NATIONAL BANK OF ROMANIA

# The legislative and regulatory framework for development banks in Romania

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# Overview

- **Law No. 207/2022 (subsequently amended)**
  - sets out the principles governing the establishment and operation of development banks in Romania, **including the general applicable prudential regime**

- **Government Decision No. 1204/2022 (subsequently amended)**
  - legislative act that formally establishes the Investment and Development Bank (IDB) pursuant to Law No. 207/2022;
  - outlines the **concrete conditions** regarding the organization and functioning of the IDB,
  - Includes provisions on the scope of activity, **the procedure for appointing members of its statutory bodies**, eligible beneficiaries, financial products, and **the concrete level of share capital**

- **National Bank of Romania (NBR) regulations on prudential requirements for development banks**
  - NBR Regulation No. 4/2023 – provides the **prudential standards for suitability assessment of a development bank's management body;**
  - ***Draft NBR Regulation (in final stage)*** - proposes **further prudential requirements tailored to national development banks**

- **NBR Regulations applicable to credit institutions concerning activities in relation to IDB**
  - **Regulation No. 11/2024 –** provides the prudential risk weight applicable to universal banks for their exposures to development banks

# Objectives/principles underpinning the development of the legislative framework

Romania has aimed to establish a national framework for development banks that **incorporates best practices already shaped at the European level**:

- The institution must be established under public law by the central administration of a Member State;
- Its activity is restricted to the pursuit of specific financial, **social**, or economic public policy objectives of a Member State and only within the national teritory
- These must be pursued on a **non-competitive** and **non-profit** basis
- The institution must be subject to **adequate and effective prudential requirements,** including minimum own funds obligations, and operate under a supervisory framework that achieves **effects equivalent to those established under Union law**;
- The central administration must either ensure the institution's viability or directly or indirectly guarantee at least 90% of its own funds requirements, financing needs, or exposures;
- These institutions must not accept eligibile deposits, as defined in Article 2(1)(5) of Directive 2014/49/EU of the European Parliament and of the Council;

# National decisions  (political factor involved in decision making )

**Type of Institution – credit institution vs. non-banking financial institution**

Depending on the strategy of each Member State, DBs may be established either as credit institutions or as non-banking financial institutions.

- In Romania, the decision to establish a development bank as **a credit institution** was taken by the Government based on a prefeasibility study;
  - ***Advantages***:  **S**upervision by the NBR provides development banks with a **high level of credibility and international recognition**. This facilitates access to international financing on favorable terms, supports the allocation of resources for long-term impact projects and enables alignment with European standards (such as Basel III/CRR). It also ensures stability, transparency, and integration into a unified, regulated system.
  - ***Constraints***: The status of a credit institution entails **compliance with a complex prudential framework**, including **stringent governance**, risk management, and reporting requirements. These generate substantial **compliance costs and administrative burdens**.

**Applicable Prudential Framework – CRD/CRR vs. national prudential framework**

- **Full application of the EU prudential framework (CRD/CRR):** This implies applying the entire set of rules designed for profit-maximizing credit institutions, although development banks cannot compete directly with commercial banks. The development bank model, guided by public policy objectives defined at government level, diverges significantly from that of commercial banks.
- **<u>Exemption from CRD and application of a dedicated national prudential framework</u>:** This allows for the implementation of a **tailored prudential regime** that ensures sound operations and adequate supervision, adapted to the specific business model of a development bank.

- In 2022, Romania decided to formally request an exemption from the CRD provisions for its development bank from the European Commission

# Justification for the exemption from the CRD Framework

**Key elements of the justification**

- The **business model**, including **product and services characteristics**, demonstrates that IDB:
  - Addresses structural deficiencies in the local financial market that hinder economic development and investment levels – **this being the principal economic rationale for establishing such an institution;**
  - Operates under a business model distinct from that of traditional credit institutions, being not oriented toward profit maximization but rather toward ensuring sufficient profitability to achieve self-financing;
  - Does not compete with commercial banks but rather complements them to correct market failures.
- Although the new development bank will be exempt from the CRD and CRR frameworks, **it will nonetheless be subject to adequate and effective prudential requirements and an appropriate supervisory framework**, which together will produce effects equivalent to those established under the Capital Requirements Directive and directly applicable EU regulations.
- The National Bank of Romania has committed to supporting the Romanian state in this endeavor by developing the applicable prudential framework and assuming responsibility for supervising the banking activities conducted by the new development bank (on its own behalf and for its own account)

# Presentation of Law No. 207/2022

## 1. General Aspects ( principles from European Commission communications and national political decisions ):

- National development banks (NDBs) must operate in accordance with the principles of **transparency, independence, and neutral competitivity.**

- NDBs are credit institutions in the sense of the banking legislation, wholly and directly owned by the Romanian state

- As credit institutions, NDBs generally conduct their activities in their own name and **<u>on their own account</u>**, utilizing their **<u>own resources</u>**

- However, NDBs may also act on behalf of and for the **account of the state**, pursuant to a mandate, including activities such as **export support** or participation in governmental programs

- **Revenues generated must cover operating costs. Any surpluses <u>must</u> <u>be capitalized for reinvestment into the bank's activities. D</u>ividends are not distributed to the shareholder**

- In the performance of their activities, NDBs act directly and/or through credit institutions **<u>but</u> IDB d**oes not compete with commercial bank. It rather complements them **to correct market failures**

- NDBs do not accept deposits from natural persons (in order to avoid competition with commercial banks). But current accounts of companies they finance are considered deposits. However, the raising of repayable funds **from qualified investors** is permitted.

- The State provides a guarantee for the repayment of principal and all guaranteed obligations assumed by the IDB, in cases where these obligations are not otherwise secured. **<u>This state guarantee is unconditional, irrevocable, and enforceable on first demand.</u>**

# Presentation of Law No. 207/2022 (cont.)

**2. Procedural aspects concerning the establishment of IDB as credit institution**

- IDB is established by law, **under an exemption from the CRD framework**, without undergoing a licensing process by the NBR;
- **From an administrative standpoint**, the bank was allowed to **commence operations** immediately upon registration with the Trade Register, specifically for undertaking preparatory and **organizational activities** such as the procurement of IT systems, **appointment of management body**, and the establishment of its internal organizational framework
- But **the commencement of core banking operations** — such as the issuance of loans and the assumption of guarantee commitments— was only permitted after the entry into force of the amendment to the CRD that formally grants IDB the exemption from the CRD/CRR framework.
- Following its establishment, the **IDB operates under the supervision of the NBR**, based on a nationally developed regulatory framework which incorporates most provisions from Regulation (EU) No. 575/2013

**3. Supervisory Competences**

- IDB is subject to **prudential** and **anti-money laundering (AML) supervision** exercised by NBR **with respect to activities conducted in its own name and on its own account**;
- NBR is not held accountable for the achievement of the development banks' objectives in the context of its supervisory functions;
- The National Bank of Romania holds exclusive competence regarding the application of banking legislation provisions **solely in connection with the banking activities** carried out by these institutions in their own name **and on their own account**

# Safety measures for setting up a bank without authorization process

Given the relatively short timeframe available to demonstrate to the EC that the bank was established and operational (a prerequisite for maintaining the exemption in the Directive's final text), it was necessary to forgo the standard authorization process and **introduce safeguard mechanisms to ensure <u>optimal capitalization and governance conditions</u> for the bank's operation without undergoing formal authorization**

**To ensure an adequate capitalization of the bank,** the legal framework applicable to the IDB provides for:

- **The State's obligation** <u>**to subscribe the share capital**</u> at a level covering the **own funds needs for the first three years of activity** (*determined according to the business plan developed under the World Bank assistance*)

- **The State's obligation** <u>**to make the first payment**</u> **at the** minimum **level so as to cover** the own funds requirement for risk-weighted exposures expected for the first year of specific activity and possible loss (similar treatment to that **applicable to universal credit institutions**)

- **The State's obligation** to make the remaining payment (up to the subscribed level) in tranches, **but no later than the expected date of registration in the NBR Register** (31.12.2024). This is a different regime from the one established for universal credit institutions which are obliged to pay the capital at the subscribed level determined *only* on the basis of the needs for the first year of specific activity.

# Safety measures for setting up a bank without authorization process

**Requirements applicable to IDB to ensure an adequate level of governance**

1. The internal governance framework, developed by NBR Regulation, imposes to IDB **all the governance requirements applicable to universal banks.**

2. In some areas IDB has **to observe the obligations** applicable to significant credit institutions **(practically the strictest requirements) –** e.g. in setting up of board committees (**risk, nomination and remuneration committees)**

3. **Suitability requirements for members of the management body and key function holders** are regulated on two levels :

    1. **The law** enforce **the general suitability requirements** (reputation, experience, knowledge) and the **obligation for the shareholder to make the nomination having due consideration the suitability requirements provided for by law and developed by the NBR regulations**

    2. **The NBR Regulation** imposes **the same eligibility conditions for the fulfillment of the suitability requirements as for other banks**

4. **The first assessment by the NBR of the first members of the management body** takes place after the nomination, either at the renewal of the mandate or before that date, during the supervisory process and not before commencement of specific activity of the IDB.

5. **However, the IDB is required to submit to the NBR its assessment of the members of the management body and key function holders within 30 days from the date on which it starts its operations.**

6. The law impose a shorter term of office of a maximum 2 years (instead of 4 years) for **the first members of the IDB's management body**, nominated by the shareholder based on the regulations issued by the NBR

# NBR Strategy on prudential requirements for IDB

The Law grants the NBR prudential supervisory competence for the activity of the IDB in its own name and on **its own account** and the competence to develop the applicable **prudential** regulatory framework.

**The vast majority of the provisions are the same as for universal bank, but there are some exceptions, as mentioned below** :

- **organization of the internal framework for the conduct of business, suitability and remuneration** – **the same provisions** but only the **dualistic governance model is allowed**, which is considered to best meet the Commission's requirements regarding the **separation between the strategy related to government policies and the execution of the strategy by the executive management**
- disclosure requirements for development banks; financial statements and audit **IFRS compliant**; professional secrecy - *the same*
- **the internal capital adequacy assessment process -** *the same*
- **Supervision** – **NBR has all the supervisory competences** as those applicable to universal banks; NBR has the obligation to apply **SREP process** and **stress scenarios at least annually for IDB**; **but supervisor's assessment against a particular peer-group does not apply; full sanctioning measures and sanctions** as those applicable to universal banks **but it is not possible for NBR to:**
    - **withdraw the authorization** - the development banks are not subject to the NBR authorization;
    - **to suspend the shareholder's voting rights** - the law stipulates that the only shareholder is the Romanian State
- **Reduction of capital may be done only after the approval of NBR; the state must provide funds form the budget to sustain the capital increases as necessary due to prudential requirements**
- **Determination of capital and liquidity requirements – CRR compliant in vast majority areas - the rules reflect a balanced approach, combining the rigor of European banking regulations with institutional specificity (specific liquidity indicator and treatment of loan portfolio guarantees)**

# NBR Strategy on prudential requirements for IDB

**Other areas where universal bank requirements <u>are tailored to IDB specificities</u>:**

- Qualifying holdings of development banks – permitted only for holdings within the scope of eligible beneficiaries. Acquisition of qualifying holdings in other entities outside the scope of eligible beneficiaries **is expressly prohibited**
- Merger and division – it is possible to merge/divide a development bank only with **i) another development bank, ii) a credit institution, iii) an investment firm and iv) a financial institution**
- **Large exposure requirements do not apply as** limits may adversely interfere with the strategic objectives of stimulating the economy in the early years of operation. However**, the concentration risk provisions apply**, and require **addressing** the concentration risk arising from exposures to individual counterparties (in the same economic sector, geographical region, industry, etc.) by qualitative measures other than imposing limits.
- **Capital buffers – the same types of buffers may apply** but it is necessary for the application of capital buffers to intervene at different times of the lending cycle in order to make the buffer mechanism efficient
- **Recovery and resolution framework <u>does not apply</u> – given the existence of the state guarantee and the state's commitment to increase capital at the request of the NBR**

# NBR Strategy on prudential requirements for IDB

## Capital and liquidity requirements

- **Capital requirements must be determined using only the standardized approach set out in Regulation (EU) No 575/2013 for credit risk, market risk, operational risk, settlement risk and leverage. Using internal models for own funds determination not permitted**

- **No LCR/NSFR but a tailored liquidity indicator, complemented by the ICAAP/ILAAP requirements, to ensure a prudent, proportionate and efficient framework to support a sustainable business model. The dedicated liquidity indicator is aimed** at ensuring a sufficient liquid asset buffer to cover expected cash outflows over the next 3 months, with a minimum level of 5%. Regulations on this indicator are currently being developed at the NBR level.

$$\text{Proposal}: \frac{\textit{Net liquid assets}}{\textit{Total liabilities} + \textit{off–balance sheet exposures}} > 5\%$$

- **Guarantees: Loan portofolio guarantess** *with a cap* and counterguarantees from IFIs . Multiple approaches posibile for capital requirements:

  i) requirements as for a simple off-balance sheet exposure for every guarantee (look through) – conservative treatment, not in line with the real level of the risk assumed as does **not reflect the subordination due to the first loss tranche;**

  **ii) apply the securitization framework** – the most conservative requirements due to the full deduction of the first loss tranche but very complex requirements (*not cost effective*)

  iii) using an **ad hoc calculation indicator**, prudent and easy to implement, to determine the RWA based on the first approach but effectively limiting the capital requirement to maximum losses, relating the capital requirements to the bank's maximum exposure level (the cap level).

# NBR Strategy on prudential requirements for IDB

- **In carrying out their activities to achieve their objectives, the NDB acts directly and/or through credit institutions**
- **Risk weight applicable to universal banks' exposures to IDB – as per CRR**
  - **Basic treatment:** 100% risk weight according to exposures to a credit institution.

    *Applying this RWA would not make it attractive for universal banks to be involved in financing sectors of the economy that are experiencing funding gaps*

    *or*
  - **Preferential treatment (national discretion) –** according to the CRR, Member States **may allow** credit institutions to apply the risk weight **associated with the State (0% for exposures in national currency) to exposures to public sector entities** if, *in the opinion of the competent authorities*, **there is no difference in risk between these exposures and exposures to the central government, due to the existence of an adequate guarantee provided by the central government**

- **The NBR imposed the preferential treatment (Regulation no. 11/2024) as the conditions provided for by CRR are fulfilled** due to the provisions in Law No. 207/2022:
  - IDB is a "**non-commercial** enterprise", owned by the **central government** and is benefiting from an **explicit guarantee agreement**
  - **The State undertakes to provide from the state budget the amounts necessary to increase the share capital as a result of the request of the National Bank of Romania during the supervision process**

Thank you!

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