

THE BANKING SYSTEM IN ROMANIA IN THE CONTEXT OF THE PANDEMIC CRISIS

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ABSTRACT

In the context of the effects of the COVID 19 pandemic on the economy, the Banking Sector in Romania had to identify new solutions to reduce risks and maintain a high financial performance within a competitive environment. This article aims to present the way in which the Romanian banking system has managed possible risks (credit risk, market risk, operational risk), and to what extent the pandemic has affected the profitability of this sector. Despite the challenges encountered, the Romanian banking system proved that it resisted its effects, as a result of the fact that the responsible authorities reacted effectively by promptly implementing the economic and legislative policies adopted at national and European Union level. Another important aspect is that commercial banks have learned the lessons of the previous economic crisis, continued the lending process, and strengthened their role as the main financier of the economy, despite the uncertainty surrounding national economic stability.

KEYWORDS: *banking risk, banking system, credit risk, digitalization of the banking system, non-performing loans rate.*

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1. INTRODUCTION

The banking system in Romania, starting with March 2020, has been subject to challenges in the context of the pandemic crisis and implicitly of the economic one. However, it has proven that it has a number of strengths that have allowed it to absorb shocks from the market. The crisis caused by the pandemic has manifested itself in a market that has adopted over the last decade measures to strengthen competitiveness and stability. They aimed to maintain a low level of the non-performing loans rate, to increase the level of competition in this sector by adopting a unified regulatory framework and to reduce the effects of the risks felt at the level of the European and national market. The pandemic started in a system characterized by a low level of interest rates, with a rising level of profitability of commercial banks and with prudential regulations oriented towards stability, compliance and control, in relation to the requirements adopted at European level.

The stability of the banking system, maintaining an increased level of lending, accelerating the digitalization process were just some of the strengths of the Romanian banking system. Since the onset of the crisis, it has been able to absorb a number of the problems of customers who were struggling to pay. The implementation of the solutions adopted at European level, in the form of

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payment moratoriums, with the risk of increasing the costs of commercial banks, has allowed during the crisis to offer a solution to the problem of increasing the level of debts. However, the measures need to be viewed on a temporary basis, as their application for an indefinite period of time may lead to an increase in the level of credit risk due to the level of the non-performing loans (NPLs) rate. In the absence of a secondary market to support commercial banks to manage and administer the recovery of non-performing arrears, the banking system could feel the negative effect of such a measure in the long term. Maintaining a high level of provisions, starting with the first part of 2021, has been an efficient solution to be able to manage credit risk at both national and European level. However, it is worth noting that even such a measure can negatively affect in the medium and long term the level of profitability in this sector. In parallel with these protection measures, according to the data provided by the National Bank of Romania (hereinafter the NBR), the banking system in Romania continued to maintain a sustained pace of lending in both the private and public sectors, covering the liquidity needs of the economy, responding quickly and effectively to the needs of the national economy.

Another challenge faced by both the national and the European banking system resulted from the operational risk materialized by the need for digitalization and the cost resulting from this process. All the measures adopted by both EU and national authorities to complete the digitalization process in the shortest possible time, including for reasons of restriction of movement rights due to pandemic, have emphasized the level of competition within this sector. The main purpose was to facilitate customers' access to banking products in the shortest time.

The need for stability and predictability at the level of the national and European banking sector has led to the reduction of the effects resulting from the legislative/regulatory risk. Consequently, the rules adopted with the arrival of the pandemic crisis no longer limited the market and proved much more predictable, given that they had a common purpose, that of protecting the market.

This article aims to carry out an analysis of the Romanian banking sector from a quantitative and qualitative perspective starting with the onset of the pandemic crisis and to capture to the extent that this sector has succeeded to manage the challenges and risks arising at the level of the national economy. In this regard, we have analyzed the effects of the main measures adopted by the central authorities at national and European level and how it has reacted to the main shocks generated by the crisis situation, which has been unprecedented in recent years. There is a very close relationship between the level of competition and that of stability and profitability within this sector. Any disruptive factor can generate negative effects in the medium and long term.

2. THEORETICAL PERSPECTIVES

With the emergence of the COVID 19 crisis, more and more economists have supported the need for a prompt and efficient response of the economy and implicitly of the national banking systems, in order to be able to cope with its effects and the potential risks that may manifest themselves. The pandemic was the first major test for the European and national banking systems after the financial crisis of 2008-2009. Jacques de Larosière (2020), honorary president of EUROFI, claimed that, from the first decade of 2020 onwards, the global economy would face a very serious situation, given that some estimates spoke of negative economic growth that could stretch over an uncertain period of time. All these premises should lead the entire European community to prepare, by adopting policies and measures, to face a severe shock. He also considered that the first measures taken by most Member States (by ensuring the liquidity of banks, by postponing payment obligations for borrowers in difficulty, by government guarantee schemes for loans to companies) helped the markets, but in the long run it can generate high costs. Moreover, Jacques de Larosière is of the opinion that it is not the monetary creation that should come as the main post-pandemic solution, against the background of its negative inflationary consequences, but the development of structural reforms at the level of national economies and, implicitly, of the European one. (De Larosière, 2020).

According to Luis de Guindos (2020), as Vice-President of the European Central Bank (hereinafter the ECB), the main effect of the coronavirus crisis is that the global and European economies will enter recession in the coming period. However, as regards the economic recovery scenarios, it argues that they will be slow and the form of recovery will be between V and U. The recovery process is closely linked to the ability of Member States to successfully protect the productive capacities of economies by developing schemes, at the level of each Member State, to guarantee loans to companies, so that they can maintain their level of convergence and support national economies themselves. Against the framework of the crisis, the ECB acted in a structured manner, on three levels: (i) it granted liquidations to banks, (ii) as the sole supervisor of the banking sector, it provided commercial banks with flexibility in how to use the available capital buffers in order to maintain and continue the financing process for the population and companies, (iii) it extended monetary policy operations. Regarding a possible debt forgiveness or cancellation of Euro Area countries, the ECB Vice-President claims that the Bank does not consider any scenario in which this debt is a problem, because the levels are sustainable and after this crisis is over the economic conditions can return to normal within a reasonable period of time. (De Guindos, 2020)

Christine Lagarde, the President of the ECB, said in 2021 that unlike previous crises, the European banking sector at the onset of the pandemic crisis had a sound financial position, was able to support the economy and help strengthen the policies adopted. The ECB's supervisory measures allowed monetary policy measures to be smoothly transmitted to the central banks at Member State level, which implicitly favored the financing of all economic sectors. However, the effects of the pandemic will gradually be felt, the problem of low profitability of some commercial banks could be the main factor limiting their ability to adapt to new market conditions and remain competitive. The response to the potential post-pandemic negative effects should take shape on two levels: (i) improving and increasing cost efficiency by commercial banks by reorienting and rebuilding business models towards resilience and long-term added value growth, and (ii) completing the Banking Union by building a sound, integrated and diversified financial sector capable of helping to increase the level of private investment in Europe. (Lagarde, 2021)

Hernandez de Cos (2021), in the first decade of 2021, claimed that the European banking system demonstrated that it had adapted quickly and managed to cope with the first effects of the pandemic crisis, although it had never faced such situations in previous history. This is mainly due to the organizational transformation processes that the banking sector has implemented against the background of the crisis of 2008-2009. In 2020, banks enjoyed better balance sheet quality and a high level of solvency, which allowed them to more easily develop and adapt their pre- and post-crisis risk operational strategies, while developing a capacity to better adapt to different possible scenarios.

Andrea Enria (2021), Chair of the ECB's Supervisory Board, believes that banking supervision and the operational resilience of Central Bank and European banks as a whole will play a key role in the pandemic and post-pandemic (Enria, 2021). Banks' own funds rates remained resilient throughout the pandemic crisis, so commercial banks were able to continue to lend to population, entrepreneurs and corporations. Starting with 2021, the *Supervisory Review and Evaluation Process* (SREP) has been resumed (European Central Bank, 2021). The need for surveillance arises as a result of the fact that there is still uncertainty about the evolution and economic effects of the pandemic. Some sectors are still vulnerable to the effects of the pandemic and may generate the emergence of latent credit risk. Banks may be affected by the high indebtedness in the banking financial system. Changing interest rates and credit spreads could increase credit risk for many banks and also affect those lenders with large exposures to non-bank financial institutions with a high degree of indebtedness. All these developments justify the need for supervision of the banking sector in order to ensure the necessary premises to avoid and prevent any market shocks. The ECB, through its bodies, continues to support the resilience of commercial banks acting across Member States and to test their ability to recover, i.e. to what extent banks can recover from severe stress by implementing operations foreseen in their recovery plans (European Central Bank, 2021).

3. THE CHALLENGES OF THE BANKING SYSTEM IN THE CONTEXT OF THE COVID 19 CRISIS

According to specialists, the crisis generated by the pandemic has structurally changed the risks that manifest themselves in the short term within the banking financial sector. In addition, it emphasized some of the vulnerabilities existing in the economies of the Member States, and implicitly of Romania. These include: (i) the high level of indebtedness, in particular of the public sector, but also the private sector, (ii) the uncertain level of solvency and liquidity of credit institutions with a direct impact on the profitability and quality of the assets they manage, (iii) the increase in the level of interdependence in the relationship between the banking and public sectors, (iv) the lack of measures and policies that encourage sustainable and inclusive economic growth and (v) the lack of digitalization and its slow growth in the financial and banking sector (National Bank of Romania, 2020). The pressure of these vulnerabilities is increased amid a low return on the banking sector since the last crisis.

Credit risk remains high at the level of the Romanian banking portfolio and against the background of the uncertain evolution of the non-performing loans (NPLs) rate and the evolution of the arrears of the debtors who benefited from the moratoriums in the form of deferral of installments (European Commission, 2015). The evolution and level of NPLs influences and may accentuate the negative effects of such vulnerabilities. The experience of the previous crisis, against the background of which non-performing loan rates in Romania exceeded the 20% threshold in 2014, must be avoided. They have a negative impact on the profitability of commercial banks and the high volume of NPLs can threaten the very functionality and stability of the banking system (Deloitte, 2020) At the end of 2020 and the beginning of 2021, the NPL rate was still below the 4% threshold, respecting the trend of recent years. However, the measures taken to prevent debtors' payment difficulties risked leading to an increase in that rate. At the end of the first quarter of 2021, the level of the NPL rate for companies, which benefited from the measure of suspension of payments, was 12.3% compared to those that did not benefit from such moratorium measures where the level was only 5.2%. As regards the loans granted to individuals, they confirm the evolution, respectively for the debtors who are beneficiaries of the suspension of the payment of installments, the level of NPL was 7.4%, and among the population that did not benefit from such a measure of only 3.1% (Deloitte, 2021). The NPL rate for all deferred exposures, both on the basis of legislative/private moratoriums and other restructuring measures, recorded a level of 10.2 % in March 2021. The results of the stress test carried out by the NBR on the Banking System in Romania showed that the level of NPL in December 2021 would reach a level of 9.2% and in December 2022 of 9.9% in the baseline scenario and 19.4% in the adverse one. Moreover, commercial banks have to adapt to the legislative regulations, in force since 2018, which increase the burden of risk resulting from NPLs. These include tax restrictions that penalize a financial institution that assigns a non-performing loan (National Bank of Romania, 2021).

At European and Romanian level, the idea that the structure, liquidity and dimensions of the national markets for the sale of non-performing assets is an obstacle to the development of a common EU-wide solution, in the absence of a single market for non-performing loans, is increasingly emerging. The existence of diverse and fragmented operating rules makes national markets to be developed below optimally, through low volumes of transactions with such NPLs. Due to a low level of competition, low demand for NPL portfolios and a low-price level offered by buyers, many commercial banks at both European and national level were discouraged from divesting such portfolios. The lack of this market for non-performing loans that could manage the process of administration and recovery of such arrears was also felt in the period immediately following the pandemic crisis because commercial banks had to incur costs also to manage non-performing loans, despite the fact that the market was strongly affected by the need for lending and liquidity.

In the context of the effects of the crisis generated by the pandemic and of the increasing macro-economic imbalances, the financing conditions have tightened both at the Union level and at the level

of Romania. The ease of access to finance remains a main objective to be achieved, without which the necessary mechanisms for the recovery of the economy cannot function, in a context where risks to the national banking sector are increasing.

Regarding the risks that affected the banking system in Romania, starting with March 2020, according to the *Questionnaire on systemic risks*, carried out by the NBR at the level of the largest domestic credit institutions (European Central Bank, 2021), two high risks and eight moderate risks were identified. It classified as high systemic risks: (i) the country risk materialized by the deterioration of domestic macroeconomic balances and (ii) the risk associated with the need to maintain cyber safety and financial innovation. The most important changes in the level of risks, compared to the previous analysis, are recorded in the case of legislative risk, due to the uncertain and unpredictable regulatory framework. This shows a decrease in the likelihood of this risk occurring by shifting it from the category of high systemic risk to that of moderate systemic risk, also surpassing the risk of nonpayment. It has been accentuated since 2015, but it has decreased at the end of 2020 as a result of the unconstitutionality decisions of the Constitutional Court regarding certain normative acts in the field of consumer protection like: Law approving GEO no. 37/2020 on the granting of facilities for loans granted by credit institutions and non-banking financial institutions to certain categories of borrower, Law for the approval of GEO no. 48/2020 on certain financial and fiscal measures, the Law on the establishment of State aid for the granting of compensation to agricultural producers affected by adverse weather phenomena, the Law on the protection of consumers against excessive interest rates. The provisions of these laws were declared unconstitutional by the Constitutional Court between August 2020 and January 2021. The impact studies that accompanied these pieces of legislation showed that their application could have had negative effects on financial stability. All other risks recorded sensitive developments, i.e. one-position climbs and declines, all of which were moderately classified and without noticeable fluctuations compared to the previous analysis. The profitability of any credit institution depends directly on how it can manage the risks and on the ability to forecast any uncertain developments. Because they must pay special attention to risk management and ensure the correct application of risk management systems. (European Central Bank, 2022)

The possible effects and additional costs that the regulations and legislation adopted in response to the crisis caused by the Covid 19 pandemic could manifest themselves in the post-crisis period. Thus, the legislative risk may reposition itself in the next period. The costs that commercial banks will have to bear later in order to be able to maintain and comply with the protection standards adopted by the normative acts entered into force will be able to influence including the level of profitability of the banking activity.

Despite the favorable developments of the Banking Sector in Romania, and the fact that it was more solid than the EU average, the challenge it has faced since March 2020, like the Central and Eastern European (CEE) system, was the need for consolidation, given that there is a high risk for commercial banks to no longer be able to cope with the challenges of maintaining a high level of profitability and meet the capital requirements. The CEE banking sector is still facing a high level of fragmentation and a large number of players in the market with marginal market shares, which makes this sector not a solid one that can manage in a unified manner any economic shocks that may arise.

Another challenge of the pandemic has been the need for digitalization. To be able to manage changes in consumer behavior, and against the background of restrictions on travel and social interaction. Banks have had to put the digitalization process at the forefront and accelerate this process. They have rethought all their strategies in order to benefit from the opportunities that the online environment brings. However, accelerating the digitalization process does not come without additional costs and challenges. These include the risks resulting from cyber-attacks, which force commercial banks to provide greater protection for customers' personal data.

4. THE BANKING SYSTEM IN ROMANIA AND COMBATING THE EFFECTS OF THE PANDEMIC CRISIS

In order to prevent and mitigate the negative effects of the pandemic, the central authorities, at European and national level, adopted extensive measures to combat the economic contraction and to reduce the risks affecting the banking system. They were applied in parallel on several levels and aimed at: reducing monetary policy interest rates, providing liquidity to commercial banks and creating a more relaxed regulatory framework, coupled with a healthy level of supervision, to maintain access to finance for the main actors of the economy: the State, entrepreneurs and the population. At European level, the Commission adopted in the second and third quarters of 2020 two normative acts, packages of measures, in the field of regulation and supervision of the banking sector called CRR QUICK FIX (EU regulations no. 575/2013, no. 876/2019 and no.873/2020). The European Systemic Risk Board has issued a recommendation on the introduction of new restrictions in the process of granting new dividends to shareholders in the banking sector, complementing the ECB's liquidity measures on credit institutions and funding lines in the form of SWAP and REPO transactions for central banks within the EU. Romania was among the first Member States to directly apply all these normative acts (European Commission, 2018).

The government's financing programs of the Romanian market have worked in this context, limiting the negative effects of the pandemic also due to the collaboration between the State and the banking system. The latter has been, throughout this period, the main actor to manage the financing mechanism of the economy through the use of instruments and mechanisms that have eased the financial burden for borrowers in difficulty, even in a limited term.

4.1 Measures to combat the credit risk

The official moratoriums offered for payments related to bank loans represented a solution that quickly gained ground among European states and in Romania. They apply from the beginning of 2020 in countries such as Austria, Bulgaria, the Czech Republic, Serbia, Slovakia, Slovenia and Romania. The adopted mechanisms for suspending/postponing the loan instalments were adapted to the national legislation of each state and were based on the Guidelines on legislative and private moratoriums on payments to loans related to COVID-19, issued by the European Banking Authority (EBA) (Final Report on The Guide to Legislative and Non-Legislative Moratoriums - EBA/GI/2020/02, 2020). According to this instrument, the moratorium mechanism, in the form of suspensions when paying bank loan installments, can be an effective tool to prevent the lack of liquidity of banking customers, amid the pandemic crisis. According to the Central Bank, the main sectors in Romania that encountered financial difficulties and benefited from these exemption measures were the processing industry, real estate activities and wholesale and retail trade. According to the data of the Romanian Association of Banks (2021) in the first quarter of 2021, the Banks in Romania received about 20,800 requests for the suspension of the payment obligations of the installments, interest and commissions, both from the individual debtors, in a proportion of 96%, but also from the debtors who are legal entities, in a proportion of 4%. (Romanian Association of Banks, 2021).

However, it should be stressed that these measures can produce negative effects on credit institutions, due to the fact that according to the legislation in force the suspension or postponement of payments leads to additional costs and capital requirements for commercial banks. This solution must therefore be of a temporary nature so that it does not result in the reclassification of exposures as restructured assets or even in default. However, the National Bank of Romania draws attention to the fact that the application of such measures may have effects on the banking sector, meaning that the level and evolution of the non-performing loans rate in the post-crisis period, at the level of individuals and companies, will depend mainly on the evolution of the financial situation of the debtors who have benefited from the moratorium measures of suspending the payments. Commercial banks will have to adopt new measures to manage the risk resulting from the increase in the level of non-performing

loans, in addition to the effects of the dynamics of the economy as a whole. The total level of loans for which payment postponement requests were approved until the end of March 2021 amounts in Romania to RON 38.9 billion (loans granted to approximately 537 thousand debtors), representing approximately 12.7% of the total loans of the banking sector (National Bank of Romania, 2021).

The degree of provisioning coverage of NPLs can be seen as a temporary solution to this risk because it has as its main purpose the mitigation of the effects and impact that NPLs may have on the market. In the Romanian banking sector, the coverage with provisions was increasing and recorded in the first quarter of 2021 a level significantly higher than the European average, respectively 63.8% in the case of Romania and 44.7% for the EU. This level materialized a low level of risk, according to the EBA's approach. With the onset of the pandemic crisis from a structural point of view, commercial banks have set up provisions for loans and for business lines that have generated the increase of the NPL balance, namely loans guaranteed with real estate, loans granted to SMEs and consumer loans. However, the portfolios of loans secured by immovable property have a lower degree to cover with provisions compared to consumer loans, because by realizing the real estate guarantee banks can increase the recovery rate compared to unsecured consumer loans where the risk of the debtor's insolvency and implicitly the probability of recovering the claim through legal proceedings is much lower.

Another solution applied by commercial banks in Romania to reduce the level of NPLs on the balance sheet is represented by the restructuring of loans with a high risk of becoming non-performing. According to the data provided by the NBR, from the moment of the pandemic crisis until the end of the first quarter of 2021, the value of the restructured loans increased by 27.3%. From the point of view of the object of restructuring, it was mostly represented by loans of non-financial companies guaranteed by real estate. SMEs hold a growing share in the total restructured loans, of 45%, compared to large, corporate companies that hold 29%. With the expiry of the moratorium measures for deferral of payment, in March 2021 the level of the restructured loans rate reached a level of 2.8%, up from the previous year. Its level is maintained, according to the European criteria, in the intermediate risk category, but exceeds the European average of 2%. Since the onset of the pandemic crisis, performing loans have contributed to the growth of the balance of restructured loans, with 81% of the increase being associated with these exposures. (European Commission, 2019).

In the context of these developments and the increasing need to establish a performing secondary market for NPLs, the European authorities have taken measures to support this challenge. The Credit Servicers, Credit Purchasers and Collateral Recovery Directive aims to remove obstacles to the management of loans by third parties and encourages the sale of such non-performing products by reducing legislative barriers to NPL transactions. It is compliant with Article 169 of the Treaty on the functioning of the European Union (TFEU) and secondary legislation adopted at Union level and is mainly aimed at ensuring a high level of consumer protection. (European Commission, 2019). It will have a common and coherent legislative framework applicable to third-party credit servicers that they should respect in order to be able to operate at Union level. The development of common standards and the existence of a harmonized process of entry with low barriers to entry will allow for the shaping of appropriate behaviors of market players and the maintenance of a high level of supervision, while allowing for increased competition between credit servicers. This will also reduce the costs of entry to the market for potential credit purchasers, by increasing the accessibility of the credit management process and reducing the costs for the enterprise of such activities. Addressing the problem of the high level of NPLs will help reduce risks in the banking sector while allowing commercial banks to focus on lending to businesses and households. Romania is in the process of transposing this directive into national law, in order to create the right regulatory framework to govern the process of recovering non-performing debts.

4.2 Measures to combat the market risk

The forecasts for the coming years are not optimistic due to the accentuation of the uncertainty that hovers over the economy itself and the market risk that is why more and more measures are emerging

to tighten the lending conditions domestically and internationally, to increase the level of interest rates and inflation. In order to be able to counteract or limit the speed of increase of the inflation rate, the national bank adopted restrictive monetary policy measures during the pandemic crisis, in the sense of increasing the monetary policy interest rate, which will determine a rise in the price of loans for companies, for individual debtors and higher financing costs that the state would sustain (National Bank of Romania, 2020). In parallel, another set of measures concerned the provision of liquidity to banks acting on the market and the purchase of government bonds in RON to finance both the public sector and the real economy.

The NBR, in order to maintain the stability of the banking sector, regardless of the effects of the pandemic crisis, has adopted a set of measures to support the efforts of the public authorities and the banking system in the process of limiting the effects of the crisis on the national economy. It has adopted measures to maintain the proper functioning of payment and settlement systems in national currency, in order to allow for the optimal functioning of financial and commercial transactions. Another aspect that the central bank has focused on is the level of liquidity of the banking system, in order to maintain high public finances and the proper functioning of the real economy. It is important that in the context of a high demand from the population, commercial banks benefit from an uninterrupted cash flow, able to cover all payment operations, including by using ATMs (National Bank of Romania, 2021).

However, the Romanian banking sector was relatively prepared to face this crisis, i.e. medium intensity shocks, given the level of capital and liquidity reserves. Romania, in order to align itself with the macro and micro-prudential measures adopted at European level, adopted at the very beginning of the European health crisis, measures to increase the degree of flexibility, of a temporary nature, of the capital requirements. In line with the recommendations of the European Systemic Risk Board, the National Committee for Macro-Prudential Supervision recommended that the NBR to ask the commercial banks it supervises, at least until 1 January 2021, to avoid the application of measures for the distribution of dividends, for share repurchases or to create obligations to pay variable remuneration to certain categories of banking staff. All the measures taken at the level of the Romanian banking system in order to strengthen the level of capital were within the trends at European level. (Romanian Competition Council, 2021)

The resilience enjoyed by the Romanian banking system is also based on the fact that it has implemented the International Framework for the Measurement, Standardization and Monitoring of Liquidity Risk and Basel III. On the basis of the new regulations imposed by Basel III, and which Romania applies, the need to implement the capital requirements has emerged because the adoption of rules in this area contributes to increasing efficiency and stability and improves the level of protection of commercial banks against long exposure to risk, also in the context of the pandemic crisis. These banking regulations, through which the BASEL Committee imposed minimum capital requirements, have the main role of strengthening the banking system and preventing banks from being exposed to risk. The reality after March 2020 showed that commercial banks in Romania understood to exceed the mandatory minimum level of capital.

The level and evolution of these indicators support theories in this field that an adequate level of capital has a significant influence on the behavior and stability of the banking sector. The reactions of banks' capital in the Romanian banking sector showed that the risks to which they were exposed since March 2020 were not the same as those in an economically normal period. However, given that the banking sector is the main provider of liquidity in the economy, the level of capital allocated must comply with the minimum requirements imposed by regulatory authorities, despite the fact that more and more specialists claim that the banking sector is one of the most regulated. The need for regulation, not only in terms of capital requirements, is based on the role and complexity of the banking system in the context of the evolution of the economy, which it has also proved amid the Covid-19 crisis.

The solvency ratio of the banking sector (TIER1) in the second quarter of 2021 recorded a level that was in the historical maximum area, respectively 23.88%, above that at the time of the incidence of

the health crisis, March 2020, 20.37%. Maintaining an adequate level of capital and solvency has helped to reduce the fragility of competition within the sector

In the context of the pandemic, the commercial banks that acted on the local market continued to lend to the economy, thus strengthening the role they have as main financiers of the national economy. Between March 2020 and the second quarter of 2021, according to the data provided by the NBR, the evolution of assets in the banking sector recorded a level of over 67 billion lei. Moreover, starting with 2021, banks accelerated the lending process and the annual growth rate of non-governmental credit reached on average by 12.8%, registering the best evolution since 2009. Thus, the Banking Sector in Romania has built its role as the main lender for both the governmental and private sector, for companies and for the population.

However, at the end of the first quarter of 2020, following the contraction of the activity in the real sector, the Banking Sector in Romania recorded an increase in the cost of credit risk that also eroded the operating profit. Thus, at the end of 2020, there were significant reductions in net profit, by about 20.7% compared to the previous year, in economic profitability – ROA (by 0.4 percentage points) and in financial profitability – ROE (by 3.5 percentage points). However, the banking sector recovered in the second quarter of 2021 when there was also an increase in profitability with an increase in ROE (return on equity) to 12.98% and the ROA (return on assets) to 1.43%. At the end of September 2021, the banking sector registered an increase in net profit of up to 6.4 billion lei, by about 42% more than in September 2020, and with a ROE indicator of 13.6%, above the EU average of 7.4%. The desire of commercial banks in the banking sector in Romania determines them to grant loans with a high level of risk, which can expose them in the medium and long term to excessive risks that can ultimately contribute to the deterioration of the quality of credit portfolios. (Dinu & Bunea, 2022)

Since the beginning of the Covid-19 crisis, the Romanian banking sector has adopted a prudential policy from the perspective of the structure of commercial banks' balance sheets in order to be able to adequately manage possible liquidity risks. Due to the fact that they recorded an adequate stock of liquid assets, which placed Romania in the top of the European banking sectors, the banks managed to manage the liquidity shocks and contribute to the reduction of the risks coming from the real sector. Throughout this period, the National Bank of Romania did not condition the commercial banks to comply with the minimum level of the liquidity coverage indicator, so that the liquidity reserves are used in the real sector. However, the banks did not have to use them and recorded a level of liquidity above the requirements in force. The LCR indicator (liquidity coverage ratio) at aggregate level (241.9%, September 2021) is compared to the one recorded at European level (266.3%, June 2021). This indicator attests to the level of efficiency of credit institutions in terms of liquidity. Its high-level attests to the fact that both in the beginning of the pandemic and in the post-crisis period, the commercial banks in Romania succeeded to manage the effects of the liquidity risk, given that they did not have to liquidate their short-term assets to cover possible deficits, nor to resort to REPO operations in relation to the NBR, to be able to support a possible need for liquidity. Moreover, the latest stress tests carried out by the central bank in mid-2021 do not reveal significant risks in the event of significant withdrawals from funding sources. However, there are vulnerabilities among small banks due to the structure of their balance sheets and the history of their shocks. However, it is worth noting that the size of liquidity deficiencies remains relatively low and the recovery at a level of liquidity that ensures continuity could be achieved in an easy manner.

4.3 Measures to strengthen the market

Specialists are of the opinion that in Romania as well, in the post-Covid 19 period, the consolidation trend will grow and will follow the European trend also due to the fact that over 70% of the assets of banks acting on the market are owned by groups of foreign banks. Between 2019 and 2021, there were six such transactions at European level in the UK, four in Serbia, three transactions to be mentioned in the Czech Republic. During the same period, the most active players in mergers and acquisitions processes at European level were Société Générale (four transactions), Danske Bank

(three transactions) and Piraeus Bank (two transactions) and the most important buyers were OTP Bank (three transactions) and KBC Group (two acquisitions).

Bank mergers and acquisitions are generally seen as the most important tools that encourage market consolidation and seem to act as a catalyst for the sector. They encourage efficiency and the maintenance of high and sustainable levels of profitability. However, at the level of the European Union and even of Romania, mergers and acquisitions are carried out internally, without them having a cross-border dimension and thus contributing to a global financial integration, at the level of the entire union. Romania was one of the most active markets in the CEE region in the field of mergers and acquisitions during the end of 2019-2021. Eximbank signed in June 2019 the contract for the acquisition of the majority stake of Romanian Bank (a 99.28% stake in National Bank of Greece) and, in December 2019, the transaction received the approvals from the Competition Council and the NBR. On October 29, 2021, Transilvania Bank completed the acquisition of the entire share package held by the Polish group Gethin Holding at Idea Bank. Thus, Idea Bank SA, Idea Leasing IFN SA and Idea Broker. Against the background of these developments, specialists believe that Romania will register a positive dynamic in this field.

The premises for emphasizing the strengthening process of the Banking Sector in Romania through mergers and acquisitions remain high, in a context in which competition intensifies and competition on the market is increasing. The need to cover costs and increase market share makes it so that there is a greater inclination on these processes in the future. We are in the presence of a market that from a quantitative point of view is characterized by a small number of commercial banks, at the end of last year there were 34 credit institutions operating on the market, three banks with full or majority capital owned by the Romanian state, three credit institutions with majority Romanian private capital, 20 banks with majority foreign capital and eight branches of foreign banks. The top 10 banks on the market actually hold the most apparent part of the market share, over 85%. However, the crisis and the post-crisis period can represent real challenges for small banks acting on the market, and in order to be able to resist on the market, the need to join a commercial bank in the top of the ranking is increasingly emerging. From a competitive point of view, of the level of the market concentration, the COVID 19 crisis has not produced great changes, because the level of concentration has remained average and has respected the trend of recent years.

4.4 Digitalization of the banking system and tackling operational risk

Digitalization has also encouraged competition among commercial banks, both at national and European level. The presence of FINTECHs in the banking sector has allowed some economic players to gain from the market share of other competitors. Their presence has a major impact in the process of defining banking strategies, as they are direct competitors of commercial banks. Reducing market entry barriers through digitalization increases competition challenges and forces traditional banks to adapt their actions by adopting new technologies that keep pace with market developments. Otherwise, they will lose the market share they hold. The implementation of digital development programs in the banking sector has been a priority in the management of this activity, given that investments in technology, geared towards increasing efficiency, managing operational risks and encouraging development are essential to ensure sustainable growth. As a study conducted in 2021 by McKinsey shows, over 40% of consumers use a FINTECH platform for their current financial operations, and over 90% of them prefer this form of digitalization.

The change in consumption habits and implicitly of the expectations of consumers, in the context of this crisis, towards the offer of banking services confirms the need to develop the digitalization process. According to Global Banking Outlook, the main factors that will determine the investment plans in technology and the technology of banking institutions in the period 2019-2021 are: strengthening the market position by increasing the market share, expanding the capacity to attract and retain customers, increasing operational efficiency and reducing costs, mitigating threats to cybersecurity, implementing cross-border programs in the field of digitalization, opening new distribution channels for business development, effective risk reduction, creation of automated

regulatory and compliance processes, simplification of procedures, obtaining access to new business methods and development techniques, increasing the level of employee productivity, developing partnerships and collaborations with FINTECHs, increasing efficiency in the process of managing financial resources and increasing the expansion process and the capacity to scale collaborations between different states or economic agents from different states (McKinsey & Company, 2021).

An immediate consequence of the digitalization of the banking sector in Romania was, in the period 2020-2021, the reduction of the physical infrastructure, being closed over 206 bank branches and over 1013 bank officials left the banking system (Medrega, 2021). Consumers have migrated to the online environment at the expense of physical branches, which are thus losing some of their usefulness.

Despite operational difficulties related to the continuation of business that commercial banks have faced since the outbreak of the pandemic, losses in operational risks have been reduced. The evolution confirms the opinion that the losses caused by the operational risk related to the pandemic would manifest themselves at its onset, because they have a circumstantial character. (European Central Bank, 2022) However, the Basel Committee has developed regulations recognizing that operational risk has a significant impact on the banking market while stressing that proper risk management is essential for the banking sector.

Initial plans to continue banking activity in response to the restrictions imposed by the pandemic have stabilized since the third quarter of 2020. According to data provided by the ECB, the most apparent part of the workforce of commercial banks, between 40% and 50%, it continued to operate on a teleworking basis. The same evolution and trend could be registered within the banking sector in Romania. Amid this redistribution of work, the incidence of cyber-attacks has moderately intensified in the first two quarters of 2021. Moreover, within the Romanian banking sector, the operational expenses, respectively the costs associated with individuals, have been adjusted. Since 2015, credit institutions have continued to optimize this type of expenses by reducing bank units by about 22% by September 2021 and reducing the number of employees by about 7.5%. This policy has respected the trend at European level. However, at the beginning of 2021, amid the acceleration of the process of digitalization of the banking sector, there were small increases in these expenses, in terms similar to operating income. In terms of the effects that investments in digitalization, commercial banks estimate an increase of over 5% in the number of customers in the online sphere, which also implies the appearance of cyber risk. In this context, operational and IT risks remain high. The important thing is that commercial banks are able to effectively manage these risks and to continuously provide financial services to the market.

5. CONCLUSIONS

The banking system in Romania during the crisis caused by the Covid 19 pandemic succeeded to manage the banking risks (credit risk, operational risk, legislative risk and market risk) and to reduce the impact and exposure they had on the profitability and profitability of this sector. However, the challenges it will continue to face concern how it will adapt to the needs of the post-crisis economy and how it will cover the costs of the measures adopted from March 2020. The exposure to credit risk, also resulting from the level of the NPL ratio, together with the market position of banks are factors that have a significant influence on the level of performance of commercial banks operating at national market level. The small number of banks acting on the market and the relatively short time horizon from the onset of the pandemic crisis are also important factors in the analysis of the effects that will be felt on this market in the medium and long term, both in terms of profitability and competition.

The evolution of the main indicators showed that the Romanian banking sector responded efficiently and quickly to the needs of the economy and correctly applied the recommendations and rules adopted at European level. So far, commercial banks have held up well to the economic shocks of the pandemic because they have also had the sustained support of the central bank. In this context they

responded quickly through the risk management policies they understood to adopt. The onset of the Coronavirus crisis has caught banks with a high level of capital and liquidity that has allowed them to adapt their products and practices to the new market needs, including from the perspective of digitalizing the banking activity in the short term and with relatively high costs. In order not to lose their clientele, commercial banks had to digitalize their processes, which also brought many benefits from a competitive point of view, a process that generated new risks and challenges, for example the risks resulting from cyber-attacks. Looking beyond the immediate effects of this crisis, we can say that the banking sector has managed to overcome the period of isolation and crisis.

However, maintaining the stability and sustainability of the banking sector's activity are key elements on which the economy should focus over the medium to long term. The banking sector in Romania, due to its specificity, has a key role to ensure the proper functioning of the economic and financial mechanisms, following the impact it has on macroeconomic developments, but also on the private sector, consumption and business environment.

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