP as of September 2017, which is extremely low by international comparison. According to the Global Leasing Report 2017, the penetration of leasing in Romania, measured as the percentage of investment financed by leasing,⁴⁸ is low, amounting to 4.5 percent in 2015. The adjustment of the NBFIs sector after the financial crisis ended in 2014, NBFIs lending subsequently re-embarking on an upward trend and, starting with 2016, the share of NBFIs lending in total lending (banks and NBFIs) exceeded the 10 percent threshold. These developments, coupled with certain practices of granting short-term, small loans at high cost to vulnerable consumers prompted the NBR to revise the regulatory framework applicable to NBFIs.

Capital Markets

55. Despite significant progress in the development of Romania's capital markets in the past few years, they are not playing a meaningful role in corporate financing. The capital market in Romania is the least deep across Europe. According to New Financial, a UK-based think tank focused on capital markets, using an index which measures capital markets activity in 23 different sectors relative to GDP, with the EU average index based to 100, Romania's index is 16.⁴⁹ Listed stock and debt securities amounted to 37.1 percent of GDP at the end of 2016, vs. 219.9 percent in the EU. In particular, the equity market, which is accessible to more established companies, is significantly smaller than regional peers even though most countries' stock exchanges were launched within the same time period in Eastern Europe between 1990 and 1997.⁵⁰ The Bucharest Stock Exchange had a market capitalization to GDP ratio of 20 percent and 87 listed companies as of end-2017. The secondary market also has very low liquidity. The topic is explored in greater detail in the Financial Sector Assessment.

56. Private equity is nascent in Romania, as in the rest of the region. Private equity is a medium to long-term option for companies that are in the early expansion phase and that are not listed on the stock exchange. This form of financing involves active ownership by investors, offering the possibility of drawing on management expertise, foster operational improvements and gain access to new markets. Within private equity, venture capital or business angels can be an appealing source of financing specifically for seed and start-up capital. Business angels, usually providing smaller financing than venture capital funds, are private high net worth individuals who directly invest part of their personal assets in new unlisted businesses. They typically bring industry knowledge and contacts to the entrepreneurs and take non-executive board positions. Private equity investment in Romania is

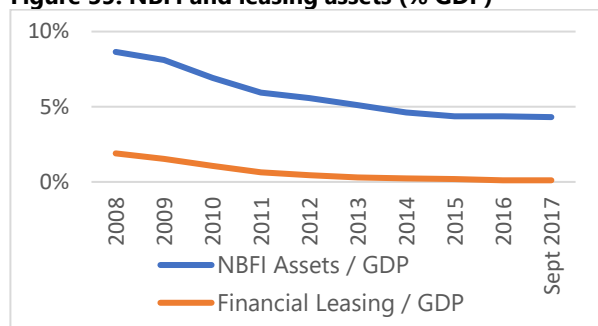
⁴⁸ Calculated as total new business volume divided by total investment, excluding real estate

⁴⁹ Including among others IPO proceeds, secondary offerings, convertibles issuance, High Yield and Investment Grade bond issuance, syndicated loan issuance, securitisation issuance, Merger & Acquisition activity, private equity, Venture capital, pools of capital. The report is available at <http://newfinancial.eu/report-on-the-benefits-of-capital-markets-to-high-potential-eu-economies-2/>

⁵⁰ For comparison, Budapest Stock Exchange was founded in 1990, Zagreb and Warsaw stock exchange was founded in 1991, Bucharest Stock Exchange was founded in 1995, and the Bulgarian Stock Exchange was founded in 1997.

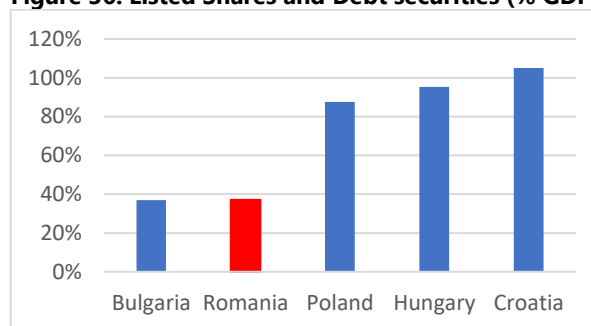
modest, in line with the region; total investments amounted to 0.1 percent of GDP in 2016. At the same time, venture capital was a mere 1.6 percent of the total private equity investment in 2016.

Figure 35: NBFIs and leasing assets (% GDP)



Source: NBR

Figure 36: Listed Shares and Debt securities (% GDP)



Source: ECB, Eurostat

Table 2: Private Capital Investment

2016	Private equity				Business angels	Crowd-funding
	total		o/w venture capital		EUR mIn	total EUR mIn
	EUR mIn	% of GDP	EUR mIn	% of total		
Lithuania	155.98	0.40%	3.22	2.06%	1.10	23.53
Estonia	75.57	0.36%	6.51	8.61%	8.80	40.57
Slovenia	72.91	0.18%	2.97	4.07%	3.30	1.74
Poland	725.41	0.17%	21.43	2.95%	12.60	38.15
Serbia	48.43	0.14%	1.08	2.23%	2.30	N/A
Latvia	25.71	0.10%	7.89	30.69%	2.40	21.70
Czech Republic	168.12	0.10%	4.20	2.50%	5.00	19.57
Croatia	41.02	0.09%	3.81	9.30%	1.00	N/A
Romania	147.26	0.09%	2.36	1.60%	1.30	1.2
Hungary	88.73	0.08%	31.25	35.22%	5.50	0.47
Bulgaria	23.03	0.05%	5.50	23.89%	5.00	0.96
Slovakia	12.72	0.02%	9.97	78.38%	2.10	3.21

Source: Invest Europe, EBAN, Cambridge Centre for Alternative Finance; WB calculations

VII. The Role of the State

57. Despite a big overall state footprint in the financial sector, the role of the Romanian state is fragmented with suboptimal coordination and monitoring. States can have a crucial role in the financial sector beyond regulation and supervision e.g. through direct ownership of banks and through financial support programs (grants, guarantees etc.) targeted to the real sector. States also facilitate financial intermediation by putting in place conducive financial infrastructure, which is treated in Section VIII. The Romanian state has a significant role with state ownership of two commercial banks and financial support programs amounting to 1.7 percent of state budget. However, there is a gap in coordination among all state actors involved. Public initiatives to support access to finance are too fragmented, and lack efficiency, coordination, proper monitoring, and accountability. There is no clear strategy encompassing all state institutions and initiatives, and existing programs are fraught with duplications, and overlapping and unclear mandates.

State-Owned Banks

58. The Romanian state is direct owner of two commercial banks. There are two state-owned banks (CEC Bank, EximBank) with combined share of 8.3 percent of banking sector assets. While both banks operate on a commercial basis and are supervised by the NBR as such, they both have a quasi-developmental mandate, especially in the absence of a development bank in Romania.

59. CEC Bank operates as a commercial bank, with a significant rural presence and a strong focus on SMEs. CEC bank is one of two state-owned banks and was founded in 1864 as a savings bank. The bank operates as a commercial bank and is the fifth largest bank, with 7.2 percent share of assets as of end 2016. While it is a universal bank, it focuses primarily on SMEs, agriculture, public administration, as well as those banking projects that, by their nature, contribute to the economic development, and support employment generation. The bank has the largest branch network, totaling 1,033 as of end 2016, including 486 in rural areas (88 percent of all commercial bank rural branches). CEC Bank is supervised by NBR, as other commercial banks. While there have been efforts to privatize the bank (including a tender in 2006), this process has been discontinued. At the end of 2016, the bank was profitable and well-capitalized.

60. EximBank operates both as a commercial bank as well as a state agent. The Export – Import Bank of Romania (EximBank) was founded in 2000 (Law no. 96/2000) as a specialized institution mandated to support the Romanian business environment and the international transactions through specific financial, banking and insurance instruments. EximBank is a private law entity, a joint stock company owned 95.4 percent by the state, through the Ministry of Public Finance (MoPF).⁵¹ EximBank operates as a commercial bank serving only legal entities, primarily exporters. As of the end of 2016, it had 1.1 percent market share of assets. In addition, it acts as a state agent, intermediating government funds for the development of the Romanian business environment through specific financing, guarantee and insurance products. These exposures are not recorded on the EximBank's balance sheet. At the end of 2016, EximBank managed total exposures (financing and guarantees)

⁵¹ The remainder is held by 5 financial investment companies (SIFs).

amounting to RON 5,065 million, of which two thirds represented commitments given out of its own account, and the remainder was given in its capacity as state agent. At the end of 2016, the bank was profitable and well-capitalized.

61. State operations managed by Eximbank focus on guarantees, which are approved by an inter-ministerial committee. Operations conducted on behalf of the state focus on guarantees for corporates, but also include loans and insurance for exports. Guarantees are provided for up to 80 percent of loans granted by commercial banks, including EximBank itself. The guarantee for large corporates covers working capital and investment loans up to a maximum of EUR 50 million while the SME guarantee facility covers SME loans for investment and working capital, up to RON 1.5 million. The portfolio of guarantees at the end of 2016, consists of 257 issued guarantees and amounts to RON 1,628 million, out of which 49 percent guarantees EximBank products. The guarantee facilities granted on behalf and to the benefit of the state, as well as individual financing, guarantee, and insurance operations are approved by the Inter-Ministerial Committee for Financing, Guarantees and Insurance, which is composed of representatives of the specialized bodies of central public administration and of EximBank, based on government's decision.⁵²

62. An initiative is underway to develop a Romanian development bank. Romania is one of the few EU countries without a development bank. In context of the renewed focus on National Promotional Banks in the EU, the Romanian authorities are considering establishing a national development bank. The MoPF has started the project on setting-up the Romanian National Development Bank with the following components: a) ex-ante assessment report on market failures in Romania, including for SMEs, and start-ups, as well as other associations, NGOs, universities etc., as well as identification of overlapping activities among public entities, b) propose two scenarios on the legal and operational structure of the development bank, one of which will be under the umbrella of EximBank, c) develop an implementation study for the new selected entity as development bank, including legal and operational framework and d) present a roadmap for the implementation of national development bank. The project is supported by the EC's Structural Reform Support Service.

Credit Guarantee Schemes

63. The state enables access to finance for enterprises through two state-owned guarantee schemes. There are two state-owned guarantee funds, focusing on facilitating access to finance for SMEs by commercial banks. Guarantee instruments are broadly considered catalytic and a useful tool in supporting SME financing by Romanian banks. Based on a preliminary assessment, both schemes

⁵² According to Decision No. 534 / 2007 On the establishment, duties, powers, and operation of the Inter-Ministerial Committee of Financing, Guarantees and Insurance, the committee is composed of: the President (State Secretary in the MoPF, Coordinator of the Budget Department), 2 Vice-presidents (State Secretary in the Ministry of Economy, President of EximBank), and 12 members (General Secretary of the Romanian Government and Representatives of the Ministry of Public Finance, the Ministry of Internal Affairs, the National Agency for Public Acquisitions, the Regional Development Ministry Public Administration and European Funds, the General Secretariat of Romanian Government, the MoARD, the Ministry of Transportation, the Agency of State Assets Administration, the Regional Development Ministry of Public Administration and European Funds, and the Ministry of Water and Forestry.

deviate from best practices in several areas including the legal and regulatory framework, corporate governance and risk management, operational framework and monitoring and evaluation.⁵³

Table 3: Comparison of FNGCMM and FRC against World Bank principles

Principles for Public Credit Guarantee Schemes for SMEs	FGCMM	FRC
Legal & Regulatory Framework		
Principle 1: The CGS should be established as an independent legal entity on the basis of a sound and clearly defined legal and regulatory framework to support the effective implementation of the CGS's operations and the achievement of its policy objectives	Compliant	Compliant
Principle 2: The CGS should have adequate funding to achieve its policy objectives, and the sources of funding, including any reliance on explicit and implicit subsidies, should be transparent and publicly disclosed.	Compliant	Compliant
Principle 3: The legal and regulatory framework should promote mixed ownership of the CGS, ensuring equitable treatment of minority shareholders.	Non-compliant	Partially compliant
Principle 4: The CGS should be independently and effectively supervised on the basis of risk-proportionate regulation scaled by the products and services offered.	Compliant	Compliant
Corporate Governance & Risk Management		
Principle 5: The CGS should have a clearly defined mandate supported by strategies and operational goals consistent with policy objectives.	Partially compliant	Partially compliant
Principle 6: The CGS should have a sound corporate governance structure with an independent and competent board of directors appointed according to clearly defined criteria.	Partially compliant	Compliant
Principle 7: The CGS should have a sound internal control framework to safeguard the integrity and efficiency of its governance and operations.	Compliant	Compliant
Principle 8: The CGS should have an effective and comprehensive enterprise risk management framework that identifies, assesses, and manages the risks related to CGS operations.	Compliant	Compliant ⁵⁴
Operational Framework		
Principle 9: The CGS should adopt clearly defined and transparent eligibility and qualification criteria for SMEs, lenders, and credit instruments.	Compliant	Compliant
Principle 10: The CGS's guarantee delivery approach should appropriately reflect a trade-off between outreach, additionality, and financial sustainability, taking into account the level of financial sector development of the country.	Partially compliant	Partially compliant
Principle 11: The guarantees issued by the CGS should be partial, thus providing the right incentives for SME borrowers and lenders, and should be designed to ensure compliance with the relevant prudential requirements for lenders, in particular with capital requirements for credit risk.	Compliant	Compliant
Principle 12: The CGS should adopt a transparent and consistent risk-based pricing policy to ensure that the guarantee program is financially sustainable and attractive for both SMEs and lenders.	Compliant	Partially compliant
Principle 13: The claim management process should be efficient, clearly documented, and transparent, providing incentives for loan loss recovery, and should align with the home country's legal and regulatory framework.	Compliant	Partially compliant
Monitoring & Evaluation		
Principle 14: The CGS should be subject to rigorous financial reporting requirements and should have its financial statements audited externally.	Compliant	Compliant

⁵³ World Bank. 2015. Principles for public credit guarantee schemes for SMEs

⁵⁴ Following reforms and improvements after the Court of Accounts audit

Principle 15: The CGS should periodically and publicly disclose nonfinancial information related to its operations.	Partially compliant	Partially compliant
Principle 16: The performance of the CGS—in particular its outreach, additionality, and financial sustainability—should be systematically and periodically evaluated, and the findings from the evaluation publicly disclosed.	Non-compliant	Partially compliant

Source: Self-Assessment Questionnaires and WB assessment

64. The preeminent state financial support mechanism for private enterprises is FNGCIMM.

The National Credit Guarantee Fund for SMEs (FNGCIMM) was founded in 2001 as fully state-owned entity with registered share capital of RON 931.3 million. The purpose of FNGCIMM is “to improve the SMEs’ access to finance” based on its legal framework (Law no.346/2004 on promoting the establishment and development of small- and medium-sized enterprises). FNGCIMM is registered in the Special Register of NBFIs with the NBR while the MoPF represents the state as shareholder.

65. FNGCIMM provides guarantees to SMEs out of its own capital and also acts as agent for various state programs. FNGCIMM provides guarantees to MSMEs based on its own funds guaranteeing up to 80 percent of the SME loan nominal amount and with a maximum individual guarantee of up to EUR 2.5 million per SME. FNGCIMM also acts as manager of various guarantee funds/schemes of the Ministry for Agriculture and Rural Development (MoARD) as well as state agent of the MoPF for a number of guarantee programs, such as the “Prima Casa” program.

66. The guarantee instrument was widely used by banks in the immediate aftermath of the crisis but operations have since declined. The guarantee business was successful in the wake of the crisis with operations growing by 65.9 percent per year from 2008-2012. The guarantee business began to decline after peaking in 2012 as bank lending to MSMEs fell. In addition, the fund faced operational weaknesses, revealed during a Court of Accounts audit in 2013. The audit identified several instances of guarantees provided outside of the established guidelines, as interpreted by the Court of Accounts, leading to cases of delayed or refused payment on called guarantees to banks. Consequently, the value of guarantees refused by FNGCIMM grew by 20.4 times in the period 2011-2016, much faster than the value of incoming requests for payments by banks (1.4 times). While the fund undertook several reforms to improve operational performance since the audit, the bank survey indicates that currently only 4.4 percent of banks’ SME loans are guaranteed by FNGCIMM and banks’ average satisfaction with FNGCIMM is rated 2.7 (1 = Very Unsatisfactory, 5 = Very Satisfactory). Banks cited as reasons for the rating high bureaucracy, delays or refusals for processing payment requests, and perceived lack of transparency in the process of enforcement. As a result, the fund now uses only a small portion of its capital: the leverage ratio at the end of 2017 was 1.1 vs a legal maximum of 7.

Table 4: FNGCIMM Key financial indicators

Amounts in RON million	12/31/2017	12/31/2016	12/31/2015	12/31/2014	12/31/2013	12/31/2012	12/31/2011	12/31/2010	12/31/2009
Number of operations	2,903	2,801	5,192	8,218	9,923	10,750	9,272	8,474	6,549
Number of outstanding guarantees	5,102	6,290	11,658	14,623	15,368	14,489	11,529	9,481	7,010
Total Credit Amount	1,134	1,434	2,410	4,078	5,113	5,661	4,254	3,759	3,447
Total Coverage Amount	724	854	1,481	2,441	2,927	3,093	2,142	1,870	1,611
Amount of outstanding guarantees	1,064	1,287	2,283	3,157	3,511	3,335	2,302	1,933	1,626
Average Coverage Ratio (%)	64%	60%	61%	60%	57%	55%	50%	50%	47%
Number of SME beneficiaries	2,647	2,339	4,155	6,320	7,571	8,336	7,468	7,187	5,607
Total Capital	998	1,001	973	1,009	976	980	954	701	279
Volume of enforced and paid guarantees	54	97	64	72	79	56	143	118	66
Number of enforced guarantees	216	229	204	277	325	250	407	274	113
Leverage Ratio	1.1	1.3	2.3	3.1	3.6	3.4	2.4	2.8	5.8

Source: FNGCIMM

67. FNGCIMM is challenged to meet its objective of supporting SME access to finance. As a result of the increasing use of other guarantees, such as EIF guarantees, the Eximbank guarantee facility described above, the privately-owned Romanian Rural Credit Guarantee Fund⁵⁵ and Loan Guarantee Fund (FRGC),⁵⁶ FNGCIMM is challenged to focus on its target segment of SMEs. The fund is currently re-balancing its guarantee operations with an enhanced focus on SMEs and specific segments such as small businesses, agriculture, rural areas, and tourism. However, it still derives an estimated 70 percent of its income from managing the “Prima Casa” program on behalf of the state.⁵⁷

68. The FRC provides counter-guarantees to guarantee funds. The Romanian Counter-Guarantee Fund (FRC) was established as a specialized financial institution in 2010, in the context of the crisis, through Emergency Ordinance No. 23/2009 with an initial capital of RON 400 million. Its purpose is to improve access to finance for SMEs by taking some of the risk assumed by guarantee funds. FRC provides counter-guarantees for up to 80 percent of the guarantees of credits, letters of guarantee and other financial instruments for both investment and working capital financing. FRC provides counter-guarantees priced below the market level (maximum fee is 0.8 percent versus estimated market rate of 3.8 percent). It is 68 percent state-owned (represented by the MoPF), and 32 percent owned by the Post-Privatization Foundation.⁵⁸ The FRC is not supervised by the NBR.

69. As the primary beneficiary of the FRC counter guarantees is FNGCIMM, FRC is also facing challenges to meet its objective. FNGCIMM accounts for 96.4 percent of all of FRC’s outstanding counter-guarantees as of the end of 2017. There is limited potential for usage of counter-

⁵⁵ The Rural Credit Guarantee Fund is majority privately owned (99.993 percent by private banks, and 0.007 percent by MoARD). It provides credit guarantee schemes for the support of SMEs in rural areas, farm, agricultural associations, and public authorities. It is estimated it has market share of 49.0 percent as of June 2017 (excluding EIF guarantees).

⁵⁶ FRGC is majority owned by four private legal entities: two financial investment companies (SIFs), following the mass privatization process, and two large private commercial banks (BCR and BRD-SocGen). It was established in 1993 based on Governmental Decision 463/1992 at the initiative and with initial funding from the Romanian government (through the National Agency for Privatization and SMEs), to support Romanian entrepreneurs’ access to investment credit in the early stage of the transition to a market economy and, inter alia, to benefit from technical assistance provided under international agreements. It is estimated it has market share of 1.7 percent as of June 2017 (excluding EIF guarantees).

⁵⁷ FNGCIMM does not have financial accounts broken down by business line

⁵⁸ The Foundation is a non-profit entity, established in 1996. The founding member is the National Agency for Privatization, with the funds provided by the EC Program PHARE. The purpose of the Foundation is to financially support SMEs with a majority private capital in Romania. The Foundation is currently in bankruptcy procedure.

guarantees by other guarantee funds.⁵⁹ While the activity with FNGCIMM halted for almost two years in the wake of the Court of Accounts audit and an ensuing litigation process, the activity was resumed in late 2016. Given the inter-connected relationship between the two institutions, the operations of the FRC have also declined in tandem with the decline in FNGCIMM guarantees.

Table 5: FRC Key financial indicators

Amounts in RON million	12/31/2017	12/31/2016	12/31/2015	12/31/2014	12/31/2013	12/31/2012	12/31/2011	12/31/2010
Number of operations	983	14	0	1,306	3,689	7,346	7,773	1,871
Number of outstanding counter-guarantees	1,769	1,485	2,482	4,405	6,783	8,688	7,420	1,780
Total Credit Amount	196.8	4.8	0.0	825.5	2,095.6	4,089.0	3,444.0	1,403.2
Total Coverage Amount	93.5	1.4	0.0	297.4	747.1	1,442.4	1,063.3	372.5
Amount of outstanding counter-guarantees	178.0	159.2	302.5	639.7	1,123.1	1,488.5	997.4	343.5
Amount of outstanding counter-guarantees with FNGCIMM as beneficiary	171.6	152.2	290.8	615.3	1,080.0	1,439.7	925.0	305.7
Average Coverage Ratio (%)	47%	28%		36%	36%	35%	31%	27%
Number of direct beneficiaries	4	4	5	5	6	6	6	5
Number of SME beneficiaries (indirectly)	943	14	0	1,166	3,248	5,879	6,428	1,635
Total Capital	405.1	402.9	390.4	424.0	445.0	441.3	434.6	417.6
Volume of enforced and paid guarantees	8.7	6.2	8.2	13.1	11.9	9.8	3.1	0.5
Number of enforced guarantees	53	58	104	140	119	58	24	1
Leverage Ratio	0.4	0.4	0.7	1.5	2.4	3.3	2.1	0.7

Source: FRC

70. While both funds are reconsidering their strategic focus, it is necessary to assess them in a holistic way. Both institutions are making efforts to improve their strategy and enhance performance (such as resumed cooperation under the Start-up Nation program, an application analysis system, etc.). However, in the context of the discussion for a development bank, it is essential to assess the operations and impact of both institutions in a holistic way.

EU financial instruments

71. Romanian enterprises have access to EU financial instruments. Romanian authorities assigned the implementation of several financial instruments from the European Structural and Investment Funds (ESIF)⁶⁰ under different operational programs, according to the relevant EU legislation, to European Investment Fund (EIF).⁶¹ These instruments include credit guarantees supporting enterprises, which offer several advantages to banks, such as the ability to provide portfolio guarantees,⁶² low or zero fees, additional funding from EU programs managed by EIB/EIF Group (the European Investment Bank and EIF), and more favorable capital treatment for the related guaranteed loans (zero capital weighting), as guarantees from the EIB/EIF Group are AAA rated. The EIF began operations in Romania in 2001. At the end of 2016, from the EIF's total exposure in Romania, the

⁵⁹ The Rural Credit Guarantee Fund cannot use counter-guarantees as it makes use of state budgetary resources, in accordance with state aid rules.

⁶⁰ The European Structural and Investment Funds (ESIF) are funds from the EU budget allocated to EU Member States for 2014-2020 multiannual financial framework, through which the EU invests in local and regional projects that contribute to job creation and a sustainable economy. These funds are implemented by national authorities through national and regional Operational Programs, mostly through grants and -to a lesser extent- through financial instruments.

⁶¹ The European Investment Fund, part of the EIB Group, was established in 1994, and is a European Union agency for the provision of finance to SMEs through commercial banks and funds.

⁶² FNGCIMM only provides individual guarantees. According to the OECD study on "SME and Entrepreneurship Financing: The Role of Credit Guarantee Schemes and Mutual Guarantee Societies in supporting finance for small and medium-sized enterprises" - Final Report (CFE/SME (2012)1/FINAL, 30-Jan-2013), portfolio guarantees are sparsely provided by credit guarantee schemes in Europe: only 4 out of 33 credit guarantee schemes from 21 countries.

committed amount of EIF guarantees was EUR 260 million for EUR 901 million of financing, through 13 financial partners and guarantee providers. Besides ESIF financial instruments, EIF programs for the period 2014-2020 include, *inter alia*, the COSME Loan Guarantee Facility and the SME initiative, which is a joint financial instrument of the EC and the EIB Group, and aims to stimulate SME financing by providing partial risk cover for SME loan portfolios of originating financial institutions. While monitoring and reporting regarding financial instruments complies with relevant EU legislation, information regarding the market share of these instruments in the Romanian banking sector is not readily available. In a survey conducted as part of the FSAP, responses from banks indicate that outstanding EIF guarantees amounted to 427 mm EUR as of the end of 2017, less than 10 percent of the outstanding FNGCIMM guarantees. While EIF operations are smaller in scale, with lower average loan size, they have been growing fast with CAGR of 20.8 percent in guarantees provided since 2012. In 2017, these guarantees supported 3,367 SME's compared to 2,647 supported through FNGCIMM.⁶³

Table 6: EIF guarantee financial indicators

Amounts in EUR mm	2012	2013	2014	2015	2016	2017
Total number of guarantees provided under the guarantee programs in the reference period	1,434	928	2,327	2,137	2,572	3,683
Total amount of loans provided under the guarantee programs in the reference period	105.45	74.23	161.43	125.69	190.53	281.57
Total amount of guarantees provided under the guarantee programs in the reference period	84.28	59.10	115.20	68.64	97.37	157.65
Cumulative amount of guarantees outstanding under the guarantee programs	88.07	128.68	222.58	253.61	317.96	426.68
Cumulative amount of loans outstanding under the guarantee programs	110.18	161.22	295.94	370.08	508.17	703.37
Number of beneficiaries SMEs who benefited under the guarantee program in the specified period	1,215	716	1,908	1,820	1,952	3,367

Source: Bank survey; Responses received from 10 banks

State Programs for Enterprises

72. The state provides significant financial support to enterprises through the budget, mostly through grants. Various forms of support for SMEs and other enterprises are financed through the state budget in Romania, representing a sizeable 1.7 percent of the total budget.⁶⁴ Existing initiatives are varied and directed at young entrepreneurs, female entrepreneurs, exporters, craftsmanship activities, etc., aiming at facilitating access to finance, through the provision of loans, grants, guarantees and technical support (see Annex 3).

73. The preeminent state program is Start-Up Nation, although its design and implementation has several weaknesses. Start Up Nation program, launched in 2016 with initial budget of RON 1.7 billion (35.9 percent of all state supports for support of enterprises) and administered by the Ministry of Business Environment, Trade and Entrepreneurship (MBETE), provides grants (200,000 RON) to start-ups. So far, about 8,000 start-ups have been selected. Stakeholders have

⁶³ Source: Bank survey for EIF guarantees, FNGCIMM

⁶⁴ Guarantee programs do not enter the budget, since they are contingent liabilities, and expenses will only be incurred as banks claim guarantees for defaulted loans. This amount does not include the capital of state-owned financial institutions.

identified a number of weaknesses in the program design and implementation hindering its sustainability and impact, including the lack of non-financial support services in the design of the program and focusing primarily on job creation versus entrepreneurship, and without achieving complementarity with the existing entrepreneurial ecosystem (see Annex 4).

74. Despite the deficit in firms' skills, state non-financial support schemes are limited.

Government programs for the enterprise sector predominantly focus on providing financial support. The report Start-ups, Scale-Ups, and Entrepreneurship in Romania,⁶⁵ prepared for the EC by a panel of experts, in October 2017, highlights that non-financial support structures are not well established in Romania. The main public policy measures offering non-financial support include Romania HUB, Start-up Plus, and GovITHub. For many start-ups and SMEs, access to additional services, including mentoring, may be even more important than funding.

75. State support is fragmented across different institutions, and programs are not necessarily administered in a commercial and sustainable manner.

Programs are spread out among 17 different entities (see Annex 3), posing a problem in terms of efficient management of resources, monitoring, and maximizing impact. No evaluation has been carried out to assess the impact and effectiveness of these programs, posing questions regarding their administrations under commercial terms and on their sustainability. The initiative for the establishment of a development bank, undertaken by the MoPF, will include a diagnostic of the instruments and entities with a clear mandate from the state to support access to funding in order to identify the overlaps and inefficiencies and also how to address these inefficiencies by the new development bank or other institutional changes.

VIII. Financial Infrastructure

76. The quality of financial infrastructure reduces the risk and determines the efficiency of financial intermediation.

Financial Infrastructure comprises the underlying foundation for a financial system, including all institutions, information, technologies, rules and standards that enable financial intermediation. Key elements of financial infrastructure, such as insolvency and creditor / debtor regimes, credit reporting, and consumer protection, are vital for facilitating greater access to finance, improving transparency and governance, as well as safeguarding financial stability in financial markets.

Insolvency and Creditor / Debtor Regimes

77. The legal framework governing creditor/debtor relationships in Romania is quite modern, but enforcement mechanisms can be improved. Several laws and institutions could be improved to make creditor/debtor regimes more effective. Corporate lending is usually secured. Real

⁶⁵ 2017, European Commission, H2020 PSF – Specific Support to Romania – Start-ups, Scale-ups and Entrepreneurship in Romania

estate is the favored form of collateral and mortgage is the security mechanism preferred by banks. Banks also take cash, bonds and pledges on tangible assets (inventory, equipment, vehicles) as collateral. Receivables are used as collateral less often due to some difficulties with enforcement. Other movable assets are rarely accepted. Lengthy and expensive enforcement process has been identified as the main obstacle for secured lending. Insolvency legislation has been recently updated, however, there are some issues with effective implementation, mostly related to institutional structures. Bankruptcy proceedings last a long time, due to procedural delays by the parties and large number of cases putting a strain on judicial resources. Successful reorganizations are rare, and pre-insolvency proceedings are seldom used in practice. Moreover, improper use of bankruptcy, and especially reorganization, proceedings has been identified as a significant problem.

78. Discussions and recommendations in this section are based on information received from the banking sector. The analysis draws on responses to the questionnaire distributed in connection with the FSAP in November 2017 to 12 commercial banks in Romania, as well as follow up phone discussions with representatives from selected banks. The questionnaires were also completed by the NBR and by the Land Registry (ANCPI).

Security Rights over Immovable and Movable Assets

79. Several pieces of legislation govern creation of mortgages and security rights over movable and immovable assets in a manner that is largely consistent with international best practices. This includes the Civil Code of Romania (Law no. 287/2009) and the Civil Code Implementation Act (Law no. 71/2011), Law Regarding the Mortgage Loans (Law no. 190/1999), Cadastre and Real Estate Registration Act (Law no 7/1996) and various orders and ordinances of the Cadastral Authority, Ministry of Justice and other agencies implementing the applicable legislation. Nevertheless, consideration should be given to strengthening the framework for movable assets to address shortcomings that lead to infrequent use of movables as collateral.

80. Creating security rights over immovable and movable assets is not problematic in general. With regards to immovable assets, most types of assets can be used as security, including land, buildings, future and unfinished construction, fixtures and attachments and after-acquired property. These assets can be used to secure present and future obligations between any type of persons/entities. With regards to creation of movable assets, the law allows the use of wide range of movable assets as collateral, including tangible and intangible assets, intellectual property rights, equipment, inventory and accounts receivable. Movable assets can be used to secure contractual and non-contractual, present and future obligations. However, movable assets are rarely accepted by banks as sufficient security, as some legislative uncertainties remain.

81. Registration system for security rights over immovable assets can benefit from updates. Security rights in immovable assets are registered with the Cadastre and Real Estate Publicity Office (ANCPI). Some records are digitalized; however, it is not possible to search title and cadastral records online and stakeholders identified the database as outdated, not easy to access and not completely reliable. According to feedback from the banking sector, it takes, on average, 6-15 days to register security rights in immovable assets, which most stakeholders consider too long, with the cost of less than 1 percent of the value of the asset.

82. The framework for registration of security rights over movable assets is adequate.

Security rights in movable assets are registered with the Electronic Archive for Security Interests in Movable Property (AEGRM) administered by the Ministry of Justice of Romania. AEGRM acts as a unified collateral registry, that is centralized and allows some electronic filing and searches. The average time for creation and registration of a security right in a movable asset is less than 5 days with the cost of less than 0.5 percent of the value of the asset. Both the time and cost of registration can be reduced, and further improvements can be made to the electronic registration and search engines. Although most users find the system satisfactory, some noted that the process of creating and registering security rights in movable assets can be overly formal and they would like the process to be more streamlined and the cost-effective. In addition, users noted that while the AEGRM is fully functional, the technological aspect would benefit from upgrades. Finally, the legislative framework governing the registry can be better aligned with international practices, by ensuring that the registration process is notice-based only and no paper documents are required.

83. There is room for improvement in the framework for enforcing security rights over both immovable and movable assets.

Although out-of-court enforcement of security rights is possible in some cases, it requires debtor's consent. In practice, debtors almost often raise objections, making out of court enforcement inapplicable. Thus, most enforcement actions are resolved in court. Judicial enforcement is lengthy and expensive, with the debtor having many opportunities for appeal. In case of immovable assets, if the debtor does not oppose the enforcement action, the entire process can take as little as 6 months. However, if the debtor challenges the claim, enforcement can take longer than 18 months. The enforcement process is longer for movable assets – if the debtor does not oppose the claim in court, the enforcement process can take 12-18 months, and much longer if the debtor introduces defenses to the claim. As a result of delays, recovery rates on loans secured by immovable assets are estimated below 75 percent and recovery rates for loans secured using movable assets are estimated at 50 percent or less of the value of the assets. In addition, most users pointed to lack of effective out-of-court enforcement mechanisms as an obstacle to enforcement, as well as overburdened courts and delay tactics used by the debtors to deliberately protract the enforcement proceedings.

Insolvency Proceedings

84. Romanian insolvency framework for corporate entities was updated in 2014 with the adoption of the new Insolvency Code (Law no 85/2014). The new law incorporated many of the best international practices, however, some room for improvement exists in the area of implementation. Out-of-court workouts are governed by the Corporate Debt Restructuring Guidelines issued by the Romanian authorities, including the NBR and the Ministry of Justice, in 2010. In addition, Law on Insolvency of Individuals (Law no 151/2015) has been adopted and became effective on January 1, 2018.

85. The Insolvency Code includes both pre-insolvency and insolvency procedures. The two pre-insolvency procedures are the ad hoc mandate procedure and the preventative concordat. Insolvency procedures include judicial reorganization and liquidation.

86. Despite availability of mechanisms to allow businesses to restructure both prior to and after the declaration of insolvency, there have been very few successful reorganizations. Pre-insolvency proceedings are rarely, if ever used. And stakeholders estimate that less than 5 percent of insolvency reorganization cases result in continuous business operation. One of the main reasons for modest reorganization success relates to late filings by debtors, when the business is no longer viable and possible to reorganize. Nevertheless, reorganization is often attempted, because the current law does not have a robust way of distinguishing viable companies from those that are no longer viable and should be liquidated. In addition, reorganization proceedings are subject to many delays, mainly due to multitude of possibilities for appeal. The delays are especially prevalent while the list of creditors' claims is being prepared and finalized, with essentially every claim being subject to an objection from either a debtor or one or more creditors. Stakeholders also refer to lack of efficient supervision for plan preparation and implementation. Another area of concern identified by the stakeholders is unwillingness of state authorities to agree to anything less than 100 percent repayment of budget claims, including taxes and social contributions. Finally, stakeholders in the banking sector expressed concern that reorganization proceedings are used by debtors to remain in control of the assets for several years while preventing execution of claims by creditors.

87. Liquidation proceedings are frequently used and are considered satisfactory by most stakeholders. The main concerns cited about the liquidation proceedings are related to delays of the judicial process. An observation period that precedes liquidation and reorganization is often extended beyond the statutory limit of one year, in some cases for 3 additional years. Further delays are often attributed to multiple opportunities for appeals by the debtor during finalization of claims, evaluation of assets and organization of auctions. As a result of protracted liquidation proceedings, recovery rates in liquidation are estimated at or below 50 percent for secured creditors.

88. The mechanism for out-of-court restructuring is not widely used. The Corporate Debt Restructuring Guidelines contain non-binding principles to encourage debtors and creditors to work out financial disputes outside of the judicial system. Most stakeholders explained that they consider the Guidelines very general and high-level principles, and most banking institutions have their own internal guidelines or use English law principles for negotiations with the debtors. Negotiations are often bilateral in nature, with each bank engaging separately with the debtor, as the multi-stakeholder workout culture in Romania is not well developed.

89. Law on Insolvency of Individuals has become effective, but have not yet been fully implemented. Law no 151/2015) became effective on January 1, 2018, however some administrative issues must be resolved before the Law can be fully implemented and no cases were reported by the stakeholders as of the time of writing of this report.

Institutional Framework

90. Institutional frameworks applicable to insolvency and secured transactions are sound but some problems remain. Courts in Romania appear to be overburdened, so they are not able to deal with enforcement and insolvency claims in efficient timeframes. Enforcement cases are judged by non-specialized judges whose workload is very considerable. Insolvency cases are resolved by specialized judges, but stakeholders express reservations that the judges apply the law mechanically

without having economic background necessary to evaluate complex financial issues. The institution of insolvency administrators, in particular, should be strengthened. Stakeholders pointed out to insufficient expertise and qualification of administrators as an obstacle to an efficient insolvency regime. In addition, the current framework makes it difficult to hold administrators responsible for misconduct. As administrators are paid hourly, without incentives based on timeliness or success, the structure of the payment system, as well, may incentivize less efficiency. Stakeholders pointed out to these two institutions as requiring the most intervention.

Credit Information Sharing

91. The Romanian Central Credit Registry within the NBR is generally effective and user satisfaction is high. The credit information sharing system consists of the Central Credit Register (CCR), established in 2000 and operated by the National Bank of Romania, and the Credit Bureau (CB), a joint stock company established in 2004 with 25 banks as shareholders. According to NBR Regulation no.2/2012, institutions reporting to the CCR are credit institutions and non-bank financing institutions registered with the Special Register. Reported entities include individuals and non-bank legal entities, with a reporting threshold of 20,000 RON. The CCR coverage for the household sector is 89 percent of the total loan amount and 30 percent of the total number of debtors.⁶⁶ In the survey conducted in the context of the FSAP, banks⁶⁷ are broadly satisfied with CCR in terms of: data accuracy (average rating of 4.2 out of maximum 5), data coverage (average 3.9), and range of services provided (average rating of 4.0).

92. Users are also satisfied with the private Credit Bureau, which covers only households. According to Decision no.105/2007 of the Data Protection Authority, participants in the CB may be banks, consumer credit companies, leasing companies and insurance companies. The CB does not collect data for legal entities. Its coverage for the household sector is 90 percent of the total loan amount and 99 percent of the total number of debtors. The CB also currently does not receive data from nor provide data to credit unions. In the bank survey, banks are broadly satisfied with the CB in terms of: data accuracy (average rating of 4.3 out of maximum 5), data coverage (average 4.3), and range of services provided (3.9 respectively). However, this should be weighed against the fact that several banks either did not answer this question or provided a low rating due to lack of coverage of the legal entities. About 80 percent of banks stated they would be interested in receiving and providing information on legal entities to the CB.

93. The combined coverage of the credit information system has significant gaps. The combined coverage of the credit information system has certain gaps, including collection agencies, non-traditional data providers, and credit unions. In many countries collection agencies with NPL portfolios are able to consult and share data with credit registries/ credit bureaus, as this facilitates both the collection process as well as the resumption of credit for borrowers who have repaid their debts to the collection agency.⁶⁸ The inclusion of non-traditional data providers (e.g. in credit bureaus),

⁶⁶ Consumer loans and mortgages

⁶⁷ Based on 27 respondent banks

⁶⁸ This EU General Data Protection Regulation (GDPR), designed to harmonize data privacy laws across the EU and protect and empower data privacy is going into effect on May 2018. The GDPR will replace Decision no.105/2007. In

such as mobile network operators, electricity companies and other utilities, also enhance access to credit with significant effects on financial inclusion.⁶⁹ At the same time, the combination of the CCR's 20,000 RON reporting threshold and the fact that the CB does not cover legal entities, leaves a gap in coverage for micro-loans, mostly to micro-enterprises. In 2015, the NBR estimated that legal entity loans below the threshold amounted to 150 million RON. Literature shows that additional information about borrowers from expansion of information sharing systems can lead to an improvement in the efficiency of credit allocation and loan performance, especially for underserved market segments.

Alternative Dispute Resolution

94. Responsibility for consumer protection in financial services is split between two bodies.

The National Authority for Consumer Protection (ANPC) deals with consumer protection in the banking sector while the Financial Supervisory Authority (ASF) deals with consumer protection (as well as regulation and supervision) in the non-banking sector. A consumer can submit a petition to ANPC/ASF under Government Ordinance 27/2002 and ANPC/ASF attempts to settle the matter. The agencies may issue recommendations and explain whether any applicable rules and regulations have been broken.

95. A well-functioning alternative dispute resolution mechanism is an essential component of consumer protection and promotes trust in financial services.

Consumers are more likely to use financial services when they know that, if anything goes wrong, they can ask a free and robust alternative dispute resolution (ADR) body to put it right. An ADR body should: be independent (to secure impartiality); be visible and accessible to consumers; have clear scope and powers; operate effectively and fairly; and be transparent and accountable.⁷⁰

96. Romania has two financial ADR bodies, one for banks and one for NBFIs.

Romania transposed the EU Directive 2013/11 on alternative dispute resolution for consumer disputes by Government Ordinance 38/2015. The Directive sets minimum standards but member states can go beyond these.⁷¹ Transposition resulted in the creation of the Alternative Dispute Resolution Centers for Banking (CSALB) and Non-banking (SAL-FIN). CSALB covers financial services that are regulated by NBR (credit institutions, non-bank financial institutions, payment institutions, and electronic money institutions) while SAL-FIN covers financial services regulated by ASF (insurance, securities and private pensions). Both bodies cannot join FIN-NET (the EU Network of financial ADR bodies) until the Ministry of Economy certifies them to the EC under the EU ADR Directive. CSALB and SAL-FIN share many

this context, Romanian authorities are preparing a Code of Conduct, to be approved by the Data Protection Authority, in which it is envisioned to include collection agencies as reporting entities.

⁶⁹ Including collection agencies in the CCR would necessitate an amendment of legislation. Reporting entities are stated in the Law No. 312/2004 on the Statute of the National Bank of Romania and the Law No. 93/2009 on non-bank financial institutions, so other reporting entities to the CCR cannot be regulated by legal acts issued by the NBR. Including collection agencies and non-traditional data providers in the CB necessitate an amendment of the decision of the Data Protection Authority.

⁷⁰ There is guidance on ADR bodies in: the World Bank's 2017 Good practices for Financial Consumer Protection; the World Bank's Fundamentals for a Financial Ombudsman; and Effective Approaches to Fundamental Principles from the worldwide International Network of Financial Ombudsmen (INFO). INFO's Setting up a Financial Ombudsman Scheme; a Practical Guide is due for publication early in 2018.

⁷¹ Article 2 includes "... 3. ... Member States may maintain or introduce rules that go beyond those laid down by this Directive, in order to ensure a higher level of consumer protection."

similar aspects in governance and operations although there are also some notable differences (see Annex 5). The dividing line between the scope of the two ADR bodies would not always be apparent to consumers (e.g. a complaint about insurance sold by a bank goes to SAL-FIN, not CSALB). The only gap in ADR for financial services relates to credit unions. While the consumer bodies are not aware of significant problems with credit unions, the MoPF receives around 200 complaints relating to credit unions per year, about half of which concern matters that it can consider.

97. As both financial ADR bodies in Romania became operational in 2016, case numbers are comparatively small and experience is limited. In 2017 CSALB received 7,644 enquiries (mainly by phone) and 505 complaints within its jurisdiction (76 percent by email). In about half, the bank did not agree to CSALB dealing with the case. There were 139 proposed solutions, 83 percent of which were agreed by both parties. In the year to 30 September 2017 SAL-FIN (in a smaller part of the financial market) received 394 enquiries calls and 3,915 emails. In 2017, it received 162 complaints within its jurisdiction (72 percent about compulsory motor insurance). It resolved 158 cases. Consumers ended up better-off in 78 percent of cases and gained a total of RON 724,888 or an average of 4,588 RON per resolved case.

98. Some consumers currently remain wedded to more traditional mechanisms, especially as many consumers have not yet heard about CSALB and SAL-FIN. In the banking sector, there are still a substantial number of cases in the courts though many relate to mortgage relief or abusive clauses. ANPC received 10,764 financial services petitions in 2017, leading to consumers being better-off by 1,100,000 RON in total – which averages out at RON 102 per case received. In the non-banking sector, ASF received 9,384 petitions in 2017 (86 percent about insurance), with 70 percent of those resolved in favor of the consumer. ASF encourages consumers to use SAL-FIN, and ASF responses to petitions mention SAL-FIN as a free/quick alternative to the courts. However, it will take time to change consumers' ingrained habits. Broadly, ANPC and ASF (unlike an ADR body) can only act where there is a breach of rules or the law. Financial service providers are required, by their respective regulators (as well as by Government Ordinance 38/2015), to provide information about the ADR bodies. CSALB and SAL-FIN have separate consumer-awareness programs.

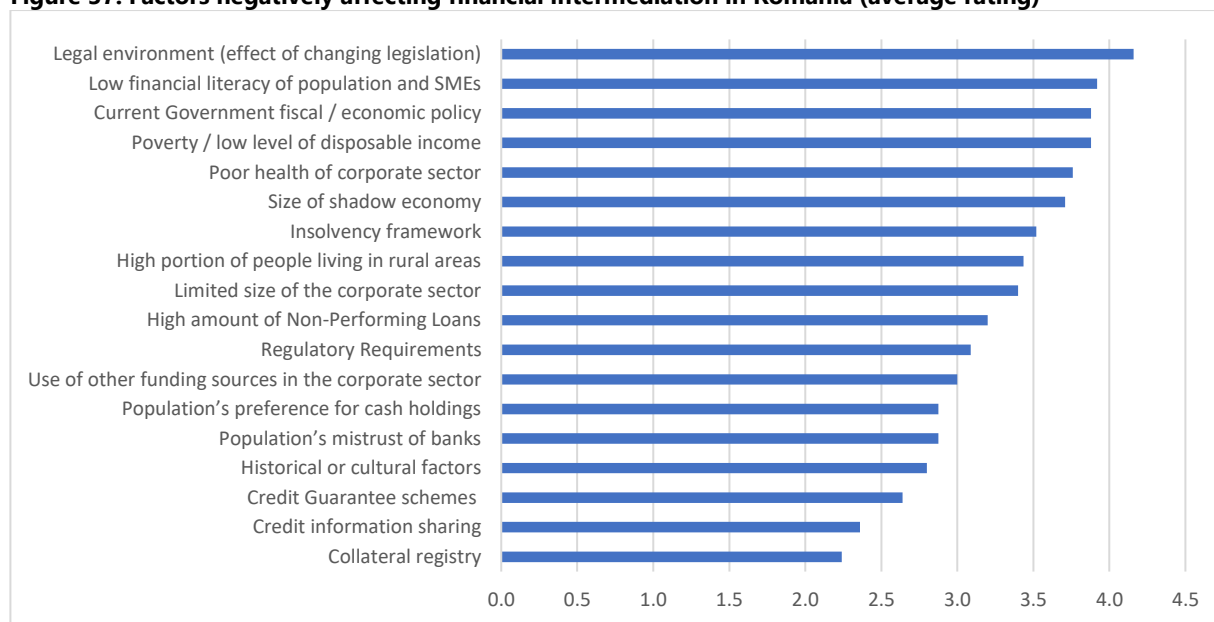
IX. Annexes

Annex 1 - Bank survey

Bank views on financial intermediation were explored with a survey with a high response rate, representing 96.0 percent of banking sector assets. A bank survey was conducted between December 2017 and January 2018 in collaboration with the NBR and the Romanian Banking Association. The survey explored banks' views on the factors negatively affecting financial intermediation and potential measures to address it, as well as attitudes of banks towards market segments, such as MSMEs, rural areas, and recent trends and developments. The survey secured a high response rate from 27 banks (out of a total of 36 operating in Romania), with a combined market share of 96.0 percent of assets.

Banks consider the legal framework and current government policy as not conducive to financial intermediation, as well as the poor financial condition and skills of enterprises. Banks were asked to rate the importance of several factors in terms of negatively affecting financial intermediation from 1-5 with 1= Unimportant and 5=Very Important. The top 5 factors identified were: the legal environment, the low financial literacy of individuals and SMEs, the current government economic policy, poverty and the poor health of enterprises. On the other hand, the surveys reveal that banks consider enabling infrastructures such as collateral registry and credit information sharing as supportive of financial intermediation, with low ratings (2.2 and 2.4 respectively).

Figure 37: Factors negatively affecting financial intermediation in Romania (average rating)

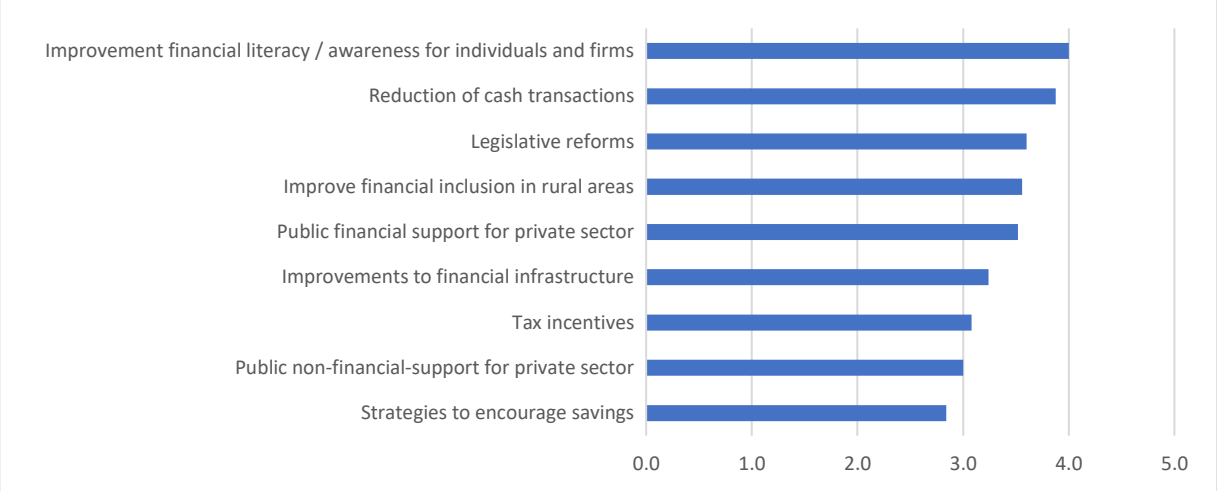


Source: FSAP Bank Survey

Potential measures to enhance financial intermediation broadly correspond with the factors identified. Banks were also asked to rate the estimated impact of several policy measures in terms of

enhancing financial intermediation from 1 to 5 with 1 = Not impactful at all and 5 = Very Impactful. The top 3 measures were those aiming at: a) enhancing financial literacy for individuals and firms (average rating: 4.0), b) reducing cash transactions (average rating: 3.9), c) reducing the unpredictability of the legal environment (average rating: 3.6).

Figure 38: Impact of policy measures (average rating)



Source: FSAP Bank Survey

Annex 2 - Credit Unions

Most credit unions are organized in one of three federations. There is one federation for pensioners and two federations for employees' credit unions. The two federations of employee credit unions (UNCARSR and FEDCAR) provide services to their affiliated members including training and IT support. They also gather and disseminate information about their affiliates. The federation of pensioners' credit unions only provides basic advocacy support to its affiliates.

The largest source of funding for credit unions is members' "social funds." "Social funds" are built in time with members' small monthly contributions. These "social funds" cannot be withdrawn in the case of the employees' credit unions, but in case that the member ends his/her membership. In contrast, pensioners' credit unions allow for withdrawals, making the "social fund account" to operate similarly to a regular passbook savings account. These funds are not covered by any form of deposit insurance, but there are efforts of the confederation of employees' credit unions ongoing to assess the viability of a form of deposit insurance scheme for them. There are regulatory limitations that affect credit unions' access to third-party-funding.

Credit unions primarily provide small loans to individuals. They typically provide short and, in some few cases, medium term loans to members. Loans are granted usually in multiples of the amounts contributed by the member in the form of "social funds." The social funds of the member applying for a loan (and in some cases from other members) serves as cash collateral covering up to 16 percent of the loans. The credit technology used by these entities relies in the vast majority of cases on an assessment of the regular income streams of the borrowers and the provision of "social funds" as collateral. Loans are granted exclusively individuals (credit unions are not allowed to serve firms and therefore cannot lend to SMEs). Even in the case of loans granted to smallholder farmers (as individuals), repayment capacity is calculated considering the income derived from verifiable regular income sources.

Credit unions are not subject to NBR supervision and legally overseen by the MoPF. The two federation of employees' credit unions maintain a separate supervision unit that oversees the operation of their affiliates. Credit unions have an internal audit structure that must comprise at least one auditor who is accredited by the Romanian Auditors' Association. Aside of this oversight, credit unions are reportedly not subject to a professional external audit. The MoPF is mandated to oversee the activities of the credit unions for employees and for pensioners although the extent to which this is exercised is unclear. Credit unions are not currently supervised by the NBR.

Credit unions are small in size, limiting efficiency in operations. The cumulative assets of the credit unions affiliated to UNCARSR and FEDCAR amount to a total of RON 3.3 billion RON, by end of 2016, which is equivalent to 0.8 percent of banking sector assets. In general, the individual credit unions are very small in size. Those affiliated to UNCARSR manage in average RON 2.2 million in assets, while those affiliated to FEDCAR reach around RON 14.5 million. Their small size can be considered to generate diseconomies of scale, as each of these entities has to bear the costs of a dedicated management. Conversely, their small size also limits their capacity to hire the skilled management that

is required to operate a financial institution in an efficient manner. Although the two apex organizations help offset some of these limitations

Credit unions have been growing and their performance seems adequate. The assets of the employees' credit unions have been increasing at a rate of 9 percent p.a. in the last 4 years, indicating a strong demand for their services. According to information received from UNCARSR and FEDCAR, the affiliated entities show adequate capitalization and performance indicators. UNCARSR and FEDCAR report a capital adequacy of 16 percent and of 12 percent respectively as of December 2016. Their reported RoE for 2016 are 6.2 percent and 10.9 percent respectively, while their level of NPL ratios of 3.3 percent and 7.0 percent. Although these indicators are not based on statements that are audited by external auditors, they indicate an acceptable level of performance. There is no information about the financial performance of the pensioners' credit unions as their apex organization in contrast to the employees' credit unions' apexes does not supervise its affiliates nor compile their financial information.

There is significant potential for credit unions to expand their outreach and to improve their performance although this would require stronger supervision. Credit unions are currently serving only about 20-25 percent of the potential market and there is room to grow e.g. by allowing them to serve MSMEs, offer more services (e.g. channeling remittances, handling payments, acting as bank agents), diversify funding sources, and by consolidating offices. Such re-orientation would necessitate stronger supervision, ideally by NBR, as well as legal and operational changes. In addition, it would be recommended to continue the ongoing efforts to establish some form of insurance for the funds contributed by credit union members.

Annex 3 - Access to finance programs for enterprises

Program	Objectives	Grantor/ Administrator	Target Beneficiaries	Amount committed for 2017 (RON)
Start-Up Nation	Stimulate the establishment and development of SMEs and improve their economic performance, create new jobs, placing disadvantaged people, unemployed and graduates on the labor market, increasing investment in innovative new technologies.	MBETE	Start-ups, MSMEs	1,713,798,000
POR (Regional Operational Programme) - Priority Axis 2, Operation 2.1 b - Improving the competitiveness of SMEs	Create sectoral business incubators, by building the related spaces and endowing them with tangible and intangible assets, as well as developing the services provided within them. In addition to reimbursing these costs, the non-reimbursable support also involves providing incubator support services for the incubated firms.	EU/Ministry of Regional Development and European Funds	SMEs, NGOs	476,190,476
POC (Competitiveness Operational Programme) - Priority Axis 1. Research, technological development and innovation to support competitiveness and business development	Increase RDI capacity in areas of smart specialization, increase participation in research at EU level, increase private investment in RDI, increase knowledge transfer, technology transfer and increase staff with RDI skills in both the public and private research environment.	EU/Ministry of Research and Innovation	Private Sector	450,095,238
POIM (Large Infrastructure Operational Programme) Priority Axis 6. Promoting clean energy and energy efficiency to support a low-carbon economy.	Increase energy production from less exploited renewable resources (biomass, biogas, geothermal), reducing energy consumption among industrial consumers, reducing average household energy consumption, increasing savings in primary energy consumption produced by high-efficiency cogeneration	Ministry of Regional Development, Public Administration and European Funds (MDRAP)	Private operators in energy distribution	239,142,857
POR (Regional Operational Programme) -Priority Axis 1. Investments for SMEs for the implementation of RDI results in partnership with a Technology Transfer Office (TTO)	Promote investments in RDI, developing links and synergies between businesses, research and development and higher education, in particular promoting investment in product development and services, technology transfer, social innovation, eco-innovation and public service applications, demand stimulation, networking and clustering and open innovation through smart specialization as well supporting technological and applied research activities	EU/Ministry of Research and Innovation	SMEs in RDI	223,056,738
POR (Regional Operational Programme) -Priority Axis 2, Operation 2.2. Improving the competitiveness of small and medium-sized enterprises	Improve economic competitiveness by increasing labor productivity in SMEs in competitive sectors identified in the ITI DD (Integrated Territorial Investments Danube Delta)	EU/Ministry of Regional Development and European Funds	SMEs	204,760,890

Guaranteeing loans to SME's		Eximbank	SMEs	200,000,000
State aid scheme for the renewal of National Vehicle Park	Environmental protection	Environment Fund Administration	Large enterprises, SME's, micro	200,000,000
The National Plan for RDI III: Program 2: Increasing the competitiveness of the Romanian economy through RDI	Stimulate enterprise value chain progress and partnerships with public universities;	UEFISCDI, Ministry of Research and Innovation	Universities, Research Institutes, SMEs and NGOs	185,920,000
State aid for the tomato production support program in protected areas	increase the ability of enterprises to absorb technology and adapt to the needs of target markets; create a stimulating environment for private sector initiative, tools for entrepreneurship, support for the marketing of RDI results and the establishment of partnerships between economic operators, research organizations and knowledge dissemination, and possibly local public authorities; support intelligent specialization processes	Ministry of Agriculture	operators in agriculture	179,752,000
State aid scheme	Support to stimulate investments related to heritage conservation and to preserve traditions and spiritual heritage	Agency for Rural Investment Financing	Large enterprises, MSME's	128,571,428
State aid scheme for programs that reduce greenhouse gas emissions in transport by promoting energy-efficient road transport vehicles	Increase the attractiveness of rural areas and to stimulate the development of the local business environment	Environment Fund Administration	Economic operators engaged in the production and / or marketing of new cars (under 3.5 tons); Large enterprises, MSME's	115,000,000
SME INITIATIVE (ERDF) POIIMM - Priority Axis 1. Support SMEs' ability to grow in regional, national and international markets and engage in innovation processes	Improve the quality of the environment by purchasing electric cars or new hybrid electric cars	Ministry of Regional Development, Public Administration and European Funds (MDRAP) / EIF	MSMEs	95,238,095
Microindustrialisation Programme	Facilitate SMEs' access to finance through the use of the guarantee instrument not attached to a loan, which leads to a difference between standard interest and interest perceived by the SME for credit risk, a difference that constitutes an economic advantage for the SME, in the form of de minimis aid.	MBETE	Start-ups, MSMEs	74,359,000

State aid schemes for cinematography, film production and organization of film festivals (6 schemes)	Support investments in the priority economic sectors established by this procedure of minimis state aid, increase the volume of activity and competitiveness of SMEs in these sectors.	National Council for Cinematography	Companies and individuals	60,497,619
Trade and Services Programme	Support economic operators, companies and cooperative societies by facilitating access to finance in order to improve their economic and technical performances, aiming at adapting to the EU requirements by increasing the level of competitiveness, creating and maintaining jobs, increasing consumer protection and food security.	MBETE	Start-ups, MSMEs	49,949,000
POR (Regional Operational Programme) -Priority Axis 2, Operation 2.1 b ITI (Integrated Territorial Investments) Improving the competitiveness of SMEs	Create sectoral business incubators, by building the related spaces, providing tangible and intangible assets, as well as developing the services provided within them.	EU/Ministry of Regional Development and European Funds	SMEs, NGOs	47,380,952
Support of investments which promote regional development through job creation (H.G. nr. 332/2014)	Enhance regional development through the performance of investments which generate the creation of jobs	MoPF	Companies	41,771,737
POC (Competitiveness Operational Programme) Priority Axis 2. Supporting the growth of added value generated by the ICT sector and innovation in the field through the development of clusters	POC Priority Axis 2 - Operation 2.2.1: Improving the accessibility, use and quality of information and communication technologies	EU/Ministry of Research and Innovation	Private Sector	33,333,333
State aid for the amounts of money representing the difference between the standard level of excise tax and the differentiated level of excise tax for the diesel used as motor fuel (HG 537/ 2014)		MoPF / The Romanian Road Authority (as part of the Ministry of Transport)	Freight and Passenger transport operators	30,473,014
Counter-Guarantee Scheme to Support SMEs Access to Finance	Improve access to finance of micro and SME firms, with priority to supporting entrepreneurship (new founded firms, SRL-D programe (ex-Start-up Nation program, microfinancing) and the absorption of EU Structural funds	Romanian Counter-Guarantee Fund	SME's, microenterprises	7,000,000
Program for organizing the Fair of SMEs	Promote entrepreneurship, stimulating business development and employment in SMEs	MBETE	Start-ups, MSMEs	5,000,000

Programme Internationalization for companies	Promote Romanian SMEs' products and services on foreign markets; stimulating communication and business partnership for internationalization; training entrepreneurs to acquire the skills for promoting products and services on foreign markets.	MBETE	Start-ups, MSMEs	5,000,000
Disbursement out of state aid scheme for the exception of some categories of final consumers from the application of Law 220/2008 for the establishment of the promotion system of the procedure for energy from renewable resources (SA.39042/2014)		MBETE	SC CEMACON SA	2,864,728
Multi-Annual National Program for Entrepreneurship Development among Women in Small and Medium-Sized Enterprises	Develop entrepreneurship among women in SMEs	MBETE	Start-ups, MSMEs	1,000,000
Multi-annual National Program for Craft and Manufactures Support	Stimulate the development of small crafts operating individually or organized through associations or other organizations	MBETE	MSMEs, registered sole traders	890,000
UNCTAD EMPRETEC Romania Programme to Support SME Development	Support SME Development by providing trainings, technical assistance, workshops to entrepreneurs;	MBETE	Entrepreneurs	504,000
Programme Made in Danube	Improve framework conditions for innovation and support the implementation of smart regional specialization strategies.	Ministry of Research and Innovation	Universities, Research Institutes, SMEs	50,000
State aid scheme: Support for the implementation of actions within the rural development strategy		Agency for Rural Investment Financing	MSME's	
State aid scheme: Stimulating regional development by investing for the processing and marketing of agricultural products in order to obtain non-agricultural products		Agency for Rural Investment Financing	Large enterprises, MSME's	

State aid scheme: Stimulation of regional development through the realization of investments in the fruit sector, for the processing and marketing of agricultural products for the purpose of obtaining non-agricultural products		Agency for Rural Investment Financing	Large enterprises, MSME's	
State aid scheme: Support to micro-enterprises and small enterprises in the rural area for the establishment and development of non-agricultural economic activities		Agency for Rural Investment Financing	MSME's	
State aid scheme for the provision of forestry services		Ministry of Water and Forestry	operators in forestry	
Transitional free allocation of greenhouse gas emission allowances to electricity producers for the period 2013-2020, including the National Investment Plan		Ministry of Energy	Large enterprises, SME's	
Scheme for the promotion of electricity from renewable energy sources through green certificates		Ministry of Energy	Large enterprises, MSME's	
State aid scheme for the promotion of high efficiency cogeneration based on the useful heat demand		Ministry of Energy	Large enterprises, MSME's	
TOTAL				4,771,599,105
			Total government budget	278,817,000,000

Annex 4 - Start-Up Program

Overview of START-UP Nation Programme

The Start-up Nation program is the biggest program to support entrepreneurship financed both from the Romanian state budget and European funds, with allocated budget of 1.7 billion RON for 2017 and an annual estimated budget of 2 billion RON through 2020. The program is implemented by the Ministry of Business Environment, Trade, and Entrepreneurship (MBETE). The program is available to new start-up companies, aiming at providing 200,000 RON to the beneficiaries, which can represent 100 percent of eligible costs. Eligible costs are investment expenditures but also for tangible assets. In 2017 8,444 firms⁷² were awarded. The program estimates 10,000 beneficiaries (firms) per year.

Eligibility criteria: a) firms that are established after January 30, 2017, b) firms with no debts to the consolidated general budget or local budgets, c) firms that have the Statistical Classification of Economic Activities codes (NACE codes⁷³) authorized by the National Trade Register Office at the time of filing the first withdrawal request, d) firms that create at least 1 job, e) shareholder(s) has not been associated with another SME that has carried out the same licensed activity during the preceding year, the enrollment year or in the year of registration up to at the opening of the sign-up session.

Selection criteria: Potential beneficiaries submit business plans on a dedicated online platform which are then scored based on a number of criteria: a) The minimum score that a firm needs to achieve in order to be accepted in the program is 50 points. The points can be obtained through: operating in specific domains: IT (40 points), creative industries (35 points), services (30 points) and commerce (25 points); by having a minimum established of 2 permanent employees (20 points); by hiring a specific group of people: for 1 disabled employee who graduated after 2012 (20 points), for hiring 2 disabled people who graduated after 2012 (25 points); by nature of equipment expenses: for software related expenses and technology equipment expenses that cover at least 50% of the total expenses (10 points).

Private sector representatives point to several weaknesses of the program:

a) Unclear method of selection: Although there were 19,296 proposals received, only 10,000 were declared to have been verified by the 8 territorial agencies of the program.⁷⁴ Of the 19,296 submissions, 270 seem to have been misregistered, and a total of approx. 8,549 firms received over 95 points pointing to an automatic selection of files; **b) Inability to fail:** the winning companies need to maintain at least one employee who they cannot fire in the first 3 years; **c) low stakes of entrepreneurs and business viability:** it is unclear how the program selects potentially successful companies. In fact market participants indicated that many firms are created for the express purpose of receiving this grant, leading to moral hazard. Around the world, start-up programs include selection panels with private sector representatives, selection based on chances of success of team capabilities, psychometric tests, business plan professionalism, proposed idea and contribution of the entrepreneurs d) **the innovation component of the program is not leading to innovation:** the

⁷² Press declaration, Minister MBECE on 20th of Dec 2017

⁷³ The list of 4 digit NACE codes allowed is published: <http://www.aippimm.ro/downloadFile/6543/5907>

⁷⁴ Idem 1

innovation criteria included in the program conditions the firm to procure at least 25% of the value of the business plan in goods/technologies/services newer than 3 years. Through this criterion, the firm does not have to innovate in terms of its own products or services but rather procure updated technology; e) **uncertainty over allocated funding**:⁷⁵ in 2017 only 250 mil RON were allocated through budget rectification from state budget, and an additional RON 500 million from EU funds. The government still has to allocate approximately RON 950 million for 2017 selected participants only. f) **Sale of firms on ecommerce sites**: OLX – an online ecommerce platform in Romania registered 200 announcements⁷⁶ for sales of start-up nation approved projects averaging 5,000 EUR for every sale. g) **bridge funding allocation**⁷⁷: there are instances where collateral funding was requested for approved participants of Start-up nation to guarantee non-payment from the program.

⁷⁵ Article 12 of the grant agreement states: "If the state budget does not cover the amounts needed to finance the project, the administrator is relieved of any liability"

⁷⁶ OLX representatives as quoted by the press: <https://www.agerpres.ro/economic/2018/02/04/olx-a-cerut-ministerului-pentru-mediul-de-afaceri-sa-precizeze-legalitatea-comercializarii-pe-internet-a-proiectelor-start-up-nation--48943>

⁷⁷ One aspect which received positive feedback from the private sector is the decision of the Ministry to partner with 3 banks (Banca Transilvania, CEC and BCR) to provide bridge loans for eligible Start-up Nation approved beneficiaries. The Banks, in turn could request grantees for the bridge loans to FNGCMM. On December 20th, out of the 8444 signed contracts, 38% were approved for credits from the 3 partner banks, and another 10% were analyzed by the banks.

Annex 5 - CSALB and SAL-FIN

Governance and operations

Many aspects of the governance and operations of CSALB and SAL-FIN are similar:

	Both CSALB and SAL-FIN
Governance	There is a Coordinating Council, with members to be nominated by the relevant regulator (NBR or ASF), ANPC, the industry and consumer bodies.
Website	They both have helpful websites.
Enquiries	They also handle phone, written and face-to-face enquiries from consumers.
Eligible complainants	They can only take complaints from consumers (natural persons acting for purposes which are outside their trade, business, craft or profession).
Prior complaint to provider	The consumer must first complain to the financial services provider, but can come to the ADR body if the provider does not solve the problem in 30 days.
One-year time limit	The consumer must bring the case to the ADR body within a year of the relevant event.
Free for consumers	The ADR body is free-of-charge for consumers.
Consumer choice of process	The consumer can choose between processes with a proposed solution (either party can accept or reject) or an imposed solution (which binds both parties).
Conciliators	Cases are handled by appropriately-qualified conciliators from an external panel.
Active investigation	The conciliators actively investigate cases, and have power to demand documents from providers.
No need to attend in person	The conciliators can deal with the parties by phone or email instead of requiring them to attend.
Quick result	Most cases are resolved within 90 days, often much sooner.
Consistency and feedback	Quarterly meetings of conciliators foster consistency of approach and outcome, and identify broader issues that emerge from cases which can be brought to the attention of the relevant authorities, the financial industry or consumer bodies.

But there are notable differences between other aspects of their governance and operations:

	CSALB	SAL-FIN
Status	It is a separate legal body.	It is a division within ASF.
Funding	Its budget is approved by the Coordinating College and levied from NBR-regulated providers.	Its budget forms part of the budget of ASF, set by ASF's Board, and is not separately identified.
Cost of phone calls	The cost of phone calls from consumers is limited to the local rate.	Phone calls from consumers are handled through ASF's free helpline.
Range of enquiries	Responses to enquiries are limited to issues of CSALB's process.	Responses to enquiries are not limited to issues of process.
Compulsory or voluntary for the financial services provider	It is voluntary for NBR-regulated providers. If a consumer refers a case to CSALB, the provider must agree before CSALB can deal with it.	It is compulsory for ASF-regulated providers. If a consumer refers a case to SAL-FIN, the provider must allow SAL-FIN to deal with it.
Proposed or imposed solution	During 2017 the consumer opted for the <u>proposed</u> -solution procedure in all cases.	During 2017 the consumer opted for the <u>imposed</u> -solution procedure in 65 percent of cases.
Conciliators, and conflicts of interest	The conciliators (mainly lawyers) cannot deal with a case involving a provider for which they have acted.	The conciliators (mainly technical experts, with some lawyers and economists) cannot act for providers.
Transparency	It does <u>not</u> publish the number of cases where the consumer ended up better-off as a result of coming to CSALB.	It <u>does</u> publish the number of cases in which the consumer ended up better-off as a result of coming to SAL-FIN.

Recommendations

- Consider filling the gap in ADR for credit unions by negotiating for one of the existing financial ADR bodies to cover credit unions as well.
- The MoPF should expedite certification of CSLAB and SAL-FIN to the EC under the EU ADR Directive so they can benchmark themselves against, and learn from, colleagues in countries with longer experience of ADR.
- Some improvements are required to both ADR bodies:
 - A clear line is needed between those responsible for governance and those responsible for resolving cases. Whilst this may be the case in practice, the rules should specify explicitly that members of the Coordinating Council are not to be involved in any way in the resolution of individual cases.
 - A single joint promotion program for both ADR bodies would be more cost-effective. This should be coordinated with financial consumer education program from other bodies. Both ADR bodies should try to foster good relations with consumer bodies, which can help inform consumers about ADR. Both should do more, particularly on their websites, to identify the boundaries between the two bodies and to signpost consumers to the other.
 - Consideration should be given to allowing an extension of the time limit of one year from the event in cases where the consumer could not have known about the event until later. This requires a change to Government Ordinance 38/2015, but is allowed by the EU ADR Directive.
- The rules of both ADR bodies require them to tell consumers that the outcome may differ from that in court. But the rules of SAL-FIN do not specify the basis on which decisions will be made, and should do so. Preferably, as is usual with ADR, decisions should be based on whether or not the provider treated the consumer fairly – not whether the provider broke any rules. And the consumer should not be held to unfair contractual provisions.
- Some improvements are required to CSALB, to comply with good practice:
 - CSALB should become mandatory for providers, as SAL-FIN already is. The rules should be amended to remove the opt out, which is a major weakness. By persuasion, CSALB has reduced the opt-out rate to 30% in recent months. But a consumer cannot know, when buying a financial service, whether or not CSALB will be able to help if something goes wrong. CSALB should not introduce any new restriction – for example, a value threshold.⁷⁸

⁷⁸ Articles 1, 2(3) and 2(4) of the Directive make it clear that participation in ADR can be made compulsory and that decisions can be binding. Article 1 of the Directive includes “... This Directive is without prejudice to national legislation making participation in such procedures mandatory, provided that such legislation does not prevent the parties from exercising their right of access to the judicial system.” Article 2 includes “... 3. ... Member States may maintain or introduce rules that go beyond those laid down by this Directive, in order to ensure a higher level of consumer protection. 4. This Directive acknowledges the competence of Member States to determine whether ADR entities established on their territories are to have the power to impose a solution.”

- CSALB should publish information about the outcome of cases, including the number/proportion where the consumer was better-off after coming to CSALB. CSALB says it is considering this. Because of the nature of many banking cases, it may not be practicable to quantify the total amount by which consumers are better off. CSALB should also publish its budget and accounts. Though it is not funded by public money, it is fulfilling an important public function.
- CSALB should tighten up its conflict-of-interest policy so that conciliators cannot act for providers. Without impugning their personal integrity, a conciliator who regularly acts for a bank is unlikely to be perceived by consumers as totally independent in cases involving other banks.
- Responses to enquiries from consumers should not be limited to issues of CSALB's process. Because of the disparity of knowledge between providers and consumers, CSALB should be willing to discuss with consumers the particular circumstances of their particular case. This can help consumers to present their cases and may also head off some hopeless cases.
- A current vacancy on the CSALB board for the nominee from consumer bodies, which has existed for more than a year, should be filled. CSALB says that this is because the consumer bodies have not agreed amongst themselves whom to nominate, and that the terms of Government Ordinance 38/2015 mean no-one else has the power to choose between competing candidates. So the consumer bodies need to agree a nominee and notify CSALB urgently. Failing this, the government should consider amending Government Ordinance 38/2015 to give ANPC power to choose.
- Longer term, the government and the relevant authorities should consider:
 - Extending the scope of eligible complainants to include microenterprises. Microenterprises are usually unsophisticated and lacking in resources, and in a family business the dividing line between consumer and microenterprise can be unclear. This would require a change to Government Ordinance 38/2015, but is allowed by the EU ADR Directive.
 - Moving to a single financial ADR body: A single financial ADR body, with robust powers, would provide economies of scale, greater flexibility and increased clarity for consumers. It should be independent from NBR, ASF and ANPC – but provide data to the regulators so that they are appropriately informed. It could enable a move towards the financial ombudsman model, which is the majority model in the EU. As a first step, CSLAB and SAL-FIN might create a shared office and/or a shared helpline.

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