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# CREDIT PORTFOLIO QUALITY ASSESSMENT IN THE ROMANIAN BANKING SYSTEM

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## Abstract

*Credit portfolio is an indicator of the bank's market share, of its business and risk strategies as well as its capacity of granting loans. During the economy ending process, the banks have to filter the businesses and to support the effective, legal and viable ones, boosting the activity of all using the loan. As a result of loan portfolio, the banks must regulate the amount of the provisions that must be supported weighting the bank's financial results. Real time provisioning of credit losses plays a crucial role for ensuring sound and safe banking environment. The paper discusses the structural elements involved in Romanian and European banking assets assessment, taking into consideration prudential and accounting aspects. We are aiming to identify the main actual and future chanlenges when trying to improve the operational and credit risk effectiveness.*

**Keyword:** non-performing loans ratio, texas ratio, forbearance ratio, loan loss provisions

**JEL Classification:** G21, M40, M48

## 1. Introduction

Within the economy of a certain country the banks are facilitating the investments, either directly participating to its financing or managing the savings. The basic function of a bank is lending, function that provides major responsibilities related to the effectiveness and profitability criteria. During the lending process, the credit institutions must filter the businesses and to promote the effective, viable and legal ones.

Each bank assumes a certain risk degree and with no exception, each bank will experience losses never to be recovered or, most likely, the delayed and partial recovery of losses. In order to avoid or to diminish this, one must analyze the potential investments

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the bank could make as well as to oversee of the way the money are used during the contract period. The investments on the inter-bank market such as State granted loan or other institutions loans that are State-guaranteed are relatively safe. There is an interrelationship among the loaning process, the accounting analysis and the assessment and the management of the credit risk.

The lending process can inherently generate the occurrence of malfunctions such as bad loans even if the balance between an effective loan activity and a prudent one is assured. The responsible management of the bad loans is an important activity of a bank and represents an effective way to manage the credit risk and completion of the funds needed for loaning risk.

As a result of the credit portfolio classification, the amount of the provisions that has to be established weighting the financial results of the financing bank. „The recognition in due time of the provisions and the withdrawal of the loans that cannot be recovered represents a key issue concerning the oversight because it's useful at consolidating the balance sheet and allows them to re-focus on their basic activity, mainly the loans for economy (ECB, 2017). Due to the fact that the loss provision decreases he bank's profit as a result of the economic crisis, the importance of the portfolio quality indicators considerably increased. (Balas, 2009). The bank loan activity implies therefore the need to deliver information in order to assess, analyze, manage and supervise the its impact on the bank's financial results (Feschiyan & Andasarova, 2017).

## II. Literature review

The bad loans are influencing the economic activity, especially the countries that are relying on the bank's financiang, such as the Eurozone. Bad loans are decreasing the profitability, increases the financing costs and affecting the adequacy of the bank's capital, negatively influencing the credit supply and finally the development (Magnus et al., 2018). The average number of bad loans increased in the EU as a result of the economic crisis (KPMG, 2018), as a consequence of the incapacity of the financial institutions to identify and to effectively manage the credit risks related to the investments (KPMG, 2018). A bank whose credit tisk is high has at the same time a higher insolvency rate (Otieno, 2016). The global financial crisis emphosized the difficulties for the supervising authorities occurred when trying to identify and compare the information regarding the way to identify and report the quality of the assets (BIS, 2016). In addition yo the regulatory authorities, the market participants require hogher levels of transparency, a better data quality reffering to the credit risk management being crucial (PWC, 2011).

Nevertheless, the discretion and the bank's ability to use the provision policy in order to manipulate its earnings were the main source of concern which has led to the development of the provisions "losses incurred" according to IAS 39 -2000s (BIS, 2017) regulations. At the same time "provisions decrease affects the capital adequacy (Gaston, 2014).

The Basel II accord offers to the banks the opportunity to use more approaches to the risk management and especially to the credit risk. The minimum capitall requirements stipulated by the European directives, based on the Basel Agreements, are srisk sensitive: yhe higher the risk, the bigger the capital neede by a bank to manage the risk and to cover the losses. As a result, when the credit risk is getting higher during the recession, the higher the minimum capital requirements needed by the banks in order to be able to manage new risks. The banks may find themselves in sthe situation where they must obtain supplementary capital for fulfilling requirements, in a moment where the capital resources are affected by losses and the chances to obtain capital are rare and costly. According to the losses provisioning model, losses can be recognized only if there are impartial proofs that a financial asset or a group of financial assets is impaired. Despite the fact that the discretion potential would have been reduced, it was admmitted that, especially due to the financial crisis, this could lead to provisions less precarious and unadequate during good times and a sudden rise of the provision during the early stages of the crisis. (BIS, 2017)

The years 2007-2008 have shown that during the stages of accelerated economic growth there is the probability that the creditors and debtors behaviors to be more relaxed towards the risks they are exposing.

During the development stages, the credit standards and security requirements are smaller which will generate a lower quality of the credits portfolio and a higher risk level, thus forming the circumstances of big losses. During the decline stages, the credit portfolio begins to diminish and, since the reserves of provisions were not constituted during the growth, the loss covering of the provisions will suddenly increase. As a result, the banks will impose more restrictive regulations for loaning and the effects will be escaladed. (Oros, 2015) The non-performing loans are used as a measure of the credit portfolio quality, the portfolio is considered of good quality when the amount of non performing assets is minimum (Otieno., 2016), (Filip, 2015). When loan are classified as non-performing, the accounting standards request provisioning; some banks may truy to

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extensively restructure the problematic loans if this will minimize the impact of the non-performing loans over the net income (Gaston & Song, 2014).

In order to prevent the descrease of the capital, the banks may intuitively adopt restructuring measures to support loaning. Nevertheless, the restructuring actions could also affect adequacy indicators (Bergant & Kockerols, 2017).

## III. Loans quality assessment

The measurement of the earnings and risk management are of capital importance in the assessment of the banking activity quality and its performance. Taking into account all possible risks, the essential goal of the bank's managers is to obtain maximum turnover under minimum risk conditions.

Risk management implies thprovisioning as a form of insurance against the credit risk. The goal of the provisioning system within banks, regulated by the current norms, is to protect the bank's capital, to protect the bank deposits, to cover some credits that are unsure to be recovered, setting up a system of provisioning coefficients assigned to the category to which the loan belongs.

The need to lower the rate of non-performing loans in Romania includes the cleaning of the balance sheet, especially for the preservation of the loaning capacity and for an effective use of the financial and human resources. The persistence of a high amount of non-perdorming loans generates difficulties due to the intensive use of the capital to cover losses. The actual losses coused by the non-performing exposures are sometimes greater than the provisions due to: (i) overestimating the recovery degree from collaterals and cash flows; (ii) underestimating the legal expenses or the time needed to recover the claims and (iii) the adjustemnts of the collateral's market values during the legal recovery process.

ABE identified the high value of the non-performing loans ratio (NPL) as the main risk against European financial stability and periodically monitors the level and the dynamics of the ratios in each country and exposure classes. For cutting down the NPL level, ABE proprosed in Januaryy 2017 the setting up of a joint management asset society (AMS) which will manage the selling of all non-performing loans. The idea was succesfuly implemented by the Great Britain, Ireland and Spain as a mean to counterbalance the NPK issue (NBR, 2018).

The objectives establised by the accounting standards are different from those established by current banking arrangements. The goal of financial reporting is to make

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the firms transparent by an accurate presentation of the significant information to the users, unlike the prudential reports that are including conditions and criterias constructed to counterbalance the excessive indebtedness, irregular transactions within the group and cash crisis. These different objectives are in the middle of the permanent debates regarding the debt losses (Bushman & Williams, 2011).

In Romania, the National Bank asseses the quality of the loans using accounting and prudential approaches.

### *III.1 Loan quality assessment from the accounting perspective*

The credit risk is seen as part of the bank's accounting policy. Accounting information in a synthetic and analytical form is a starting point for making analyzes and accounting assessments and for global credit risk management (Feschiyan & Andasarova. 2017).

In the case of banks, the assets consist of the total of their placements in loans granted to customers, government bonds and bonds, and also from placements made on the interbank market, capital market and stock market, to which are added fixed assets and other investments on short term.

IAS 39 and the future IFRS 9 are establishing the principles for recognizing impairment. This is the standard applied by SSM to the banks preparing their consolidated and / or individual financial statements in accordance with EU-approved IFRS. (EBC, 2017) Prior to the adoption of IFRS, some accounting regimes of European countries allowed entities to accumulate reserves, which served as buffeer against losses from loaning activity and determined the minimisation of the earnings volatility (Gaston & Song, 2014). From an empirical point of view, it can be assumed that the non-discretionary and retrospective character of IAS 39 could undermine the timeliness and adequacy of provisioning policies, especially in times of expansion where the losses are relatively low. Alternatively, it can be argued that a bank may choose not to take into account the evidence of expected future losses and recognition of the delay if it has full freedom over its policy of provisioning (BIS, 2017).

Romanian banks are applying the accounting regulations in accordance with the International Financial Reporting Standards beginning wyth the 1st of January 2012. For financial repoting the main existing balance is used to identify the non-performing loans portfolio and not necessarily the nack payments. The Romanian National Bank imposed the calculation of indicators, which will trace the quality of the loan portfolio, based on the financial situations prepared according to the IFRS, such as:

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- Impaired liabilities of the non-banking clients (gross value) /Overall credit portfolio for the clients (gross value);
- Impaired liabilities of the non-banking clients (net value)/ Overall credit portfolio for the clients (net value).

One of the important reactions to the recent global crisis was an extensive revision of the manner in which are recognizing the provisions for loan losses. Thereby, it was adopted a new financial reporting international standard – IFRS 9, that became operative starting with January 2018 ans implies both implementation costs and increases of depreciation adjustments.

The main amendments which IFRS 9 is introducing refer to: asset classification and measurement, asset impairment and hedge accounting.

In Romania, the potential impact of the introduction of IFRS 9 at the aggregate level of banks is estimated to be reduced at first instance: the adequacy indicators would decrease, the expected losses would marginally increase compared to the current level of depreciation adjustments, and the portfolios for which will quantify higher expected losses than current depreciation adjustments will be those specific to retail segment loans and regional governments. Given that there are significant differences in how banks identify and report asset quality (Balas, 2009), IFRS 9 principles are more aligned with the prudential calculation of expected losses, given that IFRS 9 is based on expected losses and, although necessary, accounting methods and prudential assesment differ in certain aspects (EBC, 2017).

The new standard will impact on how banks justify economic losses for all financial products at individual asset level and group asset level, affecting provisions and, implicitly, bank solvency. Adopting the new rules will require significant time and financial resources from banks. The Basel Committee on Banking Supervision has proposed a set of rules on transitional arrangements in the implementation of IFRS 9 as well as the introduction of a transition mechanism to mitigate the prudential impact of implementing the model based on expected credit losses.

A criticism to the IFRS 9 is the potential pro-cyclical character in quantification of provisions. To investigate the magnitude of this feature at the level of the most significant change associated with the implementation of IFRS 9, a prospective analysis of depreciation adjustments classified in Stage 2 - the main source of provision increase as a result of the implementation of IFRS 9 - has been made in case of stress scenarios. Given that one of the criteria used to determine the exposures in the depreciation stage 2 is that of the number of days arrears - EBA recommending the inclusion of all exposures that

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account for arrears of between 30 and 90 days at this stage - it was assumed that the volume of exposures and the related provisions evolve proportionally in relation to the arrears rate between 30 and 90 days.

From the financial stability perspective, a number of implications of IFRS 9 have been identified at European level. Firstly, accelerating the recognition of losses can improve financial stability. If the recession or its implications can be anticipated with sufficient time in advance, pro-cyclicality may be reduced, and lending contraction during the economic recession may be less severe.

The anticipated recognition of the losses may also diminish the concernings of the market referring to the capital adequacy dueinf an economic crisis and it's usually considered positive rekated to the transparency and the discipline of the market. Nevertheless, the ECL approach includes the reaction to new information such that the provisions for depreciation may suddenly increase if the macroeconomic indicators are spoiled. IFRS 9 could have pro-ciclycal effects derived from the ciclycal sensitivity of the risk parameters used to asses the ECL and from the transition of the exposures between stages (Oros & Salisteanu, 2015).

### *III.2. Loan provisioning*

Since Loan loss provisions (LLPs) are registered as expenses, tht can be used by the banks to manage the earnings, in order to satisfy market expectations and internal goals. Provisioning can also influence the amount of regulation capital either by its impacy on the reported result, or more directly due to the fact that the loan loss reserves are included in the calculation of the total regulatory capital. (Anandarajan et al., 2006).

Usually, high current provisions may signal that future earning will increase, expecially if inverstors believe that the reserves can be used in this direction (BIS, 2017).

During economic growth periods it may occurr another type of risk derived from a more relaxed behaviour of the debtors and creditors; the credit risk may be underestimated by both the borrowers and the creditors. The bank's managers are making large loan loss provisions in good years so that supplementary reserves are available for bad years, and taking into consideration this hypothesis a positive relation between loan loss provisions and bank earnings is expected.

In addition, the authors are suggesting the development of a tool for supplying loan losses according to which the banks should foresee, during the boom period, the increase of the future risk, affecting the loan portfolio. During the decline priods, the banks could use the capital accumulated during the boom periods, in order to cover the loan losses which may occur and may have impact on the portfolio, because of the previous activities" (Oros & Salisteanu, 2015).

The authorities should act anticiclycal, through measures that should counterbalance these trends, thus ensuring the maintaining of an adequate level of caution with medium and longterm benefits over the economy.

The real-time recognition of the losses also implies a perspective element rather than a limited focusing on the quality of the past loan" (BIS, 2017). Therefore, in order to reflect the risk of the loan activity and the recognition in due time of the possible losses which may occur, the provisioning loans objective need is emerging" (Feschiyan & Andasarova, 2017).

Starting with 2012, the Romanian banks are calculating the provisions level using both the prudential regulations and the IFRS standards (which are also called adjustment of impairment of receivables). The banks are registering only the adjustments for the impairment calculated according to the IFRS accounting standards, the positive difference between the total amount of the value prudential adjustments and the total value of the adjustments for impairment being used as a prudential filter for the calculations of the own funds and for the prudential indicators.

The International Accounting Standards Board (IASB) and the United States Financial Accounting Standards Board (FASB) modified the manner in which the provisions are formed in order to include prospective assements for loan loss assesments. The transition was made from the supported credit loss model to expected credit loss model.

### *III.3. Loan's quality assessment from prudential perspective*

Loan loss provisions (LLPs) plays an essential role in ensuring safety and force of the banking systems and, therefore, is a central point for bank's supervisors. The banks have to closely supervise the relative and absolute level of NPLs to a sufficiently high level of portfolio coarsness (EBC, 2017).

The non-performing assests are those that are not generating incomes. In the scholarly literature the non-performing loans are those granted by a bank to the clients with a deteriored financial situation who doesn't allow them to reimburse the loan and/or to pay the interests and fees. Considerring that the use of different definitions for NPL (an for accounting prasctices) made difficult to compare the situation among the member states. Since Basel II, the regulatory authorities from around the world asked the bank to automatically requalify as non-performing, the overdue loans whose principal or interest

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is unpayed (usually for 90 days or more) or that are unlikely to be fully reimbursed (BIS, 2017). This unique definition of the NPE is mandatory only for prudential reporting. The noon-performing loand portfolio offers clues about the quality of the overall portfolio and finally on the bank's lending decision. When the aggregated level of provisions is assesed referring to the non-performing loans, the goal ist o identify if a bank is able to face the credit risk effectivelly.

ABE plays an important role in supervisding and assessing the market assessment, as well as in the market trend identification, the potential risks and the vulnerabilities of the European banking system. The risks scoreboard is another important product belonging to the set of ABE's assessment tools. The scoreboard briefly presents the main risks and vulnerabilities for the banking system by using a set of risk indicators. For instance, according to ABE, a level of non-performing loans above 8% is placed in the red zone, a level between 3 and 8% is placed in the yellow zone and a level of NPLs less than 3% is in the green zone.

The prudential reporting is necessary to the central banks in order to find if the banks are cautionally managed and the risks are covered by capital according to the risk profile which is assumed. The regulations concerning banking prudence are imposing a single approach of the way in which the prudential value adjustments of the NPLs are calculated, ensuring the similarity of the indicators reported by the banks.

In Romania, the National Bank essesses the granted loan quality taking into consideration both criteria: accounting and prudential. The reguletaions used to classify the loans and to recognize the deposits corresponding to the NPLs have a prudent feature. The approach ios based on the prudential reasons reffering to the decrease of the deposit's values in a non-liquid market and refers to the adjustment of the deposits corresponding to the exposures representing the principal of the loans classified as "loss". In this case, the debt is older than 90 days and/or have been initiated legal procedures with coefficients whose values cannot be greater than 0.25. Accurding to the Romanian prudential banking regulations, starting legal procedures consists of at least one of the following measures for the liability recovery:

- issuing a resolution by the legal authorities for opening the bankruptcy procedure;
- opening the enforced procedure for natural or legal persons.
- The litterature (Balas, 2009), uses to describe the quality of the credit portfolio, different indicators which are frecquently implied in comparisons among different countries, such as: non-performing loan (NPL) ratio, non-

performing loans coverage by provisions - NPL coverage ratio, non-performing exposure (NPE) ratio, Texas ratio and forbearance ratio.

The NPL ratio is used as the main indicator for assessing the loan portfolio quality from prudential perspective (Balas, 2009). Despite the fact that the indicator may represent accurately the unpayment probability (or the probability of default) it is possible that the losses may not rise to the expected amount for these loans. Briefly, an increase of the NPL ratio, implies a greater probability that the bank to face in the future or to already been confronted with losses, depending on the supervision procedure (BIS, 2017).

In Romania, the banks are calculating the NPL ratio according to the Financial Stability Indicators Compilation Guide, idited by the MIF, being also the most used internationally. As the amount for the overdue loan it is taken the whole balance of the loan and the interests associated, no matter of the number of the debts.

The bank's ability to absorb the losses caused by the NPLs is measured by the NPL coverage ratio. It is calculated based on the gross exposure of the non-performing/depreciated assets as a result of the prudent approach which is aiming the value of the deposits under stress conditions or under non-liquid market, respectively. The gross exposure eliminates the effect of lowering the credit risk, proper to the deposits of the debtors. The potential losses which are not covered by provisions should be balanced by future anticipated recoveries, usually by selling the expected deposits, which is proven in practice to be a long and costly process (Magnus et al., 2018).

For analysis reasons, the national Bank of Romania uses the provisions adequacy degree indicators calculated according both to the banking prudence regulations and to the new accounting IFRS regulations, which are effective since 1st of January 2012. The coverage degree by provisions are calculated considering the gross exposure of the non-performing assets as a result of the pudent approach.

Another indicator which is calculated by banks to assesthe quality of the assets is non-performing exposure ratio (NPE) which is referring to the ratio of the non-performing exposures in the balance sheet and the overall exposure, the difference from the NPL ratio being that the coverage is broader. The Texas ratio is the value of the non-performing loans divided by the amount of the provisions and first level own fund and indicates how close is the bank to the regulations of the constraint caused by the credit risk (Bergant & Kockerols, 2017). The Texas ratio is a link between the NPL exposures and the abount of capital and is therefor another KPI usefull indicator" (EBC, 2017).

An essential instrument available to the banks for resolving or limiting the impact of the NPLs is the forebearing, if it's properly managed. The key objective from the creditor point of view which is forebearing is to oipen the way for the troubled debtors to deal with the non-performing state or to prevent debtors to obtain a non-performing status (Plata et al., 2017). The forebearing ratio is calculated as total forebeared loans divided by the overall value of the loans, on the basis of the bank's individual reports. The banks are taking forebearing measures for maximizing the recovery degree.

## IV. Research methodology

To assess the quality of bank loan portfolio in Romania, the Financial Stability Report issued for the period 2014-2018 by the National Bank was consulted. The most important part of this analysis deals with the unveiling of the Romanian banking system assets qualityIn order to assess the quality of the bank credit portfolio in Romania, the Financial Stability Report issued by the Central Bank of Romania for the period 2014-2018 was consulted. The most important part of the analysis is aimed at revealing the quality of banking system assets in Romania.

The study was conducted through the analysis of key indicators that allow for the assessment of the quality of bank assets: non-performing loans, NPL coverage ratio, non-performing loan coverage by provisions ratio, the Texas ratio, forbearance ratio. We also wanted to identify which of the specific indicators are placed in the red signal band of the Risk Map developed by the European Banking Authority (EBA), and how similar sites are located in other EU countries. By reliably analyzing the quality of the loan portfolio on the basis of the indicators used, we have proposed to highlight how the credit risk management in the Romanian banking system was carried out after the financial crisis of 2007.

The implementation of the new accounting standard IFRS 9 beginning with January 2018 proves an increase in the proactivity of the banks when they recognize the potential losses derived from the loaning activity. Similar to the European trend, the progress of the non-performing loans resolution process is a priority for the Romanian banks. The microprudential regulations initiated in the last few years by the National Bank of Romania were complemented by the implementation of the macroprudential refulations, aiming to improve the assets quality indicators. The profitability of the banking sector in Romania, despite its high value in 2017 has a transitory nature.

The Romanian banking business model continues to focus primarily on the segment of the population, by applying high interest margins, lending to non-financial companies with a low growth rate, and sovereign exposure remaining significant. Bank's

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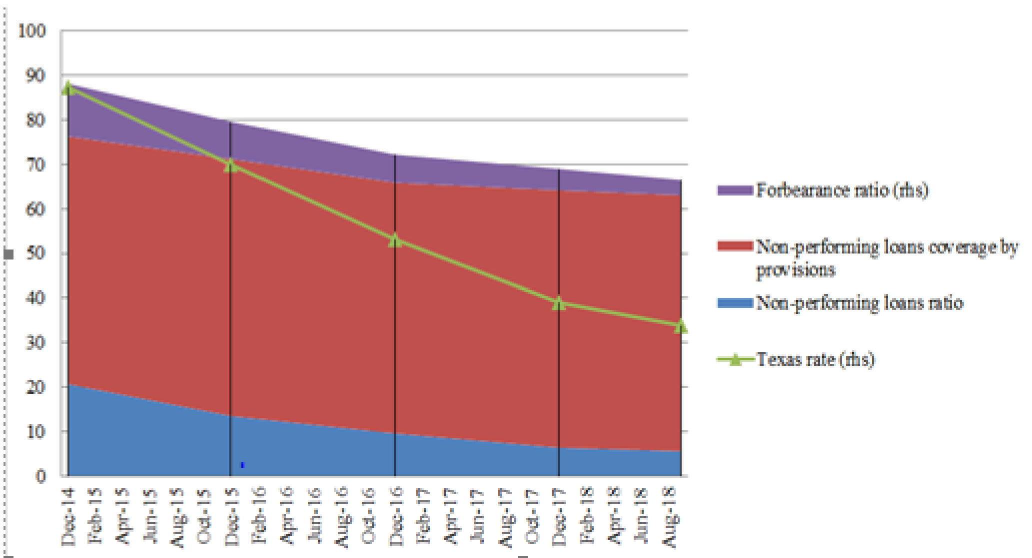
financing is based on attracting deposits from the domestic market, especially from the population. The dependence on sources of financing from parent banks is currently low, amid substitution from domestic saving sources. The credit default risk of the non-government sector is assessed at a high level, especially on the segment of the population. Although the risk of default has not materialized at present, it is a vulnerability that can be manifested in the context of the global trend of returning interest rate levels to historical trends. The credit default risk has several facets, being the result of factors related to payment discipline in the economy, the adequacy of banks' lending standards at the time of granting loans, legislative projects that have encouraged moral hazard, etc. (NBR, 2018) In this context, the financial intermediation in Romania remains at one of the lowest levels in the European Union, the evolution being determined both by factors specific to the demand and by factors specific to the supply.

**Figure 1 -** Credit risk and asset quality indicators




*Source*: NBR, 2014-2018

One can observe from Figure 1 that the quality of the assets in Romania continued to improve, the decreasing trend of the non-performing loans ratio, of the forebearing ratio and Texas ratio, are reflecting the balance sheet cleaning efforts of the Romanian banks without affecting the prudential indicators and the shifting of the loan resources. The

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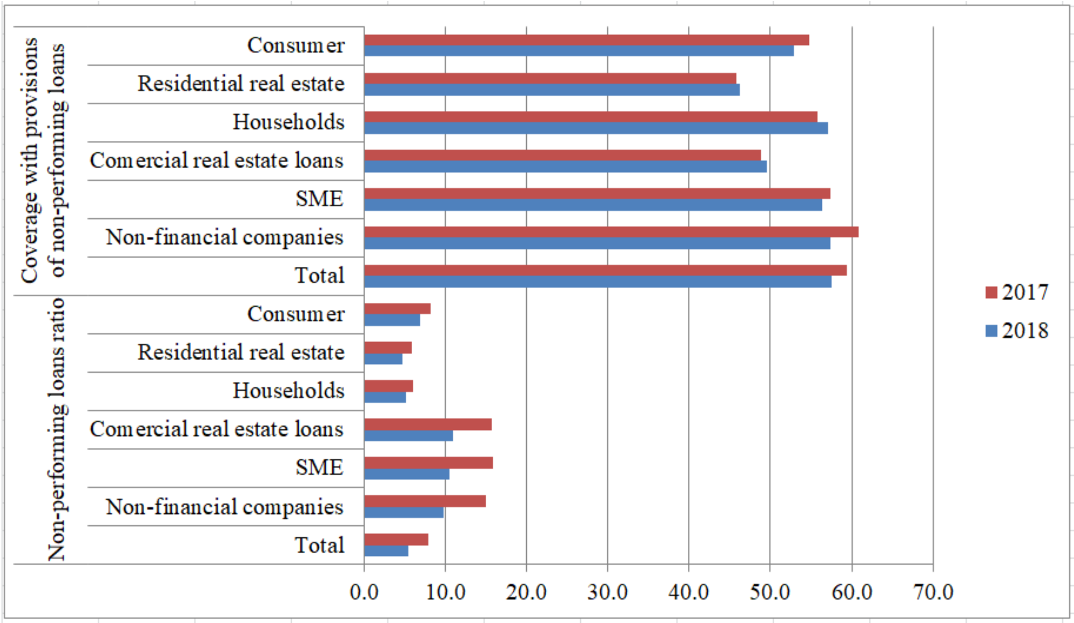
decreases of the non-performing loan loss ratio emphasizes the efficiency of the measures adopted by the Romanian banks to reduce the non-performing loans stock. Simultaneously, the non-performing exposures ratio continued to downsize, following the same trend as the non-performing loans ratio, but is still greater than the European average (3.9% in June 2017).

The process of cleaning the balance sheets which determined a decrease of the non-performing loans, was generalized to all the banks in Romania, but only three of these encountered increases of the NPL. The balance sheet cleaning was performed especially for the loans of the non-financial companies, the population's portfolio being affected in a small extent. The most remarcable decrease of the NPL balance was registered for the secured loans. The Romanian banks are still proactively recognizing the NPL, the weight of exposure with less than 90 days delays being significant, with a slight downward trend since the end of 2016. The main contributors to the decrease of the NPLs were the nonfinancial companies (see Figure 2). The NPL's provision coverage degree is improving, being a supplementary warranty of a future light impact on the own funds of the credit institutions with higher NPL rates. The current level is diminishing the risks associated with the high rate of the NPLs.

Against the background of a constant economic growth, the Romanian banks continued their effort to help borrowers in troble but in a lesser extent than in previous years. The forebearing ratio (calculated as the rate of restructured loans against total amount of loans) was 4.5% (March 2018, see Figure 3.1). Compared to 2017 the restructured loans downsize was done especially due to the balance sheet cleaning, and the contribution of the NPLs in the total amount of restructured loans increased, which is a prove of the bank's proactive eforts for supporting the client in trouble. Nevertheless, the efficiency is not very high and the number of loans at list twice restructured is significant (64%).

The indicator assessing the adequacy of provision covering of the NPLs and level 1 own funds, respectively the Texas ratio, was improved for the individual level (see Figure 1) and also for the consolidated level. Reffering to this indicator, Romania is less favourable placed compared with the European median (37.7%). The high value of the Texas ratio suggests an upsetting sensitivity to the credit risk.

**Figure 2 -** Non-performing loans ratio and non-performing loans` coverage by provisions by sectors and type of loans (September 2018)




*Source*: EBA, NBR, 2017-2018

One must note (see Figure 2) that considering the destination of the loans, high values of the NPLs are specific to the non-financial entreprises and the sub-category of loan granted (SME or secured with business premisses) with a downward trend for all important portfolios. The higher volume of NPLs is caused by the non-financial entreprises exposure, followed by the SME exposures and finally by those specific to the unsecured with bussinerss premises. The SMEs exposures one must note the high rate of the NPLs with a slight decreasing tendency as well as an important weight in the overall amount. The population sector is described by a significantly lower non-performing rate with a decreasing trend.

The provisioning coverage degree of the NPLs for the benking sector decreased in 2018, but is still adequate (56.9% in March 2018) and greater tohan the European average (44.5% in December 2017, see Figure 2). the aggregated indicator is placed in the low risk ABE signal band, but for a quarter of all banks the value is below 40% (the red signal ABE threshold) which is suggesting the need of future improvement efforts.

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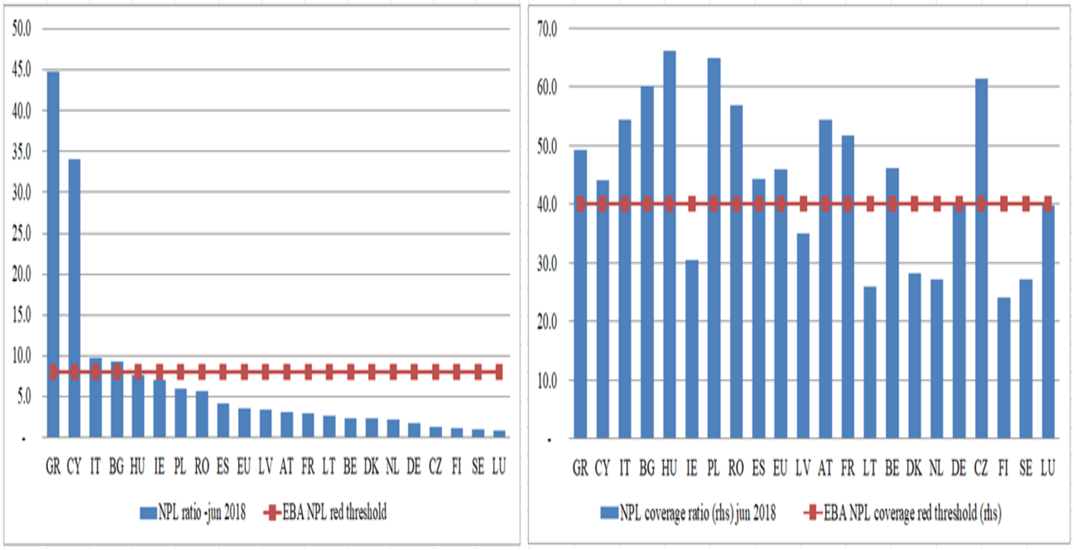
**Figure 3 -** Asset quality indicators - European comparisons (June 2018)




*Source*: EBA, NBR, 2018

At the beginning of the financial crisis, the distribution of the NPL was very unequal among the UE countries, those affected by crisis registering major increases of the NPL rates. The figure 3.3 shows that the NPL level in Romania is outside the ABE alarm threshold (8%), but it is one of the countries with an average rate of loan quality worsening in 2018, Greece, Bulgaria, Hungary and Slovenia, being in less favourable situations. ABE intermediate signal band (3-8%) as well as the higher value of the UE specific average (4% in December 2017) are premises for the need of lowering the NPL rate. We must observe that other central and eastern Europe countries, which are in the red zone of the NPL level, have eather a negative rate of lending increase (Russia, Croatia) or a medium rate, similar to the value for Romania.

The NPL provisions coverage indicator significantly differs from one member state to another. “The differences may reflect different guarantee levels (depending on the loans regulations, the most affected areas by the NPL, and the heterogenous accounting practices) but may indicate different residual risk levels” (Magnus et al., 2018).

For Romania, the NPL provisions coverage degree is placed in the low risk ABE signal band, due to microprudential measures initiated by the National Bank of Romania, and enhanced by the loss recognition assumed by credit institutions. This level is greter than the European average (45%) and one of the highest among the UE countries.

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We must say that, the continuously decrease of the NPL from the bank's point of view is a double challenge. On one side it is a stock and stream issue, because the value of new loans must be greater than the total amount of non-performing old loans. This process is ongoing in Romania, but it is not sufficient to generate and lending increase superior to the GDP increase. On the other hand, it is a signalling issue, because is difficult for a bank to signal, in the same time, a caution increase (lowering the NPL) and of the exuberancy (by aggressively increase the new loans).

Long-term maintaining of a good quality of the loans portfolio for the whole Romanian banking sector implies the existence of a macroprudential framework used to prevent the future NPL accumulation. Responsible lending, which is based on a prudent assessment of customer creditworthiness (including in the context of adverse developments in the macroeconomic framework), and the prevention of successive debt forebearing are central bank concerns. Early impairment of capital to reflect the loss in lending activity, in the context of asset quality deterioration, will be boosted in the future by the adoption of the new IFRS 9 accounting standard.

## V. Conclusion

Synthesizing the results of the research, the quality of banking assets in Romania experienced a continuing deterioration untill 2014, but it has improved considerably in recent years, although there are still specific indicators placed in the red signal band of the Risk Chart developed by the European Banking Authority ABE), similar to other EU countries. The rate of non-performing loans and the forebearing ratio are the only indicators that place the Romanian banking sector in the red signal band of the Risk Chart developed by the European Banking Authority. The study shows that alongside Romania, the most risky countries in this respect are Greece, Cyprus, Portugal, Italy, Ireland, Bulgaria and Hungary. The need to align the values of the assets quality indicators to the average european value is supporting the further balance cleaning process.

Crediting the non-financial companies, which is done as a result of a superficial credit risk assessment expertize, contributed primarily to the impairment of the non-performing loans ratio. Non-performing credit sales continued to contribute to the improvement of the asset quality indicators. Investors' interest in buying bad loans placed in the balance sheet of banks in Romania has persisted. We believe that maintaining prudent credit standards is a precondition for lowering the volume of non-performing loans. Also, excessive lending to individuals prior to the financial crisis, in the context of lax credit standards, was later transposed into debt sustainability issues at the population

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level. The political environment has initiated a series of legislative projects aimed at supporting debtors, which has contributed to creating certain uncertainties about the stability of the legal framework applicable to credit agreements. Bank's efforts materialized in debt forebearing, but the efficiency is relatively low.

At European level, there is no complete harmonization of accounting and prudential regulations. Therefore, the analysis of the provisioning coverage of the non-performing loans is inequable. In the case of Romania, was used for comparison the prudential definition of the non-performing loan, i.e. the indicator calculated as a ratio between the total provisions and the gross exposure of more than 90 days overdue loans and overdue interest and / or for which legal proceedings were initiated, reported by banks in the situation credit classification. The nonperforming loan ratio adjusted significantly in 2014, reaching 5.6% in September 2018. This decrease was one of the fastest within the UE countries. At the same time, the non-performing loans provision covering degree was adequate for the whole interval. Romania is considerred an example to follow regarding the manner in which it managed to deal with the non-performing loan issue. The quality of the banking assets improved considerably in a short interval, without affecting prudential banking indicators.

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