OUTSTANDING DEVELOPMENTS IN THE ROMANIAN BANKING SYSTEM

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Abstract:
The Romanian banking system, after 1990, went through several stages in order to adapt to a new economic context, respectively to the necessary adjustment to the transition from centralized economy to market economy, and then, after the year 2000, adapting to meet the European Union's membership requirements, and later, after 2007, adapting to adopt the euro currency. These events to which the Romanian banking system must adapt are known events. To which, however, join contingencies related to the onset and manifestation of the international financial crisis, events with direct impact on the banking system in Romania that determined changes both in the banking regulations, and in the structural level. This paper aims to analyze the main features of the Romanian banking system, based on the legislative changes that have taken place, looking at the structural changes in terms of capital and its origin country, looking at the degree of banking intermediation, following that at the end of this paper to analyze the evolution of the non-governmental credit, the latter being the motive for the bank's asset growth and also the element that caused the manifestation of the credit risk and the current existence of a very high percentage of bad loans.

Keywords: bank legislation, indicators of financial stability, non-government credit

The Romanian banking system, in an attempt to adapt to the opportunistic changes that is going through, always tried to adapt both to the EU requirements and to the requirements of the Romanian economy, and now, to the difficulties caused by the current financial crisis.

From this perspective, the National Bank of Romania was concerned about creating a legal framework outlining the characteristics of a developed banking system, taking as examples countries that have market economy, and later a banking system that can be integrated into the European banking system. Thus, analyzing the main rules that governed the banking activity after 1990 (Law 33/1991 regarding bank activity published in the Official Gazette no. 70 / April 3rd 1991; Law 58/1998 - Banking Law published in the Official Gazette no. 121/23rd of March 1998 and The Emergency Ordinance no. 99/2006 on the credit institutions and capital adequacy in the Official

Gazette, Part I no. 1027 from December 27 2006) we note that the NBR's attempt to improve the legal framework in order to create a healthy architecture of the banking sector and to harmonize the legislation with international and European requirements, but also to ensure the banking system in crisis (several examples are illustrative in box no.1).

Box no. 1 - Legislative approaches of some banking elements since 1990

- ✓ **Conducting the banking activity**

Law no. 33/1991 on banking activity

The banking activity is conducted through the National Bank of Romania and through banking companies constituted under the law as companies; banking companies are legal entities whose main activity is fundraising from individuals and legal entities in the form of deposits or negotiable instruments, payable on demand or on time, and also granting credits (according to art. 1 and 3);

Law no. 58/1998 – The banking law

Banking is conducted through the National Bank of Romania and through banks or other legal entities authorized by law to conduct banking activities; banks are defined as legal entities authorized to manily attract deposit and to grant credits in its own name (according to the original provisions in art. 2 and 3, lit. b).

Emergency Ordinance no. 99/2006 on credit institutions and capital adequacy

Banking is conducted through the National Bank of Romania and through credit institutions; the credit institution is the entity whose business is to attract deposits or other repayable funds from the public and to grant credits for its own account, which issues means of payment in the form of electronic money; the credit institutions may constitute themselves as: banks, co-operative credit organisations, savings banks and loan housing mortgage banks or electronic money institutions (according to art. 7, lit.10 and art. 3).

- ✓ **The necessary initial constitution capital**

Law no. 33/1991 on banking activity

The National Bank of Romania will set rules regarding the minimum amount of the share capital and the minimum payment at the time of subscription, which can not be less than 50%, and also the subscription period. The subscribed share capital must be fully paid up within two years from the date of the constitution of the banking society (according to art. 6 and 8).

Law no. 58/1998 – The banking law

A bank's capital must be paid up in full and in cash at the time of the subscription. The minimum share capital is established by the National Bank of Romania (the original provisions under art. 40). Subsequently, the amendments to Law 58/1998 stated the obligation to establish a minimum capital of 5 million

Euros.

Emergency Ordinance no. 99/2006 on credit institutions and capital adequacy

The social capital of a credit institution, a Romanian legal person, must be paid in full and in cash at the time of the subscription, including the case of its increase, contributions in kind are not allowed. The National Bank of Romania may not grant authorization to a credit institution if it does not have equity or a different level of the initial capital at least equal to the minimum level set by regulations, which can not be less than the equivalent of 5 million Euros. (according to art. 11 and 12 points. 2)

- ✓ **Operation of Foreign Bank Branches**

Law no. 33/1991 on banking activity

The establishment, operation and liquidation of bank branches in Romania, foreign legal persons, shall be made according to Law no. 31/1990 on trading companies, after the recognition of these banking companies as foreign legal entities. Opening branches in Romania of foreign legal persons banks takes place in accordance with the law regarding operating in Romania of representations and foreign economic organizations (according to art. 13).

Law no. 58/1998 – The banking law

Bank branches, foreign legal entities could operate only on the authorization issued by the NBR. They constitute under the legal form of joint stock companies, upon the approval of the National Bank of Romania, in compliance with the legal provisions applicable to companies (according to the current art. 9).

Emergency Ordinance no. 99/2006 on credit institutions and capital adequacy

A credit institution authorized and supervised in another EU member state may establish a branch in Romania based on a notification sent to the National Bank of Romania by the competent authority of the Member State of origin. To establish a branch by a credit institution from a Member State does not required obtaining a permit from the National Bank of Romania, or ensuring a capital endowment of the branch (according to art. 46 and 48). Regarding the opening of a credit institution branch from a third party, it must be approved by the National Bank of Romania and must respect all the conditions, including that relating to the minimum capital imposed by the law in force at like any credit institution, Romanian legal person (as art. 67)

- ✓ **Defining the exposure**

Law no. 58/1998 – The banking law

Exposure is defined as any commitment assumed by a bank towards one borrower, whether actual or potential, shown in the balance sheet or off the balance sheet, including but not limited to: loans, discounted bills, share investments and other securities, endorsed bills, issued guarantees, letters of credit opened or confirmed (according to art. 3 point. v).

This concept is not defined in the other 2 provisions analyzed.

- ✓ **Prudential supervision**

Law no. 33/1991 on banking activity

Restrictions imposed by the National Bank of Romania concerned: the participation of a banking society to a company or to an enterprise whose main activity is not related to banking, can not exceed 20% of the company's or enterprise's capital. Loans from a bank to a single borrower could not exceed the cumulative 20% of the company's capital and the reserves of the respectively bank society and the loans granted to borrowers that are in special relations with the bank society or its personnel, including family, will be permitted only in accordance with the regulations issued by the National Bank of Romania (according to art. 28.29).

Law no. 58/1998 – The banking law

Banks must comply with the prudential requirements relating to minimum solvency level, determined as the ratio between the equity and total assets and off-balance sheet items, weighted according to their risk degree; the maximum exposure to a single debtor, expressed in percentage, as the ration between its total value and the level of the bank's own funds; the maximum aggregate exposure, expressed as percentage, as a ratio of the total large exposure value and the equity level, the minimum level of liquidity, determined according to the bank's claims and liabilities; classification of granted loans and their unpaid interests, and establishing the specific risk provicions, the currency position, expressed in percentage according to their own funds; resource management and bank investments; extending the network branches and other establishments of the bank (under art. 45)

Emergency Ordinance no. 99/2006 on credit institutions and capital adequacy

This ordinance regulates the capital adequacy, mainly the capital requirements that are necessary to cover the credit risk, the market risk and the operational risk, to harmonize with the Basel Agreement II and also regulates the management of large exposures and of holdings of credit institutions (under chapter III).

- ✓ **The NBR's new reglementations in the context of the international financial crisis**

The NBR Regulation no. 18/2009 regarding the administration framework of the credit institutions activity, the internal process of evaluating the capital adequacy to risk and to the outsourcing conditions of these activities, in force since September 2009 with full compliance for the credit institutions: 30th of June 2010. This regulation contains provisions concerning risk management and the internal assessment of capital adequacy to risks such as: responsibilities of the management structure of the credit institution; crisis simulations on risk categories, determining capital requirements to cover hazards such as residual risk, securitization risk, the interest rate risk of non-trading activities, concentration risk, liquidity risk, reputational risk, strategic risk;

Source: www.cdep.ro, www.bnro.ro

Since 2007, banking is regulated by Emergency Ordinance no. 99/2006 on credit institutions and capital adequacy, which carries out the harmonization of the legislation with the Directive no. 2006/48/EC of the European Parliament and of the Council of 14^{th} of June 2006 concerning the access to activity and developing the activity by the credit institutions and with Directive no. 2006/49/EC of the European Parliament and of the Council from 14^{th} of June 2006 regarding capital adequacy of investment firms and credit institutions.

Also, the banking law includes a number of regulations (laws, ordinances, rules) wich regard the application of these ordinances in banking practice, which are continually modified to increase the strength of the banking system and its credibility to respect the provisions of the Basel Agreement II and to comply with the acquis communautaire.

After 1990 the Romanian banking system has undergone major structural changes, moving from a banking system consisting of 5 banks, to a system consisting of 43 commercial banks at the end of 2008. The Romanian banking market changes recorded over the years were caused mainly by changing the ownership structure of the banks. We notice here the entry on the domestic banking market of large amounts of foreign capital (especially in 2006), mostly coming from reputable credit institutions from abroad.

In this context, the market share held by the domestic banks has dropped significantly, from 52.5% in 1999 to 11.6% at the end of 2008, in favor of the foreign investors. (Table no. 1 and Table no. 2). In terms of the share of branches of foreign banks in total net asset balance sheet they have always held a relatively constant share of less than 9% and even of 5.6% at the end of 2008. However in the last two years, one of the significant changes in structural terms, refers to increasing the share of balance sheet assets held by banks that have a romanian capital of nearly 15%, an aspect determined by the Railway Commercial Bank’s activity starting, having majority domestic private capital.

Table no. 1. Credit institutions in Romania by ownership forms

	Number of credit institutions									
	2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Banks with majority / integral state capital, of which:	3	3	3	2	2	2	2	2	2	2
- with majority state capital;	2	2	2	1	1	1	1	1	1	1
- with integral state capital;	1	1	1	1	1	1	1	1	1	1
Banks with majority private capital, of which:	30	28	27	30	31	29	29	31	30	30
- with majoritary autochthonous capital;	6	4	6	7	7	3	3	3	4	4
- with majoritary foreign capital;	24	24	21	23	24	26	26	28	25	26
Branches of foreign banks:	8	8	8	7	6	7	10	10	10	9
TOTAL – banking system	**41**	**39**	**38**	**39**	**39**	**39**	**42**	**43**	**42**	**42**
CREDITCOOP	**-**	**-**	1	1	1	1	1	1	1	1

Source: NBR – Annual reports 2001-2010, www.bnro.ro

Table no. 2 - The structure of the market share of banks and foreign branches

Net asset balance sheet *(-percentage at the end of the periodi -)*										
	2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Banks with Romanian capital, of which:	44,8	43,6	41,8	37,9	37,8	11,4	12,1	11,6	14.5	14.7
- with state majority capital;	41,8	40,4	37,5	6,9	6,0	5,5	5,4	5,2	7,3	7.4
- with private majority capital;	3,0	3,2	4,3	31,0	31,8	5,9	6,7	6,4	7,2	7.3
Banks with majority foreign capital:	47,3	49,0	50,5	53,6	54,7	82,8	82,7	82,6	77,9	78.1
TOTAL – commercial banks, romanian legal persons:	**92,1**	**92,9**	**92,3**	**91,5**	**92,5**	**94,2**	**95**	**94,4**	**92.6**	**92.8**
Branches of foreign banks:	7,9	7,4	7,7	8,5	7,5	5,8	5,0	5,6	7,4	7,2
TOTAL – banking system	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Source: NBR – Annual reports 2001-2009, www.bnro.ro

A strong decreasing trend was registered by the share of the state-owned banks from a market share of 46.8% at the end of 1999 to 7.4% in 2010 mainly due to the completion of the privatization process of the Agricola Bank by its taking over by Raiffeisen Bank in 2001 and thanks to the passing of the Romanian Commercial Bank in the category of banks with majority private capital from the sale of the majority pack of its shares to Erste Bank in late 2005.

Regarding the size of the banking market in Romania, this has been mainly influenced by the following factors:

• the opening of the Romanian banking market for strong foreign investors;
• the emergence of new banking operators;

• bank mergers and acquisitions;

• harmonizing the legal framework in order to adapt to the EU requirements.

Regarding the origin country of the invested capital in the credit institutions that operated on the Romanian banking market in late 2008, Greece is first in the ranking of the foreign participations at the bank's capital in Romania, with an increased share from 21.5% at the end of 2007 to 22.4% at the end of 2008 (chart no. 1).

Participation of the Greek capital in the commercial banks of Romanian has been continuously increasing, reaching 33.79% at mid-2010. However, in terms of the market share held by the Greek-owned commercial banks, these are surpassed by the commercial banks with majority capital from Austria (taking into consideration the first position occupied in the top of the commercial banks in Romania after their assets by BCR - controlled by Erste Group of Austria and the third position occupied by Raiffeisen Bank - owned by Raiffeisen International Austria - according to a ranking compiled by Ziarul Financiar) – chart no. 2 and chart no. 3.

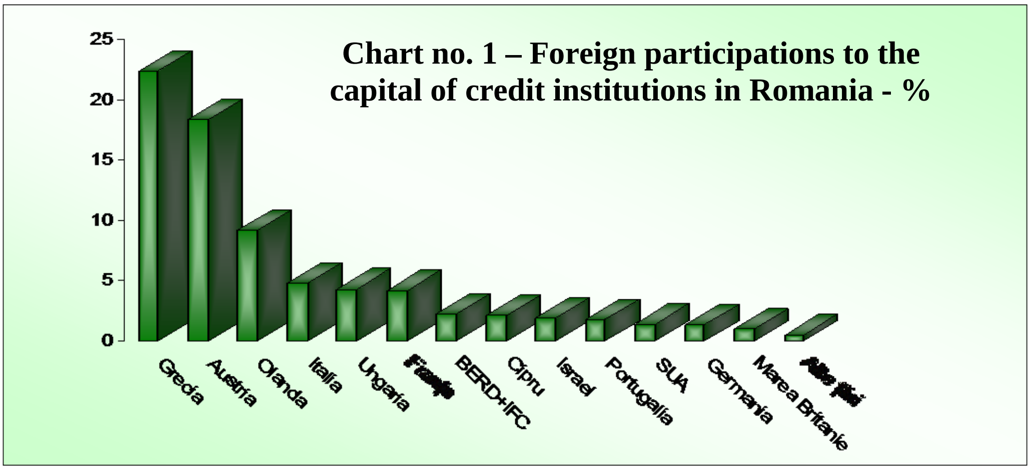
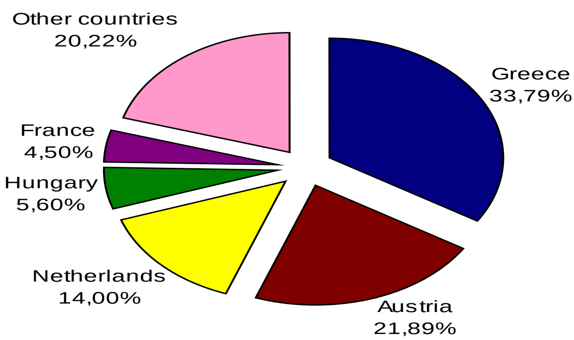


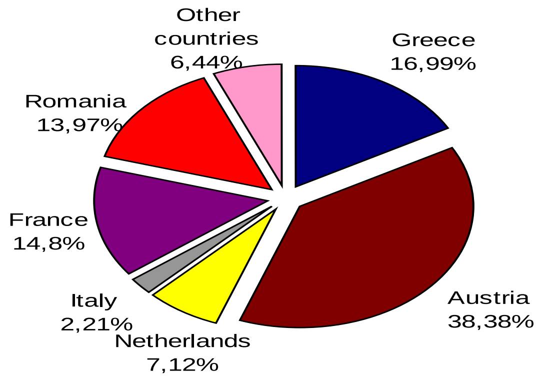
Chart no. 1 – Foreign participations to the capital of credit institutions in Romania - %

Chart no. 2 – The structure of the social capital of the credit institutions according to their origin countries at June 30 2010



Source: processing after the Financial Stability Report 2010 – NBR

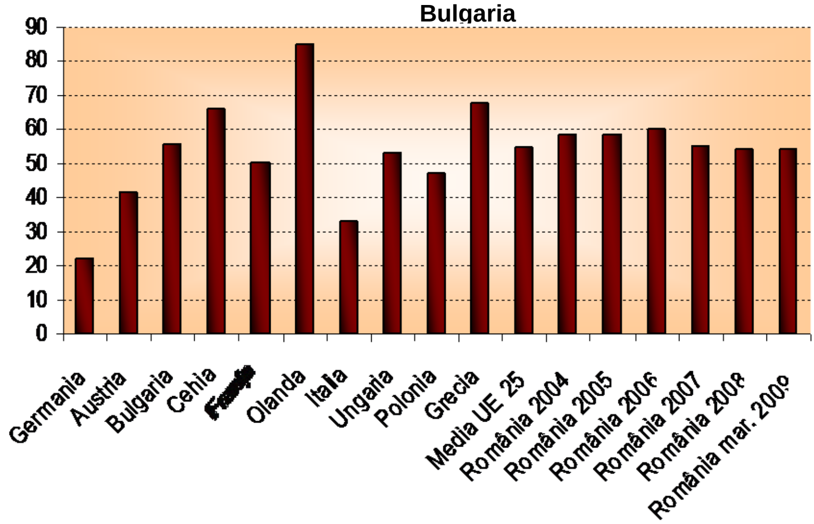
Chart no. 3 - The market share of the credit institutions according to ownership structure at June 30 2010



Source: processing after the Financial Stability Report 2010 – NBR

The existence of a majoritary foreign capital in the Romanian banks and of a large percentage of net assets held by banks with Austrian or Greek majoritary capital, determines an additional risk for the Romanian banking system. To hedge against the risk of capital withdrawal from the commercial banks, the NBR has signed a commitment in 2009, with the parent bank of nine of the largest foreign banks in Romania in order to support the opened branches in Romania.

Chart no. 4 – The banking concentration degree in the EU – 25 and Romania and Bulgaria



Regarding the **degree of concentration** in the Romanian banking sector, calculated as the combined market share of the top 5 banks, it decreased slightly in 2008 and in the first quarter of 2009, both on the credit component and on the deposit one. This is explained by the attenuation of the offensive policies of the main banks in the Romanian system. At the end of March 2009, the market share of the top five banks in total assets has recorded a decline to 54.3%. Compared with other European Union member states, in terms of the held share of the five largest banks in aggregate assets, Romania is situated close to the average of the 25 EU Member States, before the accession of Romania and Bulgaria (chart no. 4).

On the Romanian market also operates non-banking financial institutions such as mutual assistance funds, pawnshops, financial leasing companies, credit companies for individuals, micro-finance companies, mortgage companies, companies that perform factoring operations, companies specializing in financing commercial transactions, and others.

The financial assets share had an upward trend in recent years, reaching 75.8% of GDP by 2008, Romania's accession to the European Union encouraging the development of credit and foreign investments in the financial sector. The structure of the financial intermediation sector indicates ***a local financial culture mainly oriented towards the banking sector*** (62.4% of GDP), while the capital market investments, that are growing, yet have a low share (Table no. 3).

Therefore, the stock market can not yet assume, except to a limited extent, the role of financing the real economy in the case of some imbalances of the banking sector, although it benefits from a good absorption capacity tested by the underwriting level of the public offerings. The financial investment services companies have a determinant role in mediating on the stock market, but the volume of the assets held by these entities is low. Insurance companies registered a positive evolution in recent years, but the life insurance component, aimed at long-term investment is reduced. (NBR - Financial Stability Report 2008)

Table no. 3 – Evolution of the financial system's assets

Percentage of GDP

Financial intermediaries	**2004**	**2005**	**2006**	**2007**	**2008**
Credit insitutions	36,6	44,6	50,6	61,0	62,4
Insurance companies*	1,9	2,2	2,5	3,0	3,0
Pension funds	-	-	-	-	0,2
Investment funds	0,2	0,2	0,3	0,3	0,2
Financial investment companies**	1,3	1,8	2,3	2,8	1,2
Non-banking financial institutions	3,6	4,5	4,7	7,2	8,4
Total	**43,6**	**53,3**	**60,4**	**74,3**	**75,4**

*total assets; **estimative data

Source: NBR - Financial Stability Report 2009 – NBR

It can be noted that the credit institutions and the non-bank financial institutions hold the largest share of financial assets. The high concentration level of the financial system indicates that the credit institutions are the only ones that present a potential systemic risk.

Although the credit institution in Romania have a significant role in financing the economy, the Romanian banking system is characterized by a degree of banking intermediation (calculated as the ratio between the total assets and GDP) comparatively reduced to other countries from Central and Eastern Europe (table no. 4). This situation, in which Romania has the lowest degree of intermediation, during the whole analyzed period, reflects a less developed banking system.

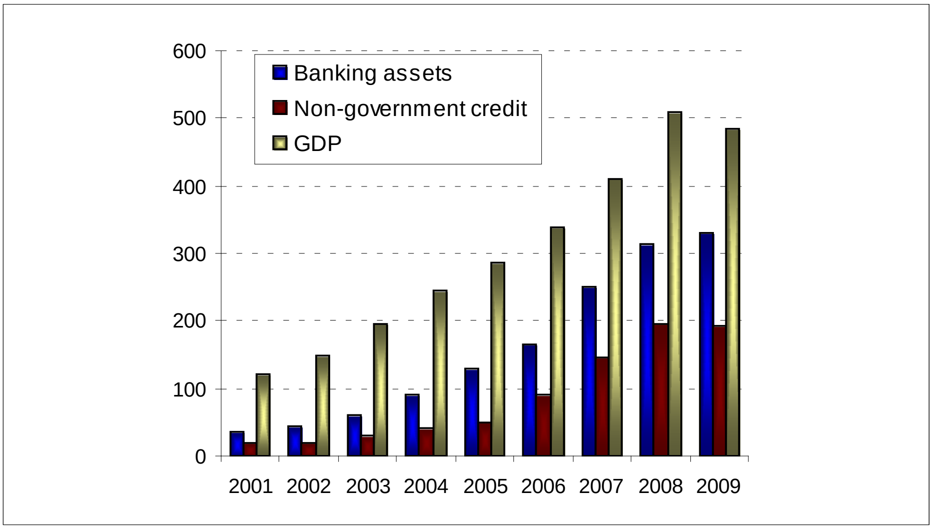
Table no. 4 - The degree of bank intermediation in Romania, calculated as the ratio between the total assets and GDP, compared with other countries in Central and Eastern Europe in the period 2007-2009 (%)

Country	2007	2008	2009
Bulgaria	108,09	107,93	112,02
Czech Republic	110,80	104,82	116,73
Hungary	107,34	118,12	135,23
Poland	75,22	72,46	88,43
Slovenia	125,82	132,00	153,05
Slovakia	105,75	132,00	153,05
Romania	**57,80**	**60,49**	**74,55**

Sursa: EU Banking Structures, September 2010 – European Central Bank

Another current feature of the Romanian banking system is represented by the ***accelerated evolution of the non-government credit value***. Regarding the evolution of loans granted by the banking system in Romania, there have been recorded important developments. Thus, in 2007 the growth rate of government loans has accelerated (50.5% in real terms) with over 3% higher compared with the previous year. The non-governmental credit has been the engine of a continous expansion of bank assets, claiming more than 70% of their growth (chart no. 5). In the context of a uncertain macroeconomic climate and liquidity problems existing on international markets, the year 2008 has marker a slower growth rate (in real terms) of government loans (26% compared to the one recorded in 2007, respectively 50%), an evolution that was also noted in the year 2009. The reasons for this phenomenon were primarily related to reducing the economic activity, visible with the last quarter of 2008 and by the accounting effect of the national currency depreciation, given that an important share in loans is represented by foreign currency credits.

Chart no. 5 - Evolution of banking assets and non-government credit

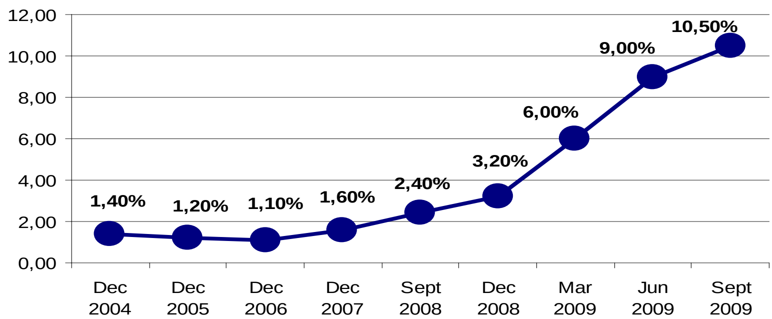


(billionRON)

Source: NBR - Financial Stability Report 2009and 2010 – NBR

The accelerated growth of non-governmental loans granted by commercial banks in Romania in 2007 and 2008 caused, with the international financial crisis, an accumulation of the overdue and doubtful loans, their share reported to equity doubled since March 2009 (chart no. 6).

Chart no. 6 - Evolution of the share of the overdue and doubtful credits reported to equity



Source: Florin Georgescu - The banking system in Romania - present and perspectives, Finmedia - November 10, 2009

Thus, another feature of the present banking system refers to the existence of a growing credit risk, manifested by the increase of the non-performing loans at the level of the credit institutions in Romania. Nevertheless, an analysis of the evolution of bank capitalization, is an essential aspect in such conditions generated by financial and economic contexts, and reflects an improvement in the solvency ratio, which reached 14.7 at the end of 2009 (table no. 5).

Table no. 5 - Development of own funds and the capital adequacy indicator (data at end of the period)

Indicator	2005	2006	2007	2008	2009	2010
Percentage from its own total funds	100	100	100	100	100	100
Personal funds at level 1	77,7	74,3	76,7	74,5	78,4	79,3
Social capital	49,2	46,5	46	49,7	46	49,8
Profit/loss from the current year	14,0	11,4	10,8	-	1,55	-3
Subordinated loans*	10,6	14,0	15,8	20,4	20,1	20,4
Reevaluation reserves*	10,0	8,8	11,3	10,1	6,06	5,6
The solvency report (>8%)	**21,1**	**18,1**	**12,3**	**12,3**	**14,7**	**13,4**

Source: NBR - Financial Stability Report 2005-2010

This situation is determined, on the one hand, by imposing a minimum prudential level of 10% for capital adequacy indicator, following the provisions of the grant agreement signed with the EU and the IMF, provision also stipulated in an agreement signed with the parent banks of the main branches operating in Romania, and on the other hand, due to the contraction of the non-governmental credit caused by restricting the credit supply and demand.

In terms of the same indicators, namely the share of nonperforming credits to total credits and the solvency indicator, Romania's situation compared to other countries from Central and Eastern Europe, reflects an unfavorable situation in terms of nonperformant credits, their share being the highest, but it also reflects a comparable situation to the other countries in terms of capital adequacy indicator (table no. 6).

Table no. 6 - Evolution of the share of nonperforming credits in total credits and of the solvency indicator in Romania compared with other countries from Central and Eastern Europe at the end of 2009

Country	Nonperforming credits/ Total credits (%)	Capital adequacy indicator (%)
Bulgaria	6,0	17,0
Czech Republic	5,3	14,1
Hungary	5,9	12,9
Poland	7,9	13,2
Slovenia	2,3	11,2
Slovakia	4,3	12,6
Romania	**14,8**	**14,7**

Source: CEE Banking Sector Report, September 2010, Raiffeisen Research

Conclusions

Regarding the structure of the banking system in Romania, we note the fact that the banking industry is dominated by foreign capital and by a strong focus on reduced number pf players on this market, players with important financial power, aspects that have facilitated on the one hand the access to an external financing, to an increasing efficiency in risk management, and on the other hand, lead to "crushing" the small players in the product and banking services market. Another essential element noticed following the analysis is the increase of the credits value, in general, and especially those on long term granted to population, in particular, elements that may cause an increase in default risk.

The analysis of the main features of the Romanian banking system reflects a growing system, but this development is done with a slower rate than the ones prevailing in other countries from Central and Eastern Europe. However, although the level of the bank assets reported to GDP is at the lowest level, the level of the nonperforming credits, reported to the total credits, registeres the highest level in Romania, compared with the other examined countries.

This aspect is primarily caused by the rapid and unsustainable growth of the non-governmental credit and secondly by the existence of an inadequate structure of granted credits, respectively a larger share of loans in foreign currency and of loans granted to households, compared with those granted in lei currency and with those granted to companies. However, this situation is kept under control by imposing stricter regulations in terms of capital adequacy, which is currently the supporting element of the banks' activity in Romania.

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