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Priorities in banking supervision of the National Bank of Moldova for 2023

Multiple shocks to which the Republic of Moldova was exposed during 2022 led to an increase in uncertainties regarding the development of the economy as well as amplified risks in the banking system.

The effective management of the immediate effects of the war in Ukraine and those caused by inflation and the COVID-19 pandemic was one of the main concerns of the National Bank of Moldova during 2022. Thus, despite the negative external factors, the indicators of the banking sector fell within the regulated limits, reflecting, in this way, the resilience of the sector due to the reforms of recent years.

The current situation requires a high degree of caution on the part of both banks and supervisors. Therefore, in order to ensure the stability of the banking sector and considering the cautious assessment of the significant geopolitical, energy, inflationary, and macroeconomic risks, the National Bank of Moldova has established priorities in terms of supervision:

- **I. Effective identification and management of credit risk and limitation of population indebtedness.**
- **II. Maintenance of an adequate level of liquid assets.**
- **III. Applicability of internal stress testing and its degree of correspondence with macroeconomic conditions.**
- **IV. Analysis, assessment, and resolution of vulnerabilities related to payment systems and payment services.**
- **V. Preventing and combating money laundering and terrorist financing.**
- **VI. Effective identification and management of risk associated with information and communication technologies.**

I. Effective identification and management of credit risk and limitation of population indebtedness.

Amid the external vulnerabilities prevailing in 2022, credit risk continues to be an area of increased interest for the supervisory process, as the quality of the loan portfolio has a direct impact on banks' capital.

Considering the unfavourable macroeconomic perspective, namely due to the significant increase in the prices of energy resources and the increase in the inflation rate, the payment ability of some debtors could be affected and generate cases of non-payment of financial obligations to creditors, resulting in a possible impairment in the quality of banks' assets. Nevertheless, the NBM and banks have a long-term policy regarding the strengthening of their own funds; therefore, the potential impact of these loans could be absorbed.

Supervisors will continue to assess banks' lending policies ex officio to ensure that they continue to be sound and in line with the applicable regulations and risk profile and that risks are identified and managed

appropriately.

During the first eleven months of 2022, the loan portfolio increased by MDL 5,482.8 million (9.7 percent) up to MDL 61,842.0 million, an increase twice as low as in the same period of 2021. At the same time, during this period, the share of foreign currency loans reached 30.2 percent, compared to 26.8 percent, as it was in November 2021.

The quality of the loan portfolio by sector registered an insignificant decline compared to the end of the previous year, due to the higher growth rate of non-performing loans compared to the growth of the loan portfolio. Therefore, the share of non-performing loans in total loans was 6.3 percent, 0.2 percentage points more as compared to the previous year.

On-site assessments will include checking the adequacy and soundness of credit classification and provisioning practices (including those granted in foreign currency) to ensure timely recognition of potential financial distress.

It is worth noting that the Regulation on Responsible Lending to Consumers by Banks was approved in 2022 in order to achieve the intermediate goal of preventing and/or limiting excessive lending and indebtedness growth. Responsible lending provides people with access to financing up to the extent of their ability to honor their obligations, limiting the situations in which people are induced to engage in aggressive lending policies and end up unable to meet their financial obligations.

Thus, during 2023, the National Bank of Moldova will ex officio supervise the dynamics of the debt-service-to-income ratio (DSTI), which is calculated as the ratio between the value of the monthly costs of servicing the debtor's total debt and their income, and the dynamics of the loan-to-value ratio (LTV), calculated as the ratio between the total value of the credit granted to the consumer and the value of the pledged real estate related to that credit. Also, within on-site controls, the assessment of the products and procedures for granting and monitoring these loans by banks will be ensured.

The correct application of the indicators will allow limiting the over-indebtedness of the population, the accumulation of non-performing loans in bank portfolios, and the unfavourable influence on the real estate market.

II. Maintenance of an adequate level of liquid assets.

During eleven months of 2022, as a result of the negative geopolitical and macroeconomic conditions and the uncertainties created, the liquidity risk increased, thus the liquidity coverage ratio (LCR) decreased by 210.2 percentage points, accounting for 209.7 percent (limit ≥ 80 percent) on November 30, 2022. The decrease in the LCR indicator was influenced by the increase in net outflows by MDL 3,580.2 million (59.1 percent), simultaneously with the decrease in the liquidity reserve by MDL 1,496.9 million (6.9 percent). It is worth mentioning that banks had sufficient liquidity to cover the decrease in the volume of deposits and ensured the continuity of their operation under normal working conditions; therefore, the banking sector remained stable and solid, the banks maintaining liquidity indicators at a high level above the regulated limits.

At the same time, considering that this indicator is relatively new for the banking sector as well as the presence of ongoing external vulnerabilities, which can damage the liquidity coverage ratio (LCR), the NBM intends to draw increased attention to the calculation method and reporting thereof to ensure data accuracy and that banks have an adequate stock of liquid assets that can be easily converted into cash in the event of

a crisis.

III. Applicability of internal stress testing and their degree of correspondence with macroeconomic conditions.

The macroeconomic risk caused by adverse conditions for the national and regional economy represented a major risk in 2022 and will persist in the following period. In this context, the National Bank of Moldova will focus its efforts on assessing the toolkit used by banks to identify the vulnerabilities and to test bank resilience. The NBM will verify the applicability of stress testing models in banks and their role in strategic decision-making. The NBM will check and examine the relevance of the models used in the crisis simulations, in relation to the national macroeconomic situation. The NBM also will investigate how stress tests are integrated into the general risk management policy for supervised entities.

Thus, it is desired to strengthen the banks' approach to stress testing exercises in order to avoid liquidity and/or solvency problems and possible negative effects on the entire economy.

The purpose of this process is to ensure the comprehensive nature of models used for risk management within banks, as well as the method of their application. It is a core element to increase the resilience of the banking system in the context of adverse conditions for the national and regional economy.

IV. Analysis, assessment and resolution of vulnerabilities related to payment systems and payment services.

The supervision of risks associated with the operation of payment systems and the provision of payment services is an essential component of the supervision process, aimed at ensuring the continuity and efficiency of the activity in the respective field, its importance being increased in the context of digitalizing payment services and the modernization of the automated interbank payment system, as well as the implementation in the near future of the instant payments scheme.

During the supervision, emphasis will be placed on the evaluation of payment services in terms of their digitization, also, increased attention will be paid to the process of analysing services and innovative payment instruments offered by payment service providers, as well as the actions taken by them in order to increase the confidence of payment service users. Therefore, the efforts of the National Bank will focus on the following aspects:

- actions undertaken in terms of digitalizing trends of payment services, in order to ensure the safe use of payment instruments;
- assessment of the aspects of transparency conditions and information of payment service users, as well as the assessment of compliance with the obligations assumed by the providers in this regard;
- analysis of unforeseen situations and unauthorized operations (fraud affecting payment service users) with the use of payment instruments, their data, and automated remote service systems (such as internet payments and mobile payments);
- examining the fees applied to payment operations that involve the use of an automated interbank payment system in order to establish compliance with the tariffs approved by the NBM;
- the operational resilience of banks, as participants of the automated interbank payment system, in case of incident situations;
- examination and resolution of petitions and complaints related to the use of payment services.

The actions of the National Bank, carried out in the framework of the risk supervision process associated with the operation of payment systems and the activity of providing payment services, aim to encourage the use of cashless payments and increase the financial mobility of consumers by strengthening their confidence in the safety of using payment instruments, as well as ensuring the transparency of fees in order to promote initiative and competition, including starting from the trends of digitalization of products and services in the field of payments and ensuring the stable and efficient operation of the automated interbank payment system. The measures taken will strengthen the payment system in the Republic of Moldova, ensuring the efficient management of operational and liquidity risks and assisting the implementation of new payment instruments.

V. Preventing and combating money laundering and terrorist financing.

In 2023, the National Bank of Moldova will continue to use the risk-based approach in the supervision of reporting entities that fall under its responsibility. The risk-based approach is a key element in the effective implementation of international legislation and recommendations in terms of preventing and combating money laundering and terrorist financing. The risk-based approach seeks to develop and implement measures to combat and prevent money laundering and terrorist financing that are proportionate to the existing risk in an entity's activity.

It should be noted that the area of supervision under the NBM in terms of preventing and combating money laundering and terrorist financing is becoming more and more complex, considering the inclusion of regulatory and supervisory requirements of service providers regarding virtual currencies, both at the level of international and national standards, following the proposed legislative amendments.

Therefore, the development of the legal framework related to this field will be pursued, as well as continuous training in order to gather new knowledge and improve the professional abilities of NBM employees trained in the supervision process.

With reference to the implementation of financial sanctions related to terrorist activities and the proliferation of weapons of mass destruction, the NBM will give priority to the monitoring of the application of these requirements by the reporting entities, as well as the assessment of the adequacy and effectiveness of their internal controls, in order to ensure compliance with these measures and identify the need to adjust or improve their systems and processes, as appropriate. These actions will also be carried out in the context of the MONEYVAL experts' recommendations.

The following activities are also of major importance: finalizing the implementation of the IT solution regarding the monitoring of shareholder transparency and remote analysis in the field of preventing and combating money laundering and terrorist financing; the approval of an instruction project related to the implementation of the procedure for identifying customers by electronic means (the eKYC solution), as part of the process of applying precautionary measures by banks to their customers; the development of inter-institutional cooperation to ensure the rapid and efficient exchange of data and information.

VI. Effective identification and management of risk associated with information and communication technologies.

As the use of information and communication technologies (ICT) and digitization increased further with the pandemic, and the crisis accelerates the technological transformation of banks, cyber risk and other external threats related to ICT have become increasingly relevant.

Taking into consideration this and the eventual threats in the cyber field, in 2023, the National Bank of Moldova will assess the situation in the ICT field and analyse whether the control measures implemented are adequate and proportional to the nature of the cyber risks to which they are exposed and are in accordance with the requirements established in the Regulation on the minimum requirements for the Banks' Information and Communication Systems, and will place special emphasis on: information security governance, monitoring the bank's systems/services, i.e. checking the use of operating systems that do not have support from suppliers at server level, databases, ATMs, the management of outsourced services, the management of vulnerabilities (assessing existing processes within the entity regarding the identification and removal of vulnerabilities) and the controls applied to counter cyber-attacks.

At the same time, the NBM will ensure that banks effectively test their business continuity plans and prove the ability to support the bank's resilience for all its critical operations.

Additionally, the NBM plans to approve a new version of the aforementioned Regulation to reflect the most important risks and vulnerabilities for the financial-banking system through the control measures proposed for compliance.

Also, based on a complex set of controls and assessments, off-site supervision in the ICT field will be carried out, which will allow the identification and assessment of the most important ICT risks to which the licensed banks are exposed.

Following the assessments carried out, the NBM expects banks to strengthen their resilience capabilities and those to ensure protection against cyber threats and attacks.

***Note**: The document will be updated once the National Bank of Moldova takes over from the National Commission for Financial Markets some attributions in the fields of the insurance market, the non-bank lending market, and the activity of the credit bureaus, starting in July 2023.*

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