

Banking Sector Monitoring Moldova

German Economic Team Moldova
in cooperation with



Ricardo Giucci, Dumitru Pintea, Woldemar Walter

Berlin/Chişinău, August 2017

Summary

Stability issues

- The banking fraud in Nov2014 deeply affected the sector
- However, confidence is returning, as shown by most sector indicators
- Lei deposits increased from MDL 23 bn in Oct2015 to MDL 32 bn in Jul 2017
- System-wide CAR increased from under 13% in Jan2015 to currently almost 30%
- Non-performing loans increased, but this was mainly due to tougher standards
- NBM took a tough stance towards ownership transparency: 43% of shares at MAIB (largest bank) and almost 64% at MICB (second largest) were blocked

Crediting

- At the same time, lending to the private sector remains weak and amounts to less than 48% of bank assets
- Lower interest rates at currently 10% might contribute to higher lending
- However, structural issues (loan recovery, competition) need to be tackled
- Finding new investors for the blocked shares would be of crucial importance

Structure

Key indicators

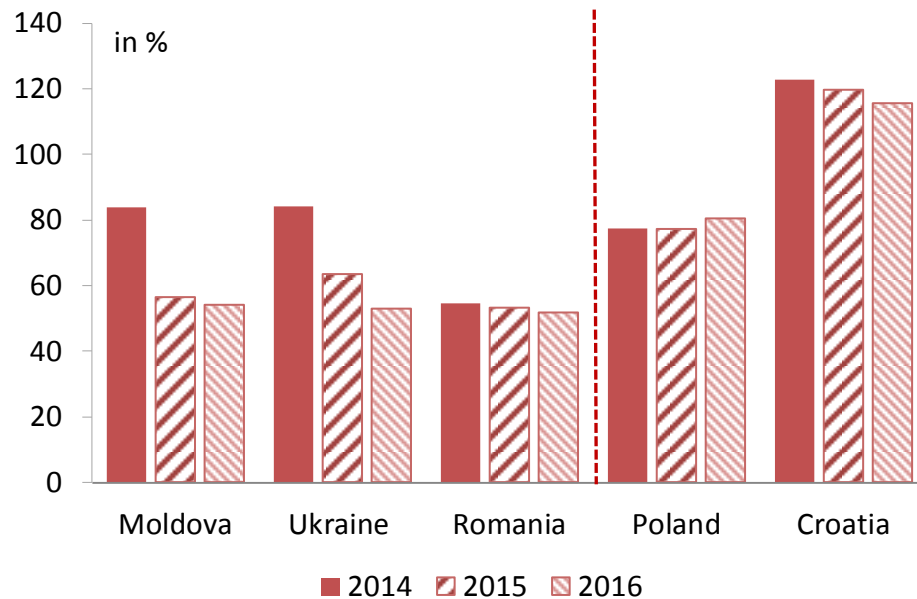
1. Banks assets in a regional context
 2. Number of banks
 3. Market shares and concentration
 4. Lending to the real sector
 5. Loan growth
 6. Interest rates
 7. Non-performing loans (NPLs)
 8. Deposits
 9. Capital
 10. External debt
 11. Bank profits
-

Special issues

12. Excess liquidity in the banking sector
13. Transparency regarding ultimate beneficial owners
14. Lending by non-banking financial institutions
15. IMF-programme priorities for the banking sector
16. EU-priorities for the banking sector

1. Bank assets in a regional context

Bank assets to GDP



Source: Central banks of different countries, eop

Moldova

- Bank assets to GDP declined from 84% in 2014 to 54% in 2016
- At the first look: Major shrinking of banking sector
- But: Decline also mirrors removal of “inflated” assets of 3 banks, which became insolvent during 2015
- Similar process as in Ukraine

→ Caution needed with interpretation

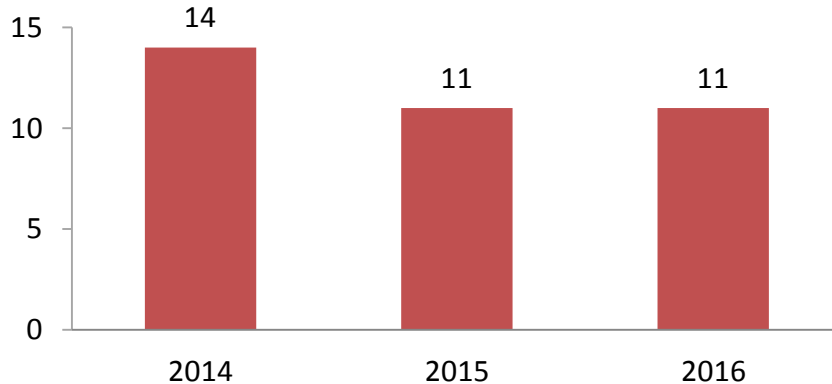
Regional comparison

- Much smaller than Poland (80%) and Croatia (115%)
- But: Similar size as in UKR and ROM

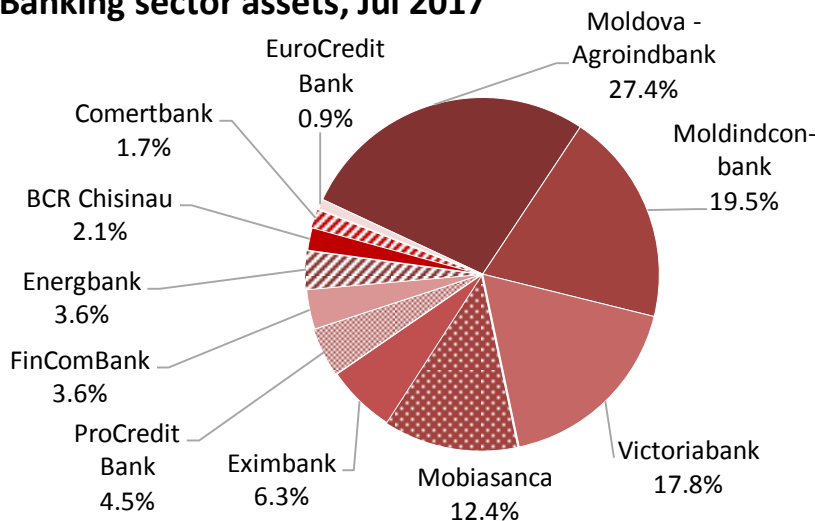
→ **Size is not a major issue in Moldova**

2. Number of banks and market shares

Number of banks



Banking sector assets, Jul 2017



Source: NBM

2015: Insolvency of 3 banks; 11 banks left

Situation 2015 regarding remaining 11 banks

- Low transparency concerning ultimate beneficial owners (“UBO”) in many banks, incl. 3 largest banks

Pre-emptive measures by NBM 2015/2016

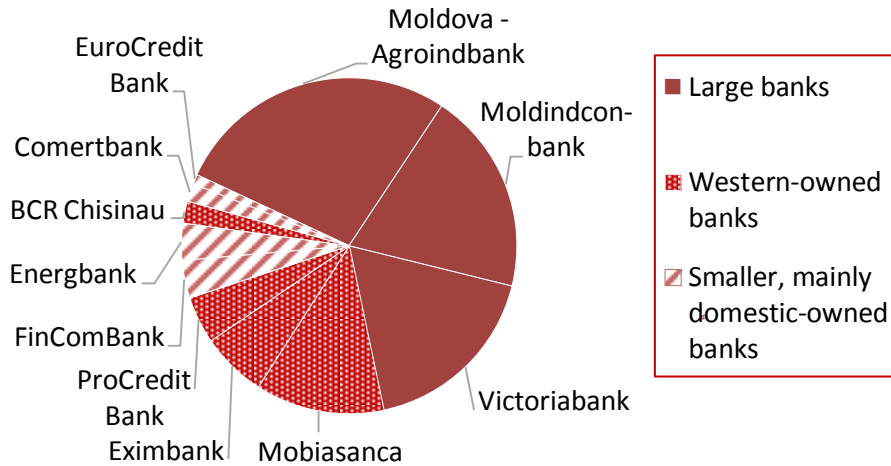
- Jun2015: Intensive supervision for 3 largest banks; diagnostic studies prescribed
- NBM blocked 3.5% (Dec2015) and further 40% (Mar2016) of MAIB shares; later on cancellation & new issuance of shares
- Oct2016: 63.9% of shares blocked and early intervention at MICB

→ **Crucial measures from NBM**

Main reason: transparency, not solvency

3. Bank segments and concentration

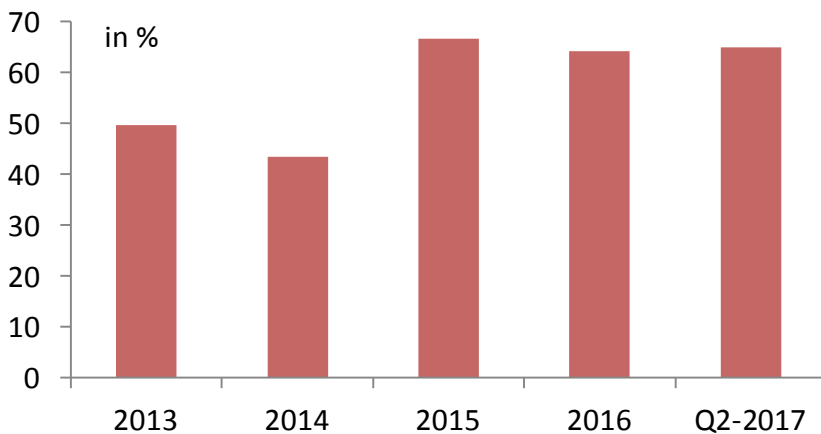
Bank segments and market shares, Jul 2017



3 bank segments

- Big banks: Market share of 65%
- Western-owned banks with ca 25% not dominant, but increasing share
- From 24.4% in Dec 2015 to 25.4% in Jul 2017
- Smaller, mainly domestic-owned banks less than 10% of market

Share of top 3 banks



Source: NBM, own calculations based on total assets

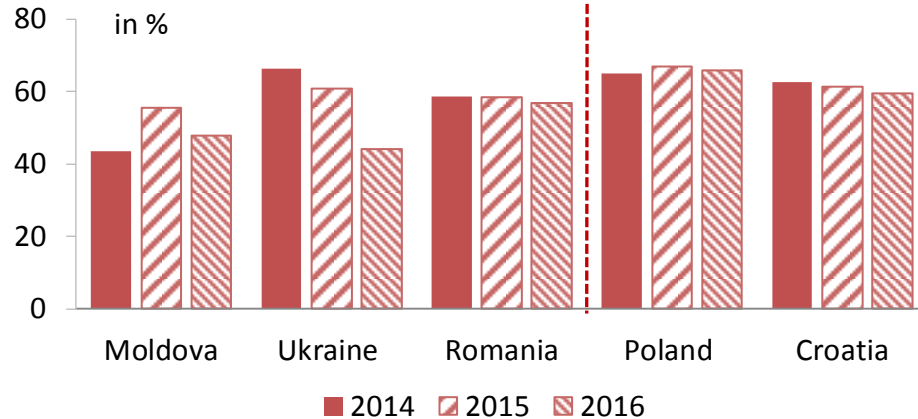
Concentration

- Top 3 banks have a 65% market share
- More important: Top 3 banks = 3 banks featuring transparency issue

→ Main issue is not concentration, but transparency; finding strategic investors for big banks is crucial

4. Lending to the real sector

Ratio of credit to private sector to bank assets



Credit to assets ratio

- MDA 2016: Lending to real economy less than 48% of banks assets
- Low value compared to Romania (57%), Poland (66%) and Croatia (59%)
- Similar picture as for credits to GDP

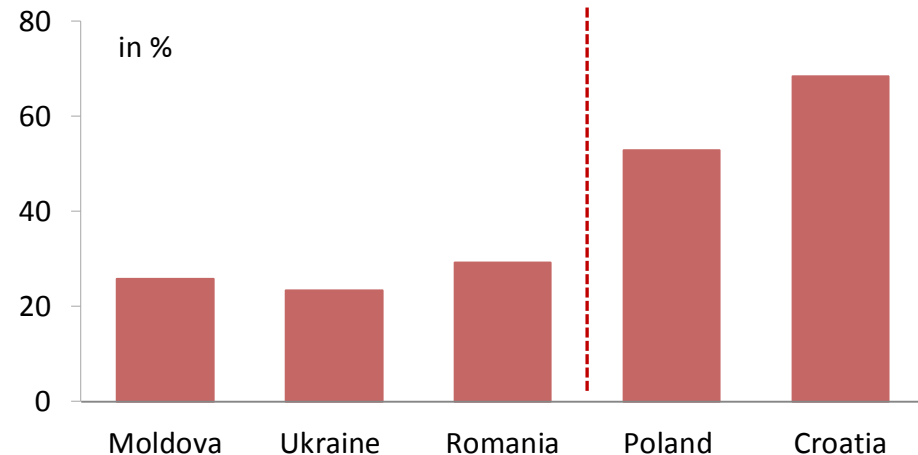
To some extent: Low ratio because of excess liquidity, which inflates assets

However: Low lending also due to

- Weak demand/lack of good projects
- High interest rates until recently
- High interests for government bonds and NBM certificates (“crowding out”)
- Structural issues (loan recovery, etc.)

→ **Low lending to real sector is an issue**

Credit to private sector to GDP

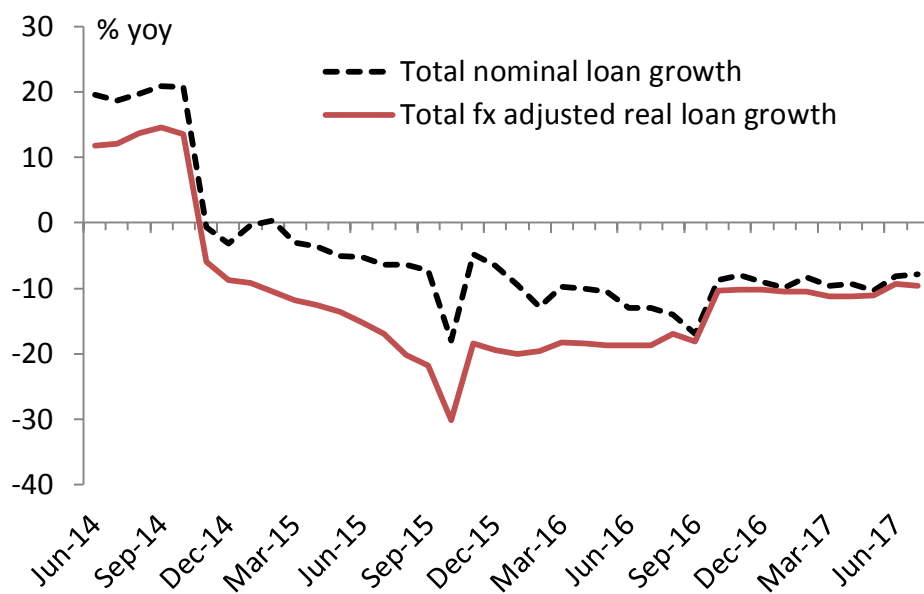


Source: National Banks of different countries

5. Loan growth

Outstanding loans

Loan growth



Source: NBM

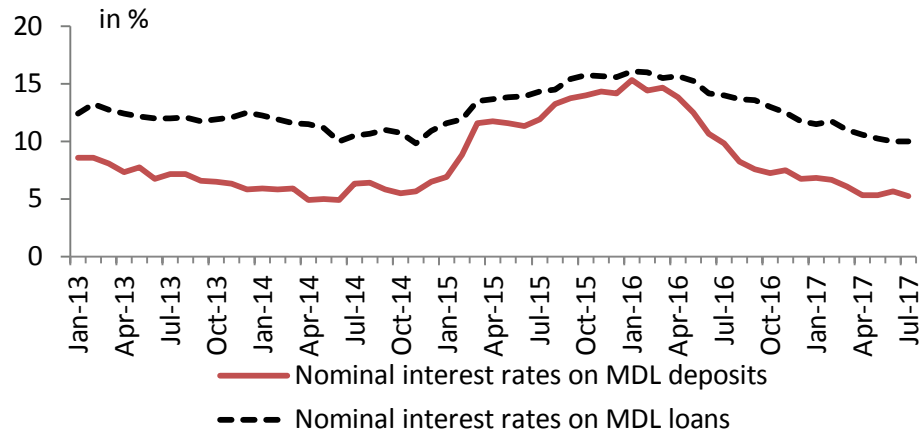
- 2015: Sharp decline of outstanding loans in the aftermath of the banking fraud in late 2014
- 2016/2017: Further reduction of outstanding loans, though at a slower pace

→ Outstanding loans continue to fall

→ Bottom has not been reached yet

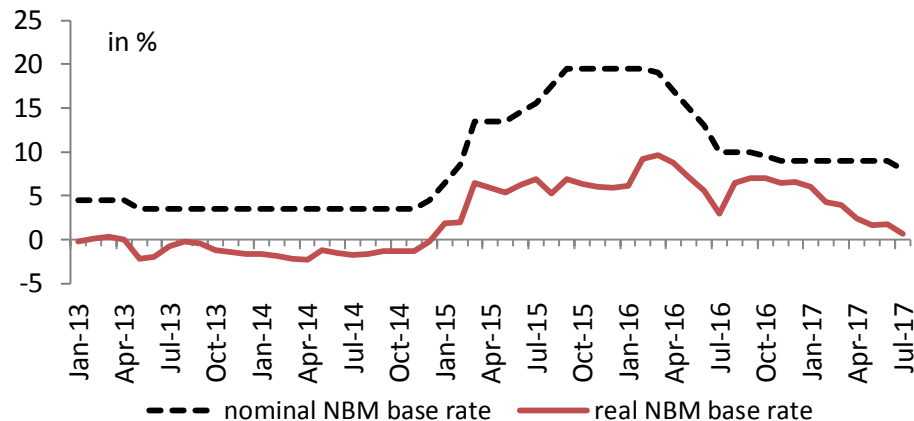
6. Interest rates

Interest rates on loans and deposits



Source: NBM, data for corporates and households

NBM base rate



Source: NBM, own calculations based on NBM data

Cost of borrowing

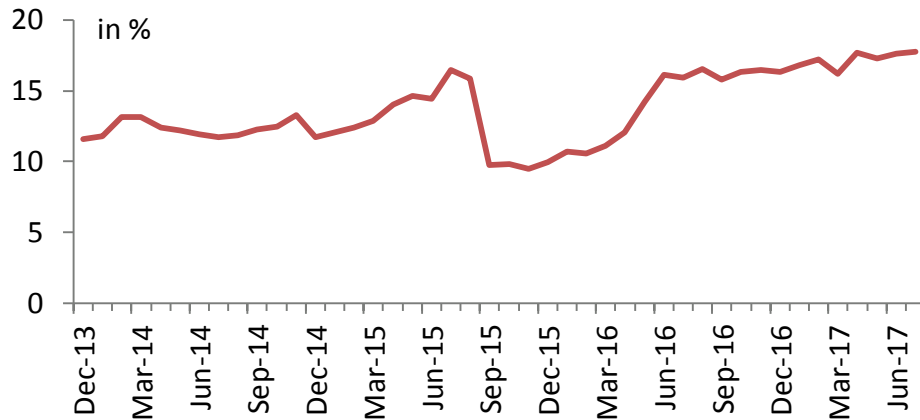
- Strong increase of interest rates for loans since late 2014
- Oct 2014: 9.8%; Jan 2016: 16.1%
- Reasons: Restrictive monetary policy and higher inflation
- Since Q2-2016: Decline of rates to currently 10.0% (Jul 2017)

→ **Lower cost of borrowing will most likely contribute to higher lending**

However: Additional, non-interest cost of borrowing remains an issue

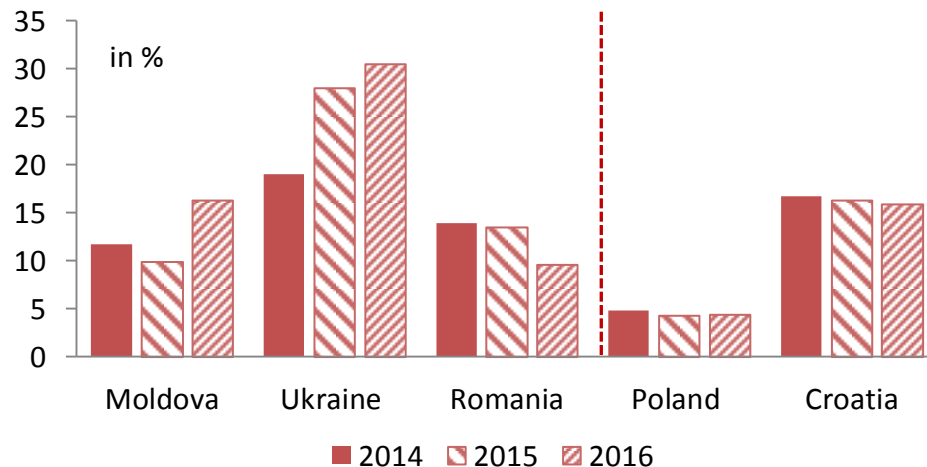
7. Non-performing loans (NPLs)

NPLs as a share of assets subject to credit risk



Source: NBM

NPL in regional comparison



Source: IMF Financial Soundness Indicators, NBM

Sep2015

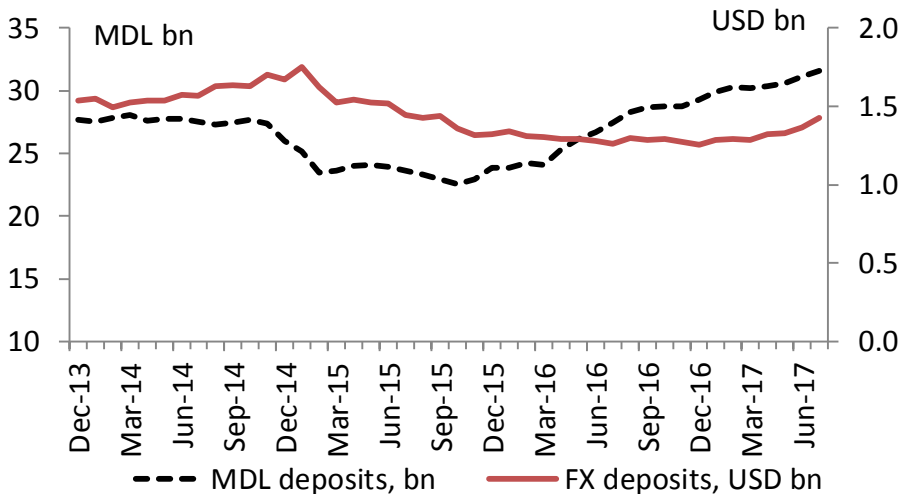
- Strong decline of NPL-ratio due to liquidation of 3 banks

2016/2017

- Increase of ratio to more than 16%
- Reason: Tougher standards for calculation and reporting of NPLs
- Thus: No worsening of situation, but tougher regulation/supervision
- Regional comparison: Smaller than Ukraine, but higher than Romania
- **Higher standards necessary for cleaning up the sector**
- **Next step:** Implementation of NPL reducing strategies by banks

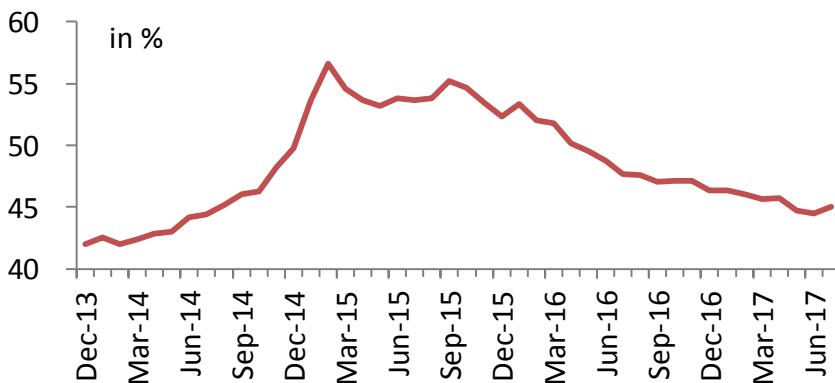
8. Deposits

Bank deposits



Source: NBM, own calculations, excl. deposits from other banks

Deposit dollarisation ratio



Source: NBM, own calculations, excl. deposits from other banks

Deposits

- No bank runs in late 2014/early 2015
- But: Shift from MLD to USD/EUR deposits
- However: MDL deposits started to recover in Q4-2015
- From MDL 22.6 bn in Oct 2015 to MDL 31.6 bn in Jul 2017

→ Confidence in MDL is returning

Deposit dollarisation (incl. EUR)

- Huge increase in late 2014/early 2015, followed by slow reduction afterwards
- From 46% to 57%, and back to 45%

→ More confidence in national currency

9. Capital

Capital adequacy ratio (CAR)

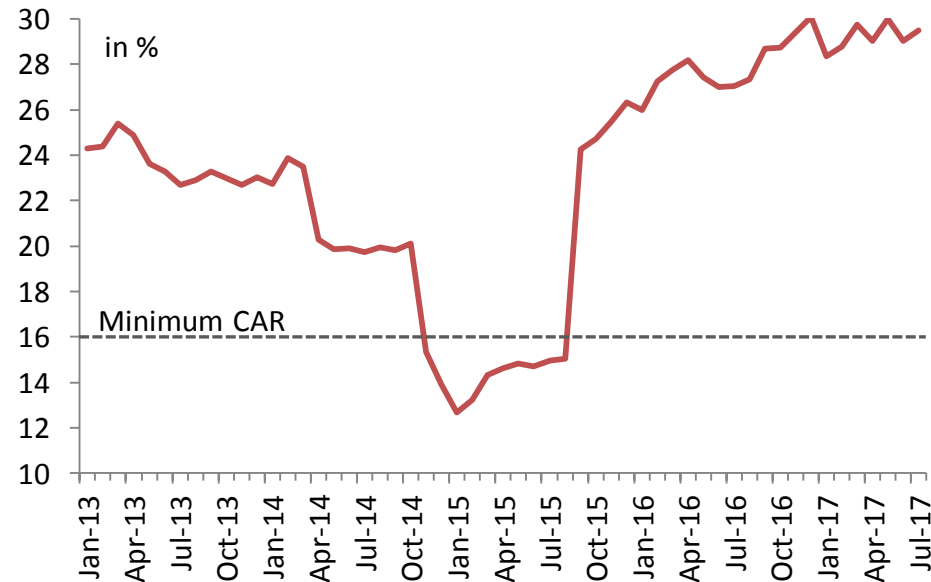
- Minimum CAR for banks: 16%
- Traditionally high CARs in Moldova
- However, system-wide CAR declined heavily in late 2014
- Jan 2015: System-wide CAR at 12.7%, i.e. below the minimum requirement
- Sept 2015: Huge increase in system-wide CAR, following the removal of 3 banks from NBM reporting

→ **As of today, no system-wide problem regarding capital**

2018: Shift from Basel I to Basel III

Open question: Impact on CAR?

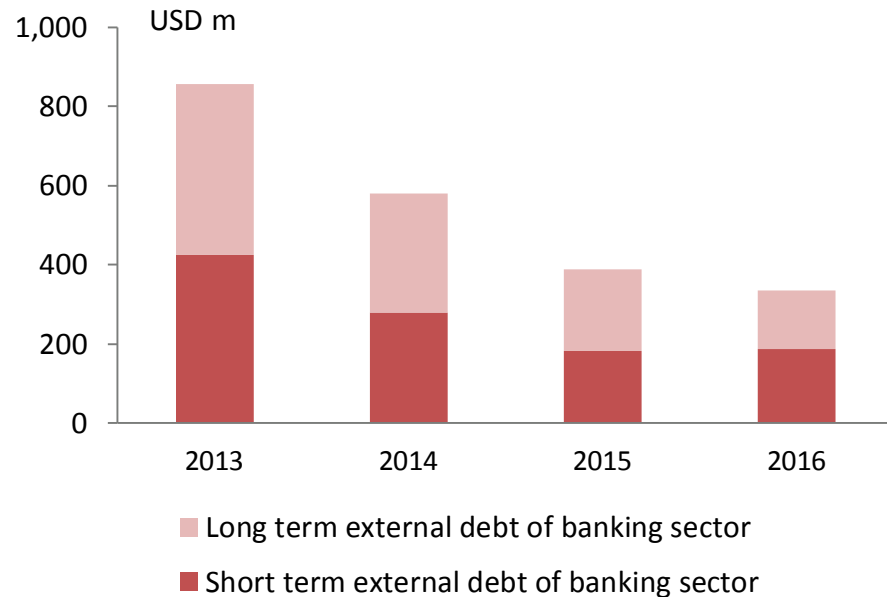
Capital adequacy ratio



Source: NBM

10. External debt

External debt of banking sector



Source: NBM, end of period

Observation: Strong decline since 2013

Major reason

- External debt of 3 insolvent banks vis-a-vis Russian banks gone
- However: This was no proper debt, but part of opaque transactions

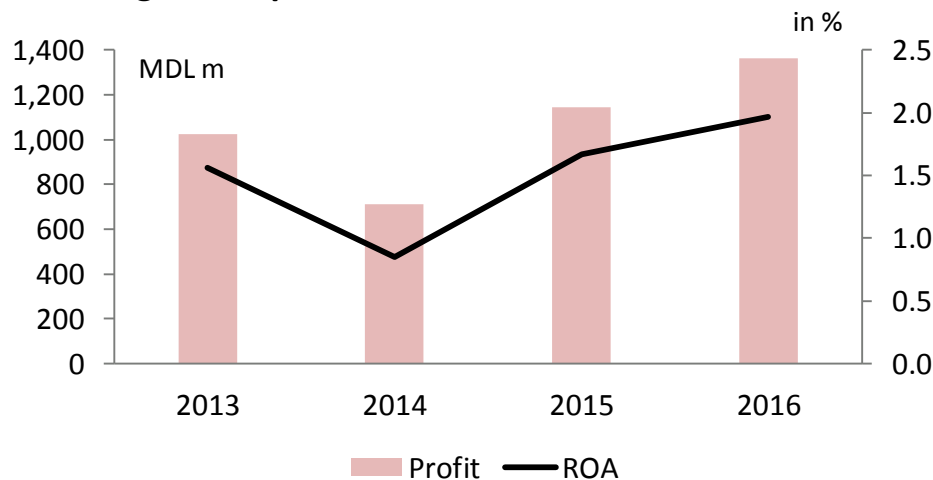
Economic reasons

- Excess liquidity in MLD, thus no significant need for external debt
- Stop of lending by IFI's to commercial banks in the aftermath of the banking crisis in 2014

→ **External debt rather limited;
no major source of risk**

11. Bank profits

Banking sector profits



Source: NBM, end of year

Significant bank profits due to

- High interest rates for government bonds and NBM certificates
- Profits from FX operations

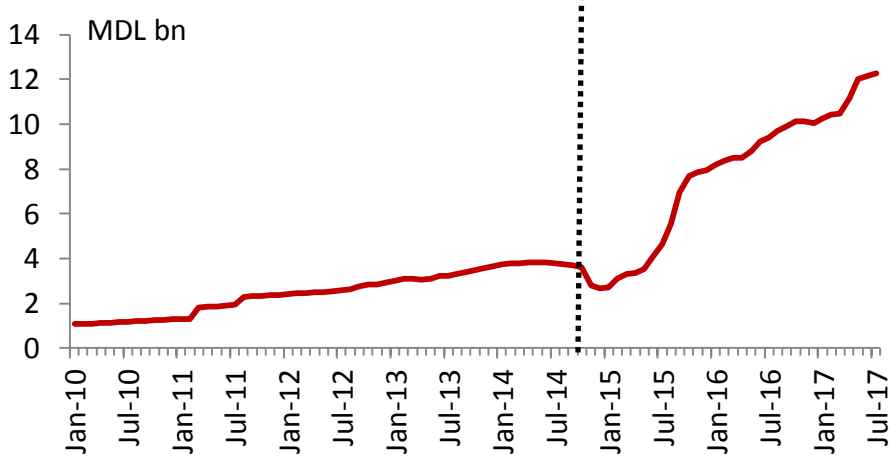
→ **Quite profitable situation for banks, despite problems in the sector**

But: Profits in 2014/2015?

- 3 banks became insolvent, i.e. by definition they lost a lot of money
- How can total profits be positive?
- Explanation: Realisation of losses during 2015, but in 2015 insolvent banks removed from statistics
- **Thus:** Yearly data does not show losses by insolvent banks

12. Excess liquidity in the banking sector

MDL required reserves



Source: NBM

Estimated cost of absorption (as of March 2017)

Instrument	Absorption, MDL m	Interest rate, %	Costs* per year, MDL m
Required reserves	12,300	5.0	640
NBM certificates	6,080	9.0	486
Total	18,380		1,126

Source: NBM; *own estimation

- Currently: Excess liquidity due to emergency loans of NBM in 2014/2015
 - Thus: NBM has to absorb liquidity
 - Required reserves ratio at 40%
 - Vast emission of own certificates
 - Cost of absorption > MDL 1 bn per year
- **Negative impact on NBM financial results; challenge to its independency**

Our recommendations

- Lower interest rates on required reserves and on certificates
- NBM to sell historic bonds (MDL 2.3 bn)
- NBM-certificates should be auctioned and only used for fine-tuning
- If necessary, Ministry of Finance should support NBM in absorbing liquidity

13. Transparency regarding ultimate beneficial owners (“UBOs”)

Starting point: No full transparency regarding UBOs, especially at 3 biggest banks

Measures by NBM

- Investigation on implausible owners
- Results: Owners shown not be the UBO, proof of action in concert
- NBM: Owners were given some time to sell their shares
- If no selling: Shares blocked and annulled; new shares issued and put for sale

Moldindconbank (“MICB”): 63.9% of shares blocked

Moldovan Agroindbank (“MAIB”): 43.1% of shares blocked, annulled and for sale

Victoriabank: Russian citizen holding 39.2% of shares has to provide documents to NBM; work in process

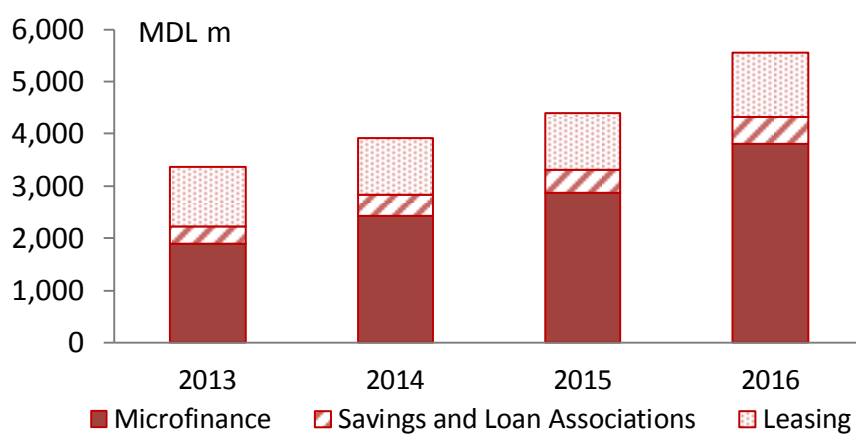
All in all: NBM is making good progress in increasing ownership transparency

Goal: Knowledge of all UBOs by end of 2017

→ Very positive, but finding new strategic investors key for long-term improvement

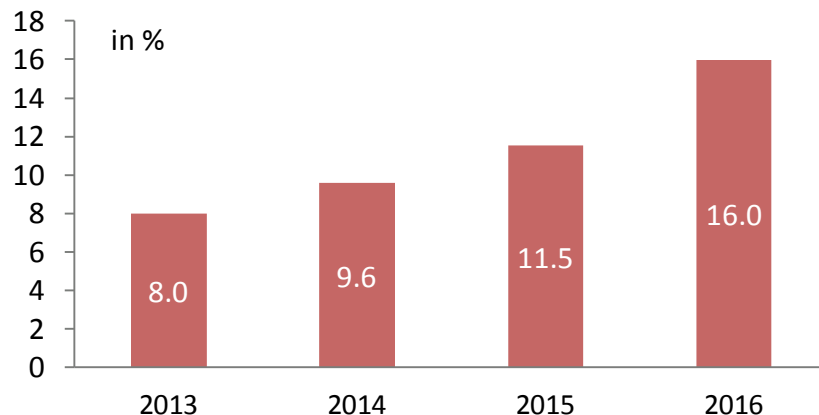
14. Non-banking financial institutions (NBFI)

Lending by NBFI



Source: NCFM, NBS

NBFI loans as % of bank loans



Source: NCFM, NBS, NBM

Lending by NBFI

- In contrast to the banking sector, NBFI are significantly increasing lending
- Share in bank loans amounts to 16%, compared to 8% in 2013

Problem: No regulation and effective supervision of these institutions

Topics for discussion

- Is a supervision arbitrage („shadow banking“) taking place?
- Is this a risky trend?
- Tougher regulation/supervision needed?
- Is the current draft law on NBFI the right answer?

15. IMF-programme priorities for the banking sector

Strengthen governance and financial conditions of banks

- Till end 2017: Final identification of UBOs for qualified shareholders in all banks, including the 3 largest ones
- Supervisory actions if UBOs are not identified
- Fit- and-proper certification of bank managers and investors
- Banks remain under NBM supervision until certain criteria met
- Thematic review of related party exposure in 3 largest banks

Enhance the regulatory and supervisory frameworks

- Continue implementing a strategy regarding deficiencies identified in Basel Core Principals assessment in 2014
- Amend the legal framework to remove shareholders who act in concert without supervisory approval
- Amend regulations for adequate treatment of cancelled shareholders in resolution

Other

- Align laws with Law on Central Security Depository (CSD) to transfer information from the 11 private registrars to the CSD
- Strategy to recover some of the 2014 bank fraud stolen assets

16. EU-priorities for the banking sector: Short-term

Two main documents

- EU-Moldova Association Agenda
- EU Macro-Financial Assistance to Moldova (EUR 100 m)

Short-term priorities in the EU-Moldova Association Agenda

- Ensure that the cases of frauds in the banking sector in 2014 are made subject to a thorough, transparent and impartial investigation, with a view to recovering the diverted funds and to bringing the responsible persons to justice
- Further improve the legal framework by providing the necessary instruments and measures (e.g. increasing the responsibility of shareholders, imposing tougher sanctions) in order to address the factors which lead to the banking fraud in 2014 and to prevent similar fraudulent transactions at all levels
- Progressively develop and adopt a deposit insurance framework
- Adopt the law on non-bank credit organisations developed by the National Commission of Financial Markets (NCFM)

16. EU-priorities for the banking sector: Medium-term

Medium-term priorities in the EU-Moldova Association Agenda

- Create a new regulatory and supervisory framework conform with internationally agreed standards (Basel III)
- Put in place a comprehensive framework for improving corporate governance and risk management
- Develop a macro-prudential supervision framework
- Build up capacity to implement the new legislation; improve the administrative capacity of supervisory authorities in accordance with internationally agreed standards
- Develop national legislation on preventing and combating money laundering and the financing terrorism

Pre-condition in the context of the EU Macro-Financial Assistance

- Reinforce the governance and supervision of the financial and banking sector

Annex: Bank sector statistics

Balance sheet data	2013	2014	2015	2016
<u>Total assets, MDL m</u>	76 190.12	93 877.27	68 790.20	72 830.42
growth in % yoy	30.98	23.21	-26.72	5.87
in % of GDP	75.80	83.78	56.45	54.16
<u>Total loans, MDL m</u>	42 177.28	40 841.98	38 187.61	34 761.27
growth in % yoy	20.57	-3.17	-6.50	-8.97
in % of GDP	41.96	36.45	31.34	25.85
<u>Loans to private enterprises, MDL m</u>	37 291.99	34 922.89	32 169.05	28 346.92
growth in % yoy	28.50	-6.35	-7.89	-11.88
in % of GDP	37.10	31.17	26.40	21.08
<u>Loans to households, MDL m</u>	4 885.29	5 919.08	6 018.56	6 414.35
growth in % yoy	-18.06	21.16	1.68	6.58
in % of GDP	4.86	5.28	4.94	4.77
<u>Loans in foreign currency, MDL m</u>	17 343.15	16 269.02	16 087.70	15 397.40
growth in % yoy	15.92	-6.19	-1.11	-4.29
in % of GDP	17.26	14.52	13.20	11.45
<u>Loans in foreign currency (% of total loans)</u>	41.12	39.83	42.13	44.29

Source: NBM

Annex: Bank sector statistics

	2013	2014	2015	2016
<u>Total deposits, MDL m</u>	51 889.94	65 462.51	50 201.51	54 838.54
growth in % yoy	43.06	26.16	-23.31	9.24
in % of GDP	51.63	58.42	41.20	40.78
<u>Deposits from households, MDL m</u>	31 349.27	34 590.69	35 017.50	37 669.10
growth in % yoy	24.12	10.34	1.23	7.57
in % of GDP	31.19	30.87	28.74	28.01
<u>Total loans (% of total deposits)</u>	81.28	62.39	76.07	63.39
Structural information				
Number of banks	14	14	11	11
Market share of state-owned banks (% of total assets)	11.20	14.84	0	0
Profitability and efficiency				
Return on Assets (RoA)	1.56	0.85	1.67	1.97
Return on Equity (RoE)	9.42	5.86	10.16	11.95
Capital adequacy (% of risk weighted assets)	23.02	13.92	26.31	30.08
Non-performing loans (% of total loans, eop)	11.56	11.73	9.95	16.31

Source: NBM

Contact

Dr Ricardo Giucci

giucci@berlin-economics.com

German Economic Team Moldova

c/o BE Berlin Economics GmbH

Schillerstr. 59, D-10627 Berlin

Tel: +49 30 / 20 61 34 64 0

www.get-moldova.de

Twitter: @BerlinEconomics

Facebook: @BE.Berlin.Economics

