FINANCIAL INDUSTRY STRUGGLES WITH RISING POLITICAL UNCERTAINTY

The Romanian government this year will take close to 5.3 billion RON from banks' profits through the newly imposed tax on assets, as it will be calculated and paid quarterly, according to calculations based on official data.

The Romanian government has recently introduced a tax on bank assets of 0.3 percent from January 1st, 2019, calculated at the current ROBOR 3M-6M level. The authorities said that the tax on assets will be calculated and paid quarterly.

By Petre Barac

The average ROBOR value in the last three months of 2018 stood at 3.17 percent per annum, which corresponds to a 0.3 percent bank fee. As the tax is applied quarterly, the annual tax rate is 1.2 percent.

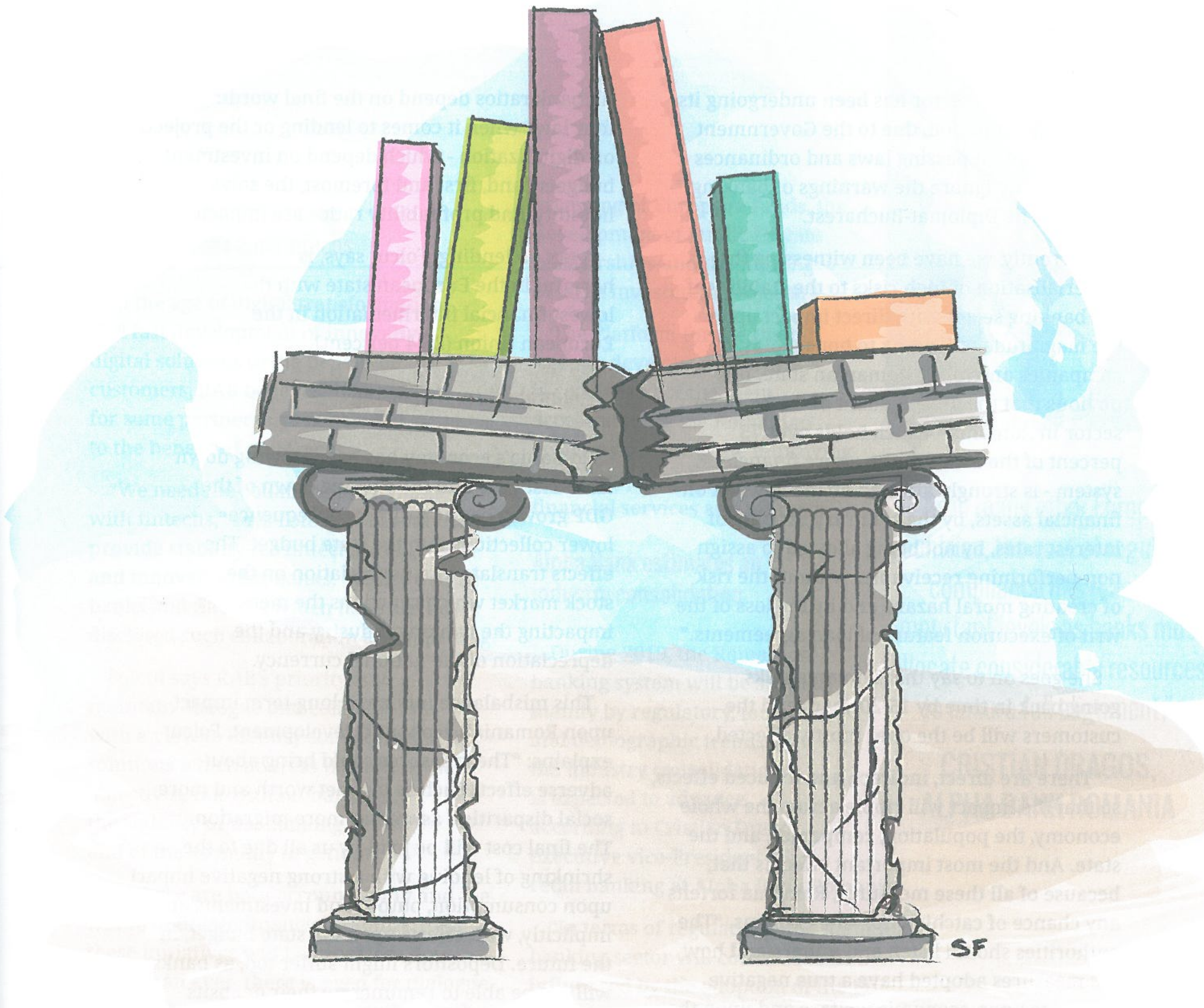
In September 2018, the total assets of the local banks amounted to 445.2 billion RON, according to central bank data.

At this level, the new tax will take 5.3 billion RON (1.1 billion Euro) from the banks this year, but the value of assets probably increased during the last quarter of last year. The value of the tax is close to the value of cumulated profits of Romanian banks registered last year.

The tax on assets will take around 91 percent of cumulated profits of the local banks, according to some calculations. But some banks will be more affected than others, as many major banks posted large profits last year while some smaller banks have had lower profits or even losses.

Based on the balance sheet of banks registered in the first nine months of last year, the new tax will take less than half of the profits of BCR or BRD and close to 50 percent of the total profit of Banca Transilvania.

The heads of the main banks said that the new taxes risk generating "a perfect storm" in the economy, as investment plans will be frozen, credit activity will decelerate and many companies will struggle to survive.



International development banks criticize Romania over bank tax

Two major international development banks, the European Bank for Reconstruction and Development and the International Finance Corporation, have formally complained to the Romanian government about proposed new banking sector taxes.

Both banks sent a joint letter to Bucharest on Feb. 1 in which they outlined their concerns about the plans. The tax proposals, which also increased taxes on energy firms to compensate for rising state spending, sent Romania's stock market tumbling and the country's currency, the RON, to a record low in December when they were announced without warning.

Analysts say they could make banks unprofitable and they have also drawn particular criticism for a complex mechanism which ties them to Romanian money market rates. The worry is the money market rates will be distorted by the changes which in turn would make it difficult for the central bank to judge the impact of its interest rate moves.

Uncertainty and lack of predictability

The uncertain and unpredictable legal framework has been for the third year in a row the most important factor with systemic potential affecting the financial industry, according to Gabriela Folcut, executive director at Romanian Association of Banks (RAB).

"The banking sector has been undergoing its most difficult period, due to the Government and Parliament passing laws and ordinances which totally ignore the warnings of banking," she tells The Diplomat-Bucharest.

"Currently, we have been witnessing the materialisation of high risks to the stability of the banking sector with direct impact upon the magnitude of lending to households, to companies and to the Romanian state. It is obvious that the development of the banking sector in Romania - which holds over 75 percent of the assets of the entire financial system - is strongly affected by the new tax on financial assets, by the arbitrary capping of interest rates, by not being allowed to assign non-performing receivables without the risk of creating moral hazard and by the loss of the writ of execution feature of loan agreements."

She goes on to say that Romania risks going back in time by 15-20 years and the customers will be the ones mostly affected.

"There are direct, indirect, and induced effects, so that the impact will ripple across the whole economy, the population, companies, and the state. And the most important effect is that, because of all these measures, Romania forfeits any chance of catching up," she explains. "The authorities should listen and understand how the measures adopted have a true negative influence upon economic welfare and upon the level of financial and banking intermediation.

All bank ratios depend on the final wording of the four laws when it comes to lending or the projects on digitalization - which depend on investment budgets - and, first and foremost, the solvency, liquidity, and profitability ratios are impacted."

A tax on lending, Folcut says, is harmful in the European state with the lowest financial intermediation in the European Union (26.4 per cent).

Accountability and dialogue

Romania's economy has been slowing down since last year and the slowing down of the GDP growth has as a direct consequence lower collections into the state budget. The effects translate into depreciation on the stock market which sanctions the measures impacting the banking industry and the depreciation of the national currency.

This misbalance induces a long-term impact upon Romania's economic development, Folcut explains: "The measures could bring about adverse effects such as less net worth and more social disparities, as well as more migration. The final cost will be paid by us all due to the shrinking of lending with a strong negative impact upon consumption, output and investments and, implicitly, with effects upon the state budget, in the future. Depositors might suffer too, as banks will not be able to remunerate their deposits with high interest rates because of all these taxes and limitations. Moreover, these measures could accelerate the birth of an economic recession which means the depreciation of the exchange rate, the shrinking of the real estate market, job losses, more expensive funding and, at the end of the day, harm to all Romanians' welfare."

"It is obvious that the development of the banking sector in Romania - which holds over 75 percent of the assets of the entire financial system - is strongly affected by the new tax on financial assets,"

GABRIELA FOLCUT, RAB

RAB calls for collaboration between banks and fintechs

In the age of digital transformation and fast development of innovative digital solutions to the benefit of customers, RAB believes there is room for some partnerships concluded to the benefit of customers.

"We need the collaboration of banks with fintechs," says Folcut. "This way, we provide stability for fintechs and growth and innovation for banks. We have some banks and fintechs which have already disclosed such collaboration as happening."

Folcut says RAB's priority is to maintain dialogue and collaboration with a view to identify some constructive solutions which address the authorities' objectives, but without harming the stability of the banking sector and of the economy in general.

"If there are both accountability and the will to maintain financial stability, then these initiatives will be repealed. Now, more than ever, there is need for dialogue and for the will to identify, together with the banking community, solutions to avoid the negative impact on the Romanians' future," she underlines. "The industry will use all the measures and actions it has available in order to mitigate the negative impact. For now, our approach is dialogue. We have been trying, even at the last moment, to have a dialogue with the authorities so as to mitigate the negative spiral effect that materializes. Banks are but a transmission belt."

The banking community aims to enhance financial literacy via the Platform for Financial Education, to accelerate the introduction of digital technologies in financial and banking services via the Platform for the Digital Agenda next to the integration of financial intermediation, in order to boost the accessing of European funds, the development of Public-Private partnerships and the funding of large investment projects.

The Platform for the Digital Agenda developed by RAB is considered of the main accelerators of the Romanian economy targeting the improving of the supply of banking and financial services and products.

Alpha Bank estimates an industry consolidation

During 2019, the Romanian banking system will be shaped mainly by regulatory, technology, and demographic trends, as the industry consolidation is expected to advance, according to Cristian Dragos, executive vice-President of retail banking at Alpha Bank Romania.

"In terms of regulations, the Romanian banking sector will continue to be influenced by the adoption of the EU financial services regulatory framework," he tells The Diplomat-Bucharest. "A significant number of EU regulations and directives have been already transposed into the local legislation while others are in the pipeline. A second category is represented by the technical regulations of the National Bank of Romania, aimed at correcting specific imbalances on the local market. Last but not least, legislation passed by the Parliament or the Romanian Government also plays a significant role in shaping the future of the local banking system. As in many other European countries, the cost of regulatory compliance has reached important levels as banks must allocate considerable resources to ensure full alignment."

Rapid adoption of new technology is critical to ensure competitiveness, as all

"As in many other European countries, the cost of regulatory compliance has reached important levels as banks must allocate considerable resources to ensure full alignment,"

CRISTIAN DRAGOS, ALPHA BANK ROMANIA

local banks are currently racing to offer a superior customer experience, investing significant resources in new technology.

"As digital natives and digital migrants currently represent the core customer segments, digital transformation projects receive important capital allocations," Dragos explains. "From new self-service technology, to new online banking platforms and mobile payment solutions, a variety of new advancements could be announced to the market in 2019 by the competing banks. However, normal business conditions and a reasonable legal and regulatory environment are important prerequisites."

In his opinion, banks will not only have to adapt their products and services portfolio to serve the evolving demographic structure but will also have to adjust their staffing policies.

Alpha Bank's representative underlines that the immediate priority for the banking sector is to adapt its business model to the new regulatory challenges, such as the unexpected changes in the fiscal legislation (Emergency Ordinance 114/2018) and the new banking legislation adopted by the Parliament (the "Zamfir Laws").

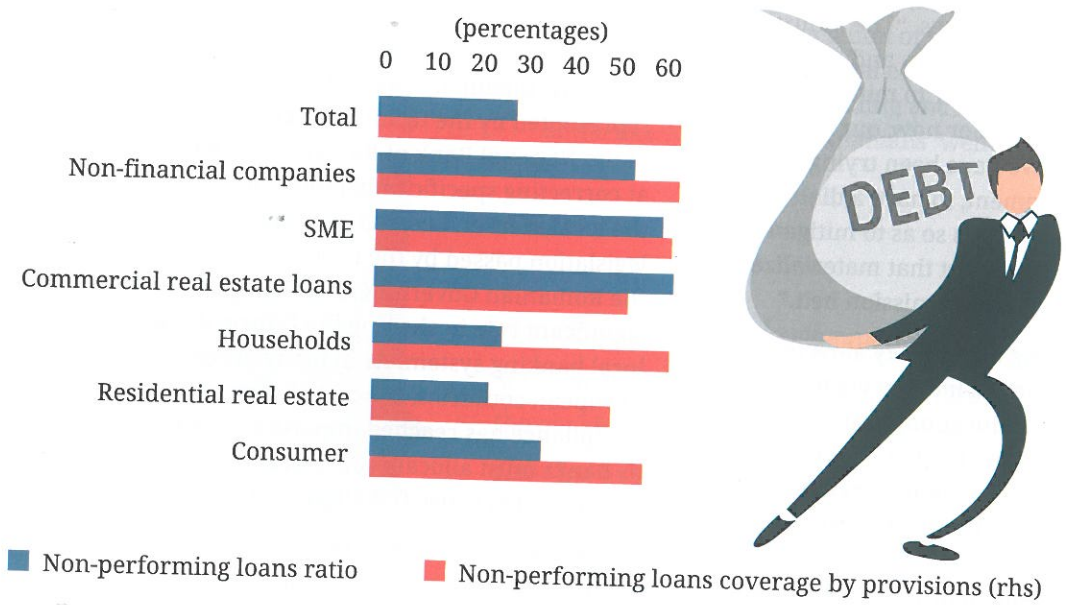
As the growth of the global economy is slowing down, Dragos suggests the local banking sector should adopt a "cautiously optimistic approach, refraining from risky endeavours, while remaining fully dedicated to their customers and the growth of the Romanian economy."

He goes on to say that the Fintech sector should be perceived as being beneficial to the European banking industry as it spurs innovation and accelerates investments in technology, increasing the overall competitiveness of the banks, to the benefit of consumers and small businesses.

"Fintech firms are mainly targeting those financial services areas where they can rapidly achieve a competitive advantage through introduction of new technology, without having to comply with the massive regulatory capital requirements," he adds. "As time passes, some of these players will be tempted to apply for banking licenses, assuming the high costs of compliance with the core banking regulations. Briefly, they will not replace banks; they will become banks."

Fintech companies are already in

NPL RATIO AND NPL COVERAGE BY PROVISIONS, BY SECTOR AND TYPE OF LOAN (MARCH 2018)



direct competition with established banks on various fronts, including payment solutions, lending, and insurance distribution.

Some of these Fintech companies, says Dragos, will expand by establishing strategic partnerships with traditional banks, while others may be acquired by more powerful financial institutions.

Alpha Bank also plans relevant investments aiming to accelerate digital transformation and to ultimately offer a better customer experience.

"We are targeting not only the customer touchpoints but also the back-office processes, seeking advanced simplification and automation. Digital customer acquisition and instant payments are just a few projects on our 2019 agenda," says Dragos.

Garanti Bank: The banking sector in Romania has become stronger

Digitalization of the banking sector will be an important trend for 2019, according to Ufuk Tandogan, CEO Garanti Bank.

"Digital banking products gain more and more ground, as customers have shown an increasing preference in this direction," he tells The Diplomat-Bucharest.

Tandogan believes the banking sector in Romania has become stronger, with NPL around five percent and solvency 20 percent and that banks "will continue to take all the steps necessary to keep this trend going."

However, there are some legislative changes which can affect the future of the Romanian banking sector.

"At this point, it is still early to make any estimation, since the applications of certain laws are still not fully clear," he adds.

Recent studies have shown that Romanian consumers would like to see more digital banks on the market, most of them asserting that they would trust their services even more if there were to have a traditional bank to support them. This is a clear sign, Tandogan says, that banks should up their game in terms of digital products and services, as there is a clear need from clients.

"We have seen this in our portfolio. For example, in 2018, the value of transactions made through our online banking service, Garanti Online, has grown by 60 per cent, compared to 2014," he adds. In his opinion, the competition in the financial industry has led to great developments in the past years, especially as far as digital banking is concerned.

"Although fintechs have been growing in the past years, so have the banks' investments in digital products and services," he explains. "The banking industry is becoming more digital, more client oriented and more competitive, year after year, which can only benefit our customers and our future development. Altogether, I believe that there is very good potential for digital financial services on the Romanian market, as only 11 per cent of the population uses digital banking services, according to the European Commission's report."

Garanti Bank is currently the seventh bank in Romania in terms of digital banking, as it covers an important slice of the market.

"If you take into account that, in terms of assets, we are the tenth largest bank in the system, we could further say that digital banking is one of the main competitive edges that distinguish and propel us in the market," Tandogan concludes.

"The banking industry is becoming more digital, more client oriented and more competitive, year after year, which can only benefit our customers and our future development,"

UFUK TANDOGAN, GARANTI BANK

Revolut Romania sees a continuation of established banks moving to create their own challenger brands

Financial institutions are focusing on customer experience, data-driven marketing, and personalization. Open Banking rules that require regulated banks to let customers share their financial data with authorised third-party providers through APIs officially went into effect this year, creating new opportunities for fintech upstarts, according to Irina Scarlat, country manager, Revolut Romania.

She sees a continuation of established banks moving to create their own challenger brands.

"The financial services industry will also see many traditional banks and fintechs partnering up," she tells The Diplomat-Bucharest. "This is driven in part by growing interest in the so-called marketplace model. Under this model, established banks and fintechs create marketplaces in which their customers can discover and acquire financial services products offered by trusted third parties."

"The financial services industry will see many traditional banks and fintechs partnering up,"

IRINA SCARLAT, REVOLUT ROMANIA

Between 2017 and 2018, Revolut increased monthly transaction volumes from 200 million USD to 1.5 billion USD, as revenue increased by 433 per cent to 12.8 million pounds. In 2018, Revolut began expansion into ten international markets, applied for a European banking license and began building a commission-free trading platform.

Looking at the Romanian market, Revolut has set up local operations in May 2018 and the company has grown exponentially from 20,000 users on the launch date to 130,000 users on December 31st.

Revolut is keeping an eye on any developments which could affect the business and the industry.

"Given that we currently operate as an e-money institution in Romania, the recently introduced "greed tax" does not impact its operations in any way and we shall consider future developments when discussing the possibility of passporting the banking license on the Romanian market," says Scarlat.

At global level, Revolut will be launched in the US, Canada, Australia, New Zealand, Singapore and Japan in the next few months.

"Our banking license will also be passported throughout Europe once our restrictions have been lifted, which will allow our customers to access to overdraft facilities and personal loans. We'll also be launching a host of new products and services, including a commission-free trading platform, family/kids app, and an acquiring product for businesses," Scarlat adds.

She believes fintechs can definitely shake up banking and compete with established banks.

"Challengers like Revolut are prepared for a tech-based banking experience and are already targeting and recruiting a younger audience who are increasingly using mobile only to handle their finances," she explains.

"We believe that traditional banks are failing by not offering effective technology platforms, they aren't integrating customer data properly for better suggestions and they aren't serving customers with enough machine-learning intelligence embedded in their processes. In other words, banks are living in the past. Fairly soon we'll start to see digital-only banks with lower fees forcing some other banks to close their branches."

Revolut was launched in July 2015 as a digital alternative to the big banks. Initially, the company started by allowing customers to spend and transfer money abroad with the interbank exchange rate.

Over the past three and a half years, Revolut has expanded its portfolio by launching services such as budgeting controls, savings features, cryptocurrency exchange, travel insurance, phone insurance, and business accounts.

Allevo wants to design a solution that allows banks to act as Fintechs under PSD2

Opel Banking is definitely one of the key markers of 2019 for the financial services sector. While some startups have been working over the past few years on designing and implementing a solution that provides banks with compliance to requirements of PSD2 (revised Payment Services Directive), others are looking beyond PSD2 and want to design a solution that allows banks to act as Fintechs under PSD2.

"The challenge is to deliver relevant services and to drive financial inclusion both among the unbanked and SMEs, who are just as left out of larger financial flows," says Ioana Guiman, Managing Partner Allevo.

"In 2019, Allevo's full attention is deliver the PSD2 compliance projects aligned in our pipeline," she tells The Diplomat-Bucharest. "We are keen on extending existing open banking infrastructures, be they ours or third party, with added value functionality. The key element is the delivery of financial services as a service to corporations and SMEs by banks. We are also aligning existing banking platforms to the demands of 2018

"The key element is the delivery of financial services as a service to corporations and SMEs by banks,"

IOANA GUIMAN, ALLEVO

technology users: instant payments."

She goes on to say that fintech cannot replace banks or shake up banking in medium to long term.

"The economies and financial systems rely heavily on banking rails, they would be very difficult to completely avoid, especially when it comes to cross border payments," she explains. "I think we will rather see a better split of roles between banks and tech providers and fintechs as utility providers, as financial services providers, as the interface with the customer. This segregation is naturally happening and it's not a matter of one replacing the other, but of defining new business models and opening the door to real collaboration between players."

Allevo plans to invest in software scanning, development and testing tools, and to continue to invest in keeping hardware and software infrastructure up to speed with latest technological advancements.