SUPPLEMENTAL MEMORANDUM OF UNDERSTANDING

(Second addendum to the Memorandum of Understanding)

between

THE EUROPEAN UNION and ROMANIA

1. On 6 May 2009, the Council of the European Union adopted Decision 2009/459/EC to make available to Romania medium-term financial assistance of up to EUR 5 billion. On 16 February 2010, the Council amended this Decision to address the impact on programme targets of the larger than expected recession. The assistance is provided as a medium-term loan under the balance of payments facility of Member States (based on Article 143[1] of the Treaty on the Functioning of the European Union (the "Treaty") and Regulation No 332/2002[2]). The EU assistance for Romania comes in conjunction with IMF support through a Stand-By-Arrangement (SBA) in the amount of SDR 11.4 billion (around EUR 12.95 billion), approved on 4 May 2009. Additional multilateral support of EUR 2 billion will be provided by the World Bank (EUR 1 billion) and the EIB and EBRD (EUR 1 billion).

2. The Memorandum of Understanding ("the Memorandum"), laying down the economic policy criteria linked to each disbursement as well as the reporting and monitoring conditions of the loan, was signed on 23 June 2009. Implementation of the fiscal, financial sector and structural reform measures foreseen in the Memorandum should enable the economy to withstand short-term liquidity pressures while improving competitiveness and supporting an orderly correction of imbalances in the medium term, hence bringing the economy back on a sound and sustainable footing. The first instalment of EUR 1.5 billion was disbursed on 27 July 2009 following the signature of the Loan Agreement of 23 June 2009. The second instalment of EUR 1 billion was disbursed on 11 March 2010. Three other instalments were scheduled over the period from the second quarter of 2010 to the second quarter of 2011.

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[1] Ex Article 119 of the Treaty establishing the European Community.

[2] As amended by Regulation No 431/2009.

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3. In August 2009, the Commission services participated in an IMF review mission, which led to the disbursement of the second instalment under the IMF programme. As no EU disbursement was planned at the time, the mission was not a formal review under the EU assistance programme. Agreement was reached with the authorities on a revision of some programme targets. In particular, the 2009 government deficit target was set at 7.8% of GDP in ESA95 terms (7.3% of GDP in cash terms), on account of the deeper than expected recession. Additional measures were identified to limit the deficit in 2010 to 6.4% of GDP in ESA95 terms (5.9% of GDP in cash terms) including measures to contain the public wage bill as a percentage of GDP and limit expenditures on pensions and on goods and services, as well as increases in excises.

4. The Commission services carried out missions in October/November 2009 and January 2010 to assess progress made with respect to the specific conditions attached to the second instalment of EUR 1 billion under the EU financial assistance programme. These were joint missions with IMF and World Bank staff. Based on the findings of these missions and after having consulted with the Economic and Financial Committee, the economic policy criteria for disbursement of the second instalment of the EU loan were fulfilled. In particular, Parliament had adopted a 2010 budget in line with programme targets and satisfactory progress had been made in other areas of structural reform. However, taking into account the changed macroeconomic outlook and delays encountered in implementing some of the reform measures foreseen in the Memorandum, the conditions attached to the disbursement of the future instalments of the financial assistance needed to be adjusted. The agreed changes in the specific economic policy criteria were laid out in the Annex to the Supplemental Memorandum (the "first Supplemental Memorandum"), which was signed by the Romanian authorities on 18 February 2010 and by Commissioner Olli Rehn on 22 February 2010. In addition, agreement was reached on a further gradual reduction of the fiscal deficit to below Treaty reference level of 3% of GDP in 2012. On 16 February 2010, this agreement was endorsed by the revised Ecofin Council recommendations to Romania under Article 126(7) of the Treaty.

5. The Commission services conducted a further review mission together with the IMF and World Bank staff from 26 April to 10 May 2010 to assess progress made with respect to the specific conditions attached to the third instalment of EUR 1.15 billion under the EU financial assistance programme. It appeared that under current policies, the 2010 fiscal deficit target of 6.4% of GDP will be missed by a significant margin due to a deterioration of economic conditions, difficulties in revenue collection and slippages on the expenditure side. However, the Romanian Government has made the commitment to take additional compensatory measures (see Annex 1). These measures will need to be adopted and implemented before the Commission can release the third instalment of the EU loan. This will be verified in July 2010. In other areas of reforms, good progress appears to have been made, including the adoption by Parliament of the fiscal responsibility law and the law aimed at ensuring the independence of non-banking financial sector supervisors, the adoption of a proposal for pension reform by the government as well as the signature of the contract for the functional review of the public administration. Based on these findings and following consultation of the

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Economic and Financial Committee, the economic policy criteria for disbursement of the third instalment of the EU loan appeared to be broadly fulfilled.

6. Nevertheless, the conditions attached to the disbursement of the future instalments of the financial assistance need to be adjusted, reflecting in particular the fiscal consolidation measures agreed by the Romanian Government. The agreed changes in the specific economic policy criteria are laid out in the Annex to this second Supplemental Memorandum of Understanding (the "second Supplemental Memorandum"), which is the second addendum to the Memorandum of Understanding.

7. Articles laid down in the Memorandum and the first Supplemental Memorandum (including their annexes) remain valid and in force, unless explicitly amended in this second Supplemental Memorandum.

8. Disbursements of all future remaining tranches under the programme are conditional on the measures being implemented by the Romanian government under the current SMoU being fully consistent with the EU Treaty. In particular, the emergency government ordinance on combating tax evasion needs to be brought in line with the EU Treaty before it can enter into force.

9. Based on the fulfilment of conditions in the Memorandum and the first Supplemental Memorandum and following the consultation of the Economic and Financial Committee, the Commission shall decide on the release of the third instalment of EUR 1.15 billion subject to the implementation of the fiscal consolidation measures spelled out in Annex 1 (section "Actions to be taken before disbursement of third instalment of the EU loan") and the signature of the second Supplemental Memorandum by the parties and its entry into force.

10. The Annex forms an integral part of this second Supplemental Memorandum.

11. All notices in relation with the second Supplemental Memorandum shall validly be given if in writing and sent to:

For the European Community

Commission of the European Communities
Directorate General for Economic and Financial Affairs
B-1049 Brussels
Fax No.: +32 2 299 35 23

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For the Prime Minister

Prime Minister's Office
1, Piata Victoriei
Sector 1, 011791, Bucharest
Fax No.: +40 21 319 15 88

For the Ministry of Public Finance of Romania

Ministry of Public Finance of Romania
Apolodor Street, 17
Sector 5, 050741 Bucharest
Fax No.: +40 21 312 16 30

For the National Bank of Romania

National Bank of Romania
Lipscani Street, 25
Bucharest 030031
Fax No.: +40 21 312 62 60

11. For Romania, the Supplemental Memorandum shall become effective after completion of internal procedures required under the Laws of Romania. The Supplemental Memorandum may be amended upon mutual agreement of the parties in the form of an Addendum. Any such Addendum will be an integral part of the Memorandum and become effective according to the same procedures as the Memorandum.

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Done in Brussels on 20.07.2010 and in Bucharest on 02.08.2010 in five originals in the English language.

ROMANIA
Represented by

Emil Boc
The Prime Minister

Sebastian Vladescu
Minister of Finance

Mugur Isarescu
Governor of the National Bank of Romania

EUROPEAN UNION
Represented by
EUROPEAN COMMISSION

Olli Rehn
Member of the European Commission

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ANNEX 1

SPECIFIC ECONOMIC POLICY CRITERIA

(Amendments and additions to Annex I of the MoU and Annex 1 of the first SMoU)

In view of the changes in the economic outlook for 2010 since the January 2010 programme review, the 2010 ESA95 deficit target of 6.4% of GDP in the first Supplemental Memorandum shall be replaced by a target of 7.3% of GDP in ESA95 terms (6.8% of GDP in cash terms). In order to maintain trust in reported general government deficit figures, the Romanian Government stands ready to submit its budget figures to a continuous audit. Progress with fiscal consolidation shall be monitored against this new target. Furthermore, the specific economic policy criteria spelled out in the Annex I to the Memorandum and Annex 1 to the first Supplemental Memorandum shall be augmented by the following actions:

Actions to be taken before disbursement of third instalment of the EU loan

- Rigorous implementation of further expenditure reducing measures, including:
  - A 25% reduction in the public sector wages, bonuses and other compensation paid to all public sector employees from 1 July 2010 onwards, while providing a minimum wage of 600 RON;
  - A further streamlining of the number of public sector employees over the coming months;
  - A 15% reduction in all social benefits with the exception of pensions and allowances for those accompanying handicapped people with a first degree handicap. Social programmes that are not targeted at the socially disadvantaged will contribute proportionally more to this reduction;
  - A freeze on early retirements from 1 June 2010 until after the pension reform is in effect. New disability pension claims will only be allowed if previously vetted by the Ministry of Labour's medical teams;
  - Cuts in transfers to local governments amounting to 0.3% of GDP.
- Rigorous implementation of further revenue enhancing measures, including:
  - An increase in the VAT rate from 19% to 24%;
  - A broadening of the personal income tax base to lunch vouchers, incomes from capital gains, including interests on bank deposits, and severance payments as well as the gradual elimination of the tax exemption for IT programmers.
- If these actions are not implemented by beginning July 2010 or are not on track to deliver the expected consolidation, additional fiscal consolidation measures will be implemented to close any anticipated budgetary gap.

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Fourth instalment [2010Q4]

A: Fiscal consolidation

- Progress with the implementation of the 2010 budget targeting a government deficit of 7.3% of GDP in ESA95 terms (i.e. 6.8% of GDP in cash terms);
- Adoption of a draft budget for 2011 targeting a further sizeable reduction in the structural deficit consistent with the Council recommendation under Article 126.7;
- Abolition of the 2010 thirteenth month salary for public sector employees. This will show up in the 2011 budget;
- Observance of the 2010 budget target on goods and services excluding the repayment of accumulated arrears.

B: Fiscal governance and structural fiscal reform

- Give appropriate incentives to tax collection officers in order to raise tax revenues.
- Effective action on tax evasion, in particular in order to increase excise tax revenues by RON 2 billion compared to the 2009 levels.
- Approval of the revised pension legislation by Parliament by end-September 2010.

C: Financial sector regulation and supervision

- Entering into force of the law on the independence of non-banking financial sector supervisory authorities by end-September 2010;
- Ensure the capacity of the NBR to cope with challenges to financial stability stemming *inter alia* from the pressures on asset quality, including through contingency planning.
- Enhance the funding of the deposit guarantee fund by: *(i)* increasing the effective rate of contribution to 0.3% in 2011 and gradually raising the *ex-ante* coverage ratio to 2%; *(ii)* phasing out the stand-by credit lines from credit institutions as of January 2011; *(iii)* reviewing the governance arrangements of the Deposit Guarantee Fund, to ensure that neither members of the board nor employees of credit institutions are represented in the managing board. The necessary amendments should be effective as of end-September 2010;
- Maintain the current prudent regulatory framework for provisioning;
- Further enhance financial stability by refraining from promoting legislative initiatives (such as the personal insolvency law) which undermine credit discipline;
- Make the necessary legislative amendments aiming at clarifying the damage compensation regime of creditors of banks placed under special administration to ensure an effective implementation of the recently amended legislation on the resolution of credit institutions in financial distress. This legislation should be effective by end-December 2010.

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D: Structural reforms

- Enforcement of quarterly targets resulting in a 2.5% quarterly reduction of payment arrears by each of the ten largest loss-making publicly owned enterprises. Enforcement should start from the third quarter of 2010;
- Concrete steps towards the privatisation or closure of SC Termoelectrica and the privatisation of S.N. De Transport Feroviar CFR Marfa S.A.;
- Streamlining the number of schools and hospitals;
- Adoption of a multi-annual performance agreement between the ministry of transport and the implementing agencies thirty days following the adoption by the Government of the medium term budgetary framework.

Fifth instalment [2011Q2]

A: Fiscal consolidation

- Implementation of provisions in the budget ensuring that the public wage bill in 2011 should not exceed 39 billion RON. This objective should be achieved by reducing the total number of public sector employees to 1.29 million at the beginning of 2011;
- Introduction of a co-payment system on medical services. The share of exemptions to the obligation to make such payments should not exceed 40%.

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