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Concept Environmental and Social Review Summary

Concept Stage

(ESRS Concept Stage)

Date Prepared/Updated: 06/26/2019 | Report No: ESRSC00601

BASIC INFORMATION

A. Basic Project Data

Country	Region	Project ID	Parent Project ID (if any)
Romania	EUROPE AND CENTRAL ASIA	P171039	
Project Name	Romania: Institutional Strengthening and Financial Safety Net Resilience Project		
Practice Area (Lead)	Financing Instrument	Estimated Appraisal Date	Estimated Board Date
Finance, Competitiveness and Innovation	Investment Project Financing	12/2/2019	3/2/2020
Borrower(s)	Implementing Agency(ies)		

Proposed Development Objective(s)
The PDO is to strengthen the institutional and financing mechanism of the Deposit Insurance Agency to effectively deal with a financial sector crisis.

Financing (in USD Million)	Amount
Total Project Cost	452.00

B. Is the project being prepared in a Situation of Urgent Need of Assistance or Capacity Constraints, as per Bank IPF Policy, para. 12?

No

C. Summary Description of Proposed Project [including overview of Country, Sectoral & Institutional Contexts and Relationship to CPF]

The FGBD was created in August 1996, with the mission of insuring deposits held exclusively by individuals up to the amount of RON 1,000 (then equivalent to roughly USD 239). Over time, and especially after Romania joined the European Union, coverage was extendedin line with the applicable EU directives, and since December 2010 it is equivalent to EUR 100,000 and benefits not only individuals but also legal entities. There have been substantial improvements in terms of payout time, which came down from 90 to 7 days.

Romania has transposed the European Union Directive 2014/49/EU, on deposit guarantee schemes, by enacting Law nr. 311/2015 on Deposit Guarantee Schemes and the Bank Deposit Guarantee Fund, which is the current legal diploma regulating FGDB. The law extended FGDB's mission to include not only paying out depositors, but also (i)

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managing Romania's resolution fund, (ii) functioning as temporary administrator for failing institutions, (iii) functioning as special administrator for institutions undergoing resolution, (iv) owning bridge-banks and asset management vehicles incorporated within resolution procedures, (v) functioning as administrative liquidator for failed financial institutions. The law also determines, in line with the EU Directive, that FGDB can be required, by NBR, to contribute from deposit insurance fund to the resolution of financial institutions with an amount equivalent up to 0.4% of the covered deposits. However, there is a need for making provisions for credible and timely funding lines available to FGDB. In case of multiple bank failures, FGDB's assets may be depleted and the fund may be unable to comply with its obligations thus impacting overall confidence in the financial sector.

In this context the FGDB expressed interest in a WB contingent financing instrument for the deposit insurance fund. In a letter to the WB dated December 18th, 2018, the FGDB requested further technical discussions regarding instrument and related operational/procedural workflows. This was followed by a WB identification mission held during March 6-8, 2019 to define the main parameters of the lending product.

Regarding the size of a potential contingent investment loan, and following best practices, the FGDB calculated its funding needs in the event of the simultaneous failure of 3 large, non-systemically important banks (which would be subject to resolution). In such a case, and after full use of its reserves, the FGDB would need additional financing of around RON 1.2 billion (EUR 250 million). In addition, in the case of resolution of a bank, and according to Romanian law, a request from the NBR (acting as the Resolution Authority) for the FGDB to contribute from deposit insurance fund up to 0.4% of covered deposits, under current conditions would add about another RON 800 million (EUR 170 million) to the funding needs.Considering these two scenarios, the upper limit for a contingent financing instrument would be in the vicinity of EUR 420 million.

The FGDB's preference is to have a contingent facility up to 5 years starting in 2020.

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D. Environmental and Social Overview

D.1. Project location(s) and salient characteristics relevant to the ES assessment [geographic, environmental, social]

Gaps in access to finance for enterprises persist for micro, small and medium-sized enterprises (MSMEs) as well as start-ups, with significant regional disparities. There are also big discrepancies in access to bank finance depending on firm size with large firms relying on banks to a much higher degree than SMEs: 33 percent of large firms have overdrafts and 22 percent have investment loans vs. 12 and 7 percent for SMEs, respectively. In addition, there are significant variations in access to finance within the country. Banks are focusing on urban areas, in particular Bucharest, which accounts for more than a third of SME loans. 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.

Regarding households, Romania lags its regional and income level peers in terms of financial inclusion. According to the Global Findex database 2017, 58 percent of adults are banked in Romania, unchanged from 2014 data. However, the poor are 33 percentage points less likely to have an account than the rich, significantly higher than the income gap for developing countries. Among the unbanked, some commonly cited barriers included high cost and lack of trust in financial institutions (about a quarter of unbanked adults). Majority of the unbanked cite poverty as a barrier (17 percent report it as the only reason) implying that a product suitable to their needs may not be available. About 5-7 percent of unbanked adults cite "no need" and "family member has an account" as the only reason for not having one.

The Project will strengthen the FGDB resilience as it will provide it with a reliable source of funds to be assessed in case of a systemic crisis. In times of crises, although FGDB remains solvent, it may not be able to sell its assets (mainly, government bonds) for their fair price because of the lack of interested parties. By having the ability to draw on the contingency line instead of conducting such “fire sales”, FGDB’s financial situation will be significantly strengthened, and so will its ability to effectively contribute to restoring financial stability.

In addition, the Project will also focus on strengthening the bank deposit insurance institutional framework. During the Project the WB team will provide technical assistance to the authorities to address remaining gaps in the institutional framework. Existing shortcomings include the following: (i) banks pay contributions annually instead of quarterly, which makes it impossible to account for fluctuations in the deposit base and poses risks to FGDB, (ii) FGDB is not allowed to keep funds deposited with NBR, and therefore must deposit its resources in private banks, which are subject to failure; and (iii) there are no proper arrangements with NBR to supply liquidity (via repo transactions or otherwise) to FGDB in case of a severe crisis which impacts FGDB’s ability to sell its assets on the market.

The Project also aims to explore ways to expand protection for currently underserved individuals. Although bank cooperatives and EMHHs are a relatively small segment and may not pose concerns in terms of financial stability, they are highly relevant in terms of financial inclusion. Therefore, the project will explore how to enhance protection for “social funds” in EMHH and deposits at the coop banks. Currently, FGDB only covers deposits in the Central Cooperative Bank, but not on individual institutions. Throughout this project, the WB team will explore various mechanisms for improving the access and coverage of the financial safety net in Romania.

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D. 2. Borrower’s Institutional Capacity

The FGDB will serve as the Borrower and implementing agency. Implementation arrangements for this Project are expected to be fairly straightforward, as i) there may not be any disbursement of funds if no event is triggered, and ii) in case funds are disbursed, they will not be used for procurement of goods or services. The Borrower will be asked to ensure that throughout the project implementation period it maintains adequate governance and financial management arrangements, and support will be provided as necessary by the WB fiduciary team.

The Project will also focus on strengthening the bank deposit insurance institutional framework. During the Project the WB team will provide technical assistance to the authorities to address remaining gaps in the institutional framework. Existing shortcomings include the following: (i) banks pay contributions annually instead of quarterly, which makes it impossible to account for fluctuations in the deposit base and poses risks to FGDB, (ii) FGDB is not allowed to keep funds deposited with NBR, and therefore must deposit its resources in private banks, which are subject to failure; and (iii) there are no proper arrangements with NBR to supply liquidity (via repo transactions or otherwise) to FGDB in case of a severe crisis which impacts FGDB’s ability to sell its assets on the market.

FGDB is mandated with managing the deposit insurance fund in Romania and more recently the resolution fund. The FGBD was created in 1996, with the mission of insuring deposits held exclusively by individuals up to the amount of RON 1,000 (then equivalent to roughly USD 239). Over time, and especially after Romania joined the European Union (EU), coverage was extended in line with the EU Directive 2014/49/EU, on deposit

The FGDB does not have a history of working with WB projects and therefore has not developed capacity to address environmental and social policies or standards. As a part of project implementation, capacity concerns will be addressed to ensure proper attention is paid to social concerns especially with regards to stakeholder engagement and developing avenues of access to financial institutions for the underserved households.

II. SCREENING OF POTENTIAL ENVIRONMENTAL AND SOCIAL (ES) RISKS AND IMPACTS

A. Environmental and Social Risk Classification (ESRC)

Low

Environmental Risk Rating Low

The project environmental risk is assessed low. The project potential adverse risks to and impacts on human populations and/or the environment are likely to be negligible. The project will not directly result in any works or procurement of goods, as it provides contingent financing to the FGDB to meet potential deposit insurance and bank resolution obligations. The project will help ensure that insured depositors individuals and legal entities) will not lose their savings in case of a bank failure.

Social Risk Rating Low

This project will be focused upon strengthening the institutional and financing mechanism in Romania to effectively deal with a financial sector crisis by provision of a contingency financing instrument to the Bank Deposit Guarantee Fund (FGDB) to effectively meet the deposit insurance and bank resolution obligations of Romania. It is not expected to impact on staff within institutions. It is also not intending to involve physical works. Finally, it is expected that the outcome will improve the stability of financial system to prevent economic crisis.

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B. Environment and Social Standards (ESSs) that Apply to the Activities Being Considered

B.1. General Assessment

ESS1 Assessment and Management of Environmental and Social Risks and Impacts

Overview of the relevance of the Standard for the Project:

Based on information available at the PCN state, no negative environmental or social impacts are expected, and no material environmental and social risks are associated with the proposed project. The project will not finance any works or other construction activities, will not support purchasing of goods, preparation of plans, studies or policies that could potentially generate impact to environment. The project is not expected to finance civil works. The project social impact is expected to be overall positive, as it is expected to ensure the financial system is better protected from economic shocks. There is no expected changes in staffing and instead will include capacity building where necessary. Finally, the project will explore ways to expand protection for currently underserved individuals but exploring ways in which to increase access and coverage to improve financial security within currently underserved households.The project will explore how to enhance protection for “social funds” in EMHH and deposits at the coop banks which tend to be more accessible in rural, underserved, or remote areas. Social funds often serve as an accessible source of investment opportunity for persons that would otherwise have no access to finance opportunities. This would provide increased options for those living in more remote and rural areas and have larger population of underserved and poorer households.

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If an economic crisis were to transpire, poorer households would be more dramatically impacted as they would be less likely to have alternative resources by which to rely upon. Therefore, ensuring safety nets are in place could significantly reduce the severity of hardships that a poor or vulnerable household may experience.

Mutual Help Houses (MHH), a type of credit union, play a limited financial inclusion role. Access to financial services is also supported by about 2,000 mutual help houses serving 2.7 million members (equivalent to about 17 percent of Romania's adult population), including employees (about 1.1 million) and pensioners (about 1.5 million). Total credit provided by MHH amounted to 4.7 bn lei in June 2017, equivalent to about 0.54 percent of 2017 GDP. The MHH are affiliated to the national federations that provide a range of services to their members and report its aggregated network data to the regulator. The largest federation for employee credit unions (UNCARSR) estimates that about 20 percent of its affiliated entities are in rural areas. MHH are non-deposit taking institutions funded through the members' "social funds," which constitute a form of long-term savings that, while resembling deposits, can only be withdrawn in case the member ends his/her membership or when the member dies. Social funds are built up by members over time, oftentimes through monthly contributions. Although they oftentimes represent rural household's only form of savings, social funds are not covered by any form of deposit guarantee. Supervision of employee MHHs is not carried out by the NBR, but by the federations, while pensioners' MHH are not externally supervised. Legal limitations on funding sources, scope of financial services and type of members significantly reduce their operations.

The Project also aims to explore ways to expand protection for currently underserved individuals. Although bank cooperatives and EMHHs are a relatively small segment and may not pose concerns in terms of financial stability, they are highly relevant in terms of financial inclusion. Therefore, the project will explore how to enhance protection for "social funds" in EMHH and deposits at the coop banks. Currently, FGDB only covers deposits in the Central Cooperative Bank, but not on individual institutions. Throughout this project, the WB team will explore various mechanisms for improving the access and coverage of the financial safety net in Romania.

The project scope is focused on those that are covered under the deposit insurance agency mandate. These also include the bottom 40%.

This is a financial crisis operation that plans to ensure that commitments to existing depositors are met, thus the focus will be on disadvantaged and vulnerable groups and thus benefit from project activities. The largest known vulnerable group in Romania is the Roma peoples. Other vulnerable groups include low-income households and pensioners, and households with disabled members. A stakeholder mapping will identify the vulnerable groups most in need of assistance in the financing sector.

Areas where "Use of Borrower Framework" is being considered:

The use of Borrower Framework for addressing environmental and social issues is not anticipated.

ESS10 Stakeholder Engagement and Information Disclosure

Most activities will occur within institutional levels. However, stakeholders will need to be directly consulted to determine what services, banking institutions, they are most likely to use and the ways in which they are able to access these services. Information campaigns will also need to be developed which explains FGDB improvements

which ensure vulnerable depositors that their deposits are adequately protected, and that gaps have been filled in the financial safety net system.
A simple Stakeholder Engagement Plan should be developed by which stakeholders located in underserved areas, vulnerable households, and poor will be involved in determining ways in which to improve access to financial services. While vulnerable households tend to be Roma, disabled, and low-income persons, a stakeholder mapping can identify vulnerable households which may encounter barriers to finance safety nets.

The project scope is focused on those that are covered under the deposit insurance agency mandate. These also include the bottom 40%.

This is a financial crisis operation that plans to ensure that commitments to existing depositors are met, thus the focus will include disadvantaged and vulnerable groups who currently lack insurance coverage. In order to ensure that such vulnerable groups do receive project benefit, stakeholder mapping to be conducted during preparation will include identification of such groups, and measures to help ensure the project reach out to them will be included in the SEP.

B.2. Specific Risks and Impacts

A brief description of the potential environmental and social risks and impacts relevant to the Project.

ESS2 Labor and Working Conditions

The ESS2 is relevant to FGDB staff although they will not be financed by the project and therefore not considered project workers. The contingency funds will not be used for services of any kind. As the project will not employ, directly, or indirectly, workers to perform activities related to the project, the Borrower will not prepare a Labor Management Procedure. The task team will review FGDB HR policy to ensure alignment with ESS2.

ESS3 Resource Efficiency and Pollution Prevention and Management

This project focuses on institutional capacity building of financial institutions. The project will not support any works or procurement of goods, any activities that may result in investments, and therefore the ESS3 is not currently relevant.

ESS4 Community Health and Safety

This project will not fund activities which will cause negative impact on community health and safety. It can be stated that with improved safety nets and financial security, their will be reduced stress caused by economic concerns. Therefore, the ESS4 is not currently relevant.

ESS5 Land Acquisition, Restrictions on Land Use and Involuntary Resettlement

This project does not intend to require land acquisition, impact negatively on assets, or cause loss of assets. ESS5 is not currently relevant.

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ESS6 Biodiversity Conservation and Sustainable Management of Living Natural Resources

As the project will not support any works or procurement of goods the ESS6 is not currently relevant.

ESS7 Indigenous Peoples/Sub-Saharan African Historically Underserved Traditional Local Communities

No indigenous peoples are known to reside in Romania.

ESS8 Cultural Heritage

The project will not finance civil works and no interaction with tangible or intangible cultural heritage is expected. Therefore, the ESS8 is not currently relevant.

ESS9 Financial Intermediaries

ESS9 is not currently relevant. By definition ESS applies to FIs that receive financial support from the Bank. FIs include public and private financial services providers, including national and regional development banks, which channel financial resources to a range of economic activities across industry sectors. FIs use various financial products such as project finance, corporate finance, medium and small enterprise finance, microfinance, housing finance, leasing and trade finance. This ESS covers all types of financing and financial products provided by FIs that are targeted to productive business activities. As the project provides institutional strengthening to reduce risk of economic crisis in banking system, it does not provide support directly or indirectly to FIs.

C. Legal Operational Policies that Apply

OP 7.50 Projects on International Waterways	No
OP 7.60 Projects in Disputed Areas	No

III. WORLD BANK ENVIRONMENTAL AND SOCIAL DUE DILIGENCE

A. Is a common approach being considered? No

Financing Partners

n/a

B. Proposed Measures, Actions and Timing (Borrower’s commitments)

Actions to be completed prior to Bank Board Approval:

- Stakeholder Engagement Plan prepared and disclosed before appraisal. The Stakeholder Engagement Plan will include a stakeholder mapping exercise to identify vulnerable persons, groups, and households.

Possible issues to be addressed in the Borrower Environmental and Social Commitment Plan (ESCP):

The team is currently preparing, and finalizing, a study on financial inclusions that looks at a number of additional facets which includes access and barriers. This study will assist Borrower in identifying barriers and cultural norms which prevent underserved areas, vulnerable households, and poor households from accessing financial services. Provide recommendations by which to address barriers and improve involvement of the underderserved.

C. Timing

Tentative target date for preparing the Appraisal Stage ESRS 02-Dec-2019

IV. CONTACT POINTS

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Borrower/Client/Recipient

Implementing Agency(ies)

V. FOR MORE INFORMATION CONTACT

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VI. APPROVAL

Task Team Leader(s):	Natalie Nicolaou, Isfandyar Zaman Khan
Practice Manager (ENR/Social)	Satoshi Ishihara Recommended on 24-Jun-2019 at 10:52:17 EDT
Safeguards Advisor ESSA	Kevin A Tomlinson (SAESSA) Cleared on 26-Jun-2019 at 09:18:14 EDT

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