Macroprudential policy strategy

2023

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The macroprudential policy strategy was approved by the National Committee on Financial Stability at its meeting on September 15, 2023.

Objectives of the strategy

The Macroprudential policy strategy (hereafter - the Strategy) sets out the operational framework for macroprudential policy and its implementation, ensuring transparency and predictability of the decision-making process.

In particular, this document:

- characterises the national regulatory framework;
- links the ultimate aim of macroprudential policy to intermediate objectives and macroprudential instruments;
- explains the coordination mechanism between the relevant national authorities involved in the policy decision-making process;
- sets out the elements of macroprudential policy communication.

Definitions

- *financial system* - all entities in the banking and non-banking financial sector, financial markets, financial market products and infrastructures
- *macroprudential policy* - a set of policies and instruments aimed at limiting systemic risk, whereby the competent authorities intend to contribute to the stability of the financial system in order to ensure a sustainable contribution of the financial system to economic growth,
- *macroprudential policy instruments (macroprudential instruments)* - instruments applicable to achieve the objectives of macroprudential policy, including capital requirements, asset requirements, liquidity requirements and measures related to the management of credit or funding exposures of specific sectors;
- *systemic risk* - the risk of disruption to the financial system, which may have serious negative consequences for the financial system and the real economy;
- *structural dimension of systemic risk* - the distribution of risks within the financial sector;
- *cyclical dimension of systemic risk* - changes over time in systemic risk, generated by the tendency of financial institutions to take excessive risks during economic booms and to excessively increase their risk aversion during downturns.

Legal and institutional framework

Pursuant to Article 4, paragraph 2, of the Law No 548/1995 on the National Bank of Moldova (hereinafter - NBM Law), the National Bank of Moldova (hereinafter - NBM), without prejudice to its fundamental objective, aims to ensure the stability and viability of the banking system and supports the general economic policy of the state. In this respect, the NBM may apply macroprudential measures, set out in the Law No 202/2017 on the activity of banks.

Pursuant to Law No 209/2018 on the National Committee on Financial Stability (hereinafter - NCFS Law), the National Committee on Financial Stability (hereinafter - NCFS) is the designated national macroprudential authority responsible for coordinating the implementation of macroprudential policy. The members of the NCFS are representatives of the authorities that play an important role in maintaining financial

stability: the NBM, the Ministry of Finance, the Ministry of Economic Development and Digitalization, the National Commission for Financial Markets, the Deposit Guarantee Fund in the banking system.

The national framework for maintaining financial stability is also complemented by Law No 232/2016 on bank recovery and resolution and Law No 575/2003 on deposit guarantees in the banking system.

The bank recovery and resolution framework lay down rules and procedures on bank recovery and resolution. The NBM is the competent authority as well as the resolution authority within the meaning of Law No 232/2016. Resolution instruments protect the public interest in maintaining financial stability and are applied when they are necessary to achieve the objectives of resolution, i.e., when the bank cannot be wound up in accordance with the compulsory liquidation procedure, as this could destabilise the financial system.

The framework for guaranteeing deposits held in banks is the Deposit Guarantee Fund in the banking system. The Fund guarantees deposits in national and foreign currency held by resident and non-resident individuals and private legal entities, and the guarantee ceiling is MDL 50,000. The provisions of the Law No 160/2023 on guaranteeing deposits in banks, which regulates the functioning of the deposit guarantee scheme for banks operating in the Republic of Moldova, shall enter into force on 1 October 2023. The changes introduced by the new law include an increase in the coverage level (maximum guaranteed amount per depositor and per member institution) to MDL 100,000 once the law enters into force and to MDL 200,000 from 1 January 2025.

Macroprudential policy: end goal and intermediate objectives

The ultimate objective of macroprudential policy is to contribute to safeguarding the stability of the financial system as a whole, including by strengthening the resilience of the financial system and limiting the contagion effect, as well as reducing the build-up of systemic risks, thereby ensuring a sustainable contribution of the financial sector to economic growth.

The achievement of the ultimate objective of macroprudential policy is pursued through the implementation of six intermediate macroprudential policy objectives, which would increase the operationality, transparency and accountability of macroprudential policy and help inform decisions at the instrument selection stage:

1) reducing and preventing excessive credit growth and leverage;
2) reducing and preventing excessive maturity mismatch and market illiquidity;
3) limiting concentrations of direct and indirect exposures;
4) limiting the systemic impact of misaligned incentives to reduce moral hazard;
5) strengthening the resilience of financial infrastructures;
6) increasing the level of financial education.

Objectives 1 to 5 are also proposed to national macroprudential authorities in Recommendation ESRB/2013/1 and are capable of addressing both the cyclical and structural dimensions of systemic risk.

The NCFS conducts a regular assessment of the appropriateness of the intermediate policy objectives and macroprudential instruments set, also considering any emerging risks to financial stability.

Macroprudential policy instruments

In order to achieve the objectives of macroprudential policy, international experience recommends that the competent authorities apply a set of macroprudential instruments, without being limited to them. The recommended macroprudential instruments have been grouped into six categories, based on the intermediate objective to which the instrument contributes.

Table 1. Risk dimension and corresponding examples of macroprudential instruments

Intermediate objective	Risk addressed	Macroprudential instrument
Reduce and prevent excessive credit growth and leverage	Accelerated credit growth accompanied by relaxation of credit standards	Countercyclical capital buffer
	Accelerated lending and risk accumulation within a given sector or asset class	Sectoral capital requirements
	Increased leverage of entities, increased off-balance sheet risk	Macroprudential adjustment of leverage ratio
	Risk of mismatch between property prices and investment property loans	Loan-To-Value ratio
	Risk of excessive indebtedness and significant credit servicing pressure on the population	Debt limit requirements (loan-to-income ratio, debt service-to-income ratio)
	Low level of risk weights for a significant part of the loan portfolio	Capital conservation buffer
Reduce and prevent excessive maturity mismatch and market illiquidity	Short-term liquidity risk	Macroprudential adjustment of liquidity coverage ratio
	Long-term liquidity and funding risk	Macroprudential adjustment of the net stable funding ratio
	Risk of over-reliance on less stable sources of funding	Macroprudential unweighted limit to less stable funding sources
	The risk accumulated during the upswing of the financial cycle, resulting in the incurrence of secured funding during the financial market downturn	Margins and adjustment factors
Limiting concentrations of direct and indirect exposures	Concentration risk of exposures in the real estate sector	Systemic risk buffer
	Intra-sector contagion risk	Intra-sector exposure requirements in the financial sector
	Concentration risk, counterparty risk and possible contagion	Large exposure requirements
	Contagion risk and counterparty risk	Central counterparty clearing requirement

Intermediate objective	Risk addressed	Macroprudential instrument
Limiting the systemic impact of non-aligned incentives to reduce moral hazard	Potential impact of systemically important institutions' difficulties on financial market stability and the real economy	Capital buffer for systemically important institutions
		Systemic risk buffer
Strengthening the resilience of financial infrastructures	Counterparty default risk, interconnection of financial infrastructures	Margin requirement and haircut factors for central counterparty clearing
	Market liquidity risk, excessive pro-cyclicality, and systemic risks	
	Uncertainties about the size and location of certain exposures and interdependencies within the financial system	Disclosure requirements
	Structural systemic risk	Systemic risk buffer
Increasing the level of financial literacy	Uncertainties about the financial condition of entities in the financial system	Disclosure requirements

Note: The main objective of these tools is to strengthen the resilience of the supervised sectors. The classification of intermediate objectives and instruments is based on the European Systemic Risk Board Recommendation on intermediate objectives and instruments of macroprudential policy (ESRB/2013/1).

The macroprudential toolkit is constantly evolving, which implies a regular review of the instrument set. International experience suggests that the impact of the instruments should also be assessed against their intended intermediate objectives and their effectiveness in mitigating systemic risk monitored. The competent authority shall also study the transmission mechanisms of macroprudential instruments to ensure a more appropriate selection and accurate calibration of instruments.

The competent authorities shall consider the following criteria when deciding on the application of a macroprudential instrument:

- effectiveness, i.e., the degree to which market failures can be addressed and intermediate objectives met,
- efficiency, i.e., achieving the intermediate objectives at minimum cost, ensuring a trade-off between resilience to shocks and economic growth,
- proportionality of the instrument to the size of the systemic risk.

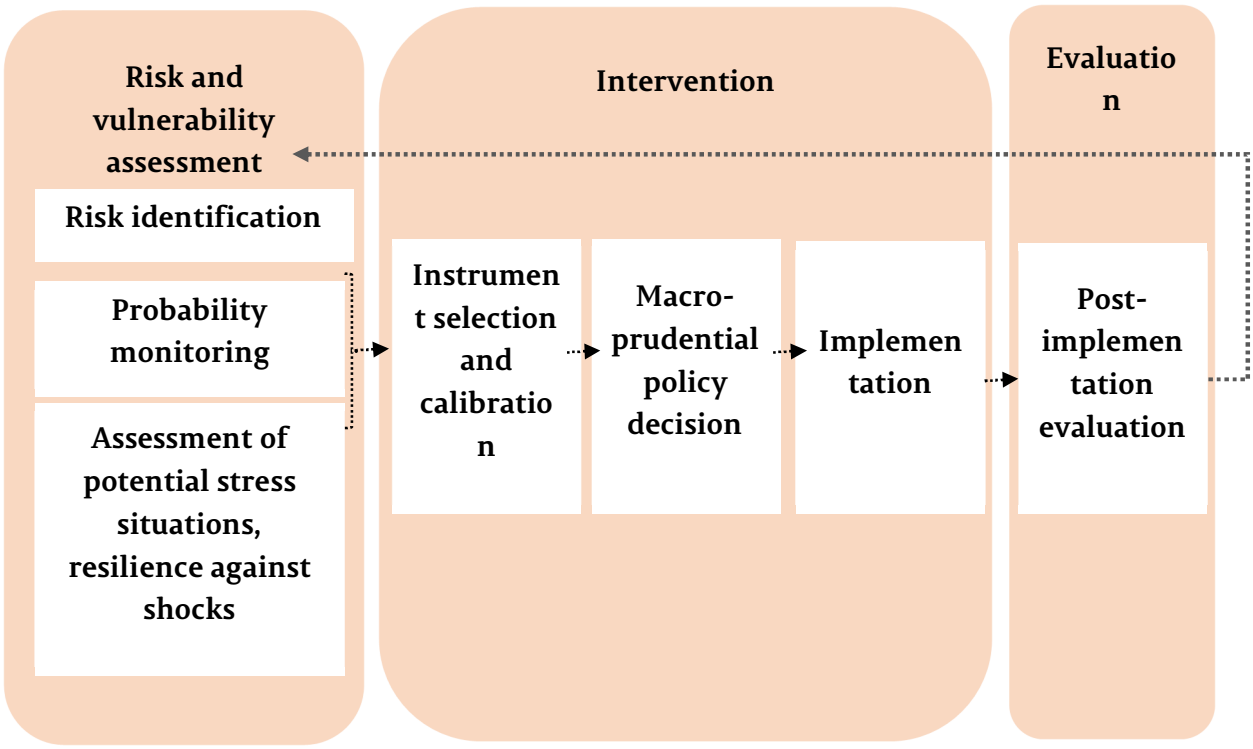
However, a decision to apply a macroprudential instrument shall not be taken automatically on the basis of pre-established rules, but shall also have a discretionary component, considering qualitative factors, which complement the pre-established rules.

Stages of the macroprudential regulatory cycle

The implementation of macroprudential policy is carried out in three stages. The first stage of the decision-making cycle is the analysis and assessment of systemic risk. As part of this process, the competent authority identifies existing and potential systemic risks. The analysis is followed by the selection of appropriate instruments for potential intervention, their calibration and estimated assessment of effectiveness, followed by the actual implementation of the instrument. The third step is the periodic reassessment of the effectiveness of the tool and the preconditions that led to its implementation.

Schematically, the stages of the macroprudential regulatory cycle are shown in the chart below.

Chart 1. Stages of the macroprudential regulatory cycle



The identification and assessment of systemic risk is carried out by monitoring financial and economic developments and other available information. The competent authority shall assess financial conditions and identify vulnerabilities in the financial system, monitor risk factors and assess the capacity and probability of causing stressful situations.

The competent authority shall also seek to ensure that supervised entities demonstrate resilience against potential shocks. In this regard, stress tests, which are simulations of hypothetical situations in which extreme but plausible shocks affect the financial system, are often used. These exercises allow the quantification of the impact of the materialisation of major risk events and help in taking measures that would strengthen the resilience of financial institutions.

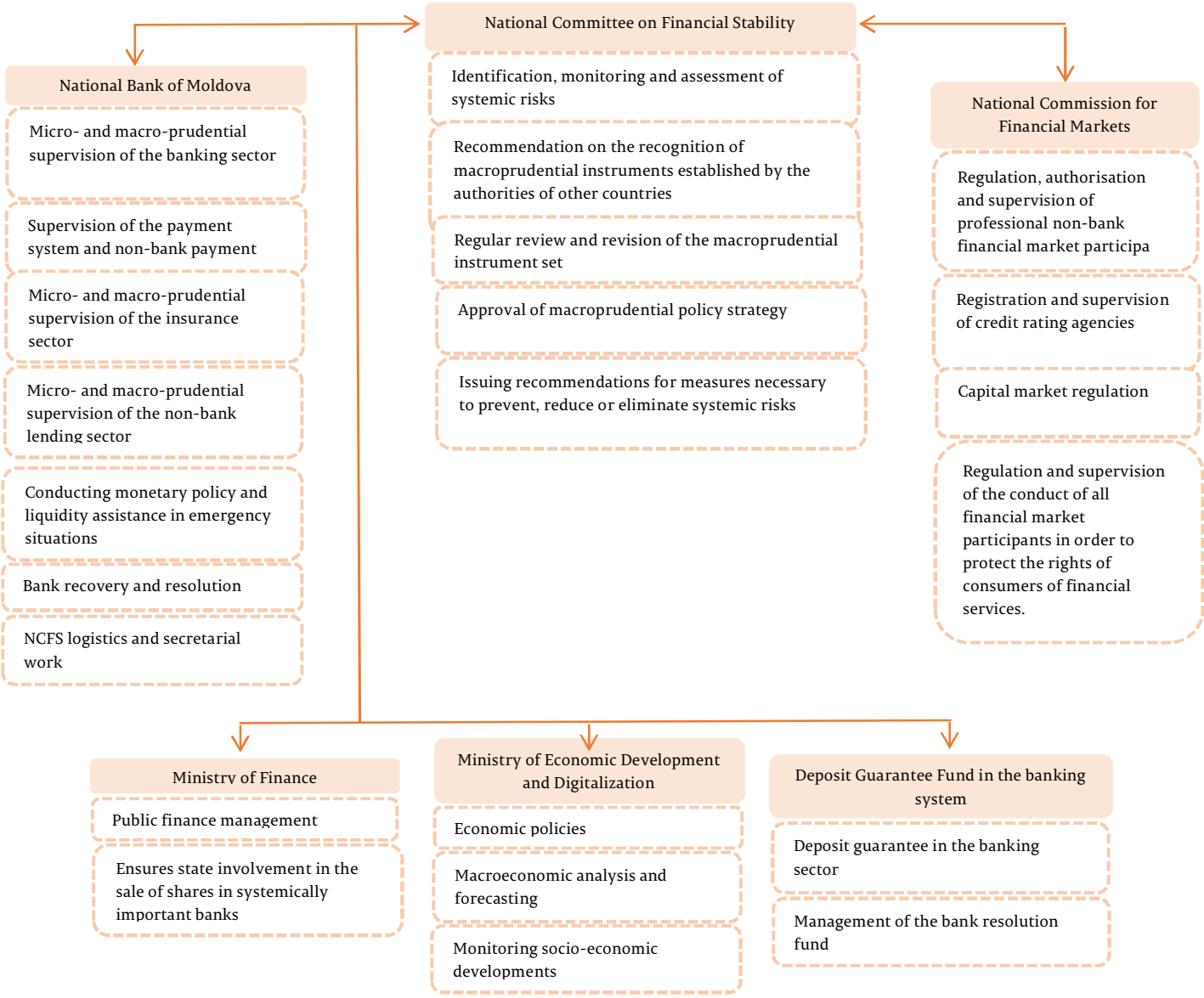
Independence of macroprudential policy and interaction with other policies, interinstitutional cooperation

Macroprudential policy is conducted by the competent authorities within the limits of the sectors supervised. At the same time, at national level there is a designated national macroprudential authority responsible for coordinating the conduct of macroprudential policy - the National Committee on Financial Stability.

The members of the National Committee on Financial Stability in its extended composition (Extended Committee), which has powers in the field of macroprudential policy, are: the Governor of the NBM; the Minister of Finance; the Minister of Economic Development and Digitalization; the President of the National Commission for Financial Markets; the Director General of the Deposit Guarantee Fund in the banking system; the member of the Executive Board of the NBM, responsible for financial stability; the member of the Executive Board of the NBM, responsible for the banking supervision function; the

member of the Executive Board of the NBM, responsible for bank resolution; the Head of the NBM Subdivision, responsible for financial stability.

Chart 2. Structure and role of the members of the National Committee on Financial Stability



Competent authorities shall have a high degree of independence from other government authorities so that they can take decisions and actions in the interest of financial stability without being influenced by political or economic interests. Its independence enables decisions to be taken that are beneficial in the long term, irrespective of political cycles or the popularity of the measures taken and can ensure financial stability accompanied by sustainable economic growth.

For macroprudential policy to be implemented effectively, it needs to be consistent and interlinked with other policies. Within the mandate of the NBM, macroprudential policy interacts with monetary policy, micro prudential supervision policy and the bank recovery and resolution regime. While each policy pursues its own objectives and responds to different factors, coordination between these policies is essential.

Macroprudential policy in relation to monetary policy. The fundamental objective of the NBM, established by Article 4 of the NBM Law, is to ensure and maintain price stability. Price stability can be defined as a situation in which price increases are sufficiently low

and stable so as not to influence the economic decisions of society. This objective is achieved through monetary policy.

Although the objectives of monetary and macroprudential policy are distinct, they complement each other. Low and stable inflation is one of the preconditions for financial stability (the objective of macroprudential policy). At the same time, price stability cannot be ensured in an unstable financial system. At the same time, a stable financial system and accessible financial services contribute to the efficiency of the monetary policy transmission channel.

However, monetary policy can in some cases have undesirable side effects on financial stability. Most of the time the business cycle and the financial cycle are not synchronised, as the financial cycle is longer in duration than the business cycle. Therefore, there may be situations where monetary policy may adversely affect intermediate macroprudential objectives. For example, low monetary policy rates can lead to excessive lending and increased indebtedness, combined with an overvaluation of assets (including real estate) which therefore poses risks to financial stability. On the other hand, in small open economies, high interest rates (necessary to counter inflationary shocks) may contribute to excessive financial risks resulting from the attraction of capital inflows, which could be withdrawn when monetary policy is loosened, thus endangering domestic financial stability.

A strong macroprudential policy framework addresses the undesirable side-effects of monetary policy and creates more room for manoeuvre for monetary policy. Macroprudential policy tools can be targeted directly to counteract the side effects of monetary policy by tightening or easing financial conditions in specific segments. Coordination between monetary and macroprudential policies is therefore necessary to find an effective policy mix, while maintaining the independence and credibility of monetary policy.

Macroprudential policy in relation to micro prudential supervisory policy. In the context of the performance of the tasks conferred by Article 5 letters d), f), m) and p) of the NBM Law, the NBM carries out the supervision of financial entities (banks, foreign exchange offices, non-bank payment providers, insurers and reinsurers, savings and loan associations and non-bank lending organisations). The macroprudential and micro prudential policies aim at strengthening the financial system by ensuring the resilience of the supervised entities. The former focuses on the stability of the financial system as a whole, while the latter focuses on the soundness of individual financial entities. Macroprudential and micro prudential policy measures are mutually reinforcing for example, systemic risks arising from excessive lending and/or mismatching of maturity of funding sources with assets are associated with the accumulation of credit and/or liquidity risk in individual entities.

However, there may be differences between the macroprudential and micro prudential perspectives. For example, in the growth period, macroprudential policy prescribes an accumulation of capital buffers, even though institutions may appear sufficiently capitalised from a micro prudential perspective. At the same time, in times of crisis, the micro prudential concern of increasing capital buffers at the individual level to protect against potential credit losses may adversely affect the creditworthiness of the economy and amplify the effects of the crisis. Therefore, macroprudential and micro prudential policies need to be coordinated, which would contribute to policy effectiveness, and shared

information, common risk analysis and effective communication can strengthen the resilience of the financial system at both individual and aggregate levels.

Macroprudential policy in relation to the recovery and resolution regime. In the context of the implementation of the tasks conferred by Article 5 letter (o) of the NBM Law, the NBM acts as resolution authority for banks in accordance with the Law on bank recovery and resolution. The macroprudential policy and the recovery and resolution regime aim to strengthen confidence in the financial system by ensuring the stability of the financial system. Macroprudential measures are complemented by recovery measures, which shall be applied to banks in the event of solvency problems, thereby limiting contagion and reputational risks in the event of a financial crisis. In addition, the resolution authority has resolution plans in place for situations where recovery measures are not sufficient. These plans allow the most appropriate decisions for the particular case to be selected relatively quickly and in an organised manner, thus limiting the impact on financial stability.

Communication

Communication is a key element of macroprudential policy. The competent authorities aim to explain macroprudential measures and make relevant information available to the general public. In this respect, the basic components of communication in the area of macroprudential policy are:

1. Macroprudential policy strategy - explains macroprudential policy, its objectives and how it is organised and implemented;
2. Report on financial stability - communicates to the general public the risk assessment for the main components of the financial system and other relevant sectors;
3. Communications related to macroprudential policy decisions - announces the implementation of macroprudential instruments, the objective pursued and the factors underlying the macroprudential policy decision;
4. Information presented at meetings of the National Committee on Financial Stability - communicates to the members of the designated national macroprudential authority on the situation and risks in the supervised sectors.

Communication is mainly carried out via the official website of the NBM. It provides information on financial stability in the Republic of Moldova, the legislative framework, and the work of the NCFS; the tasks of the NBM and the macroprudential policy instruments applied by the NBM; and regular publications such as the Financial Stability Report.

Transparency is one of the basic principles of the communication strategy. At the same time, the communication of macroprudential policy issues strikes a balance between providing the necessary information and preventing panic or undue disruption if disclosure of certain information could have knock-on effects throughout the financial system with repercussions for financial stability.