

BANKING SYSTEM OF MOLDOVA

STRUCTURE OF THE BANKING SYSTEM

The banking system of Moldova represents **21** commercial banks, as of September 1999. The bank Association of Moldova has **19** banks-members.

There are no legal restrictions to the entry of foreign banks, the granting of the license can be protracted process. Foreign participation in Moldova bank is limited to two offices of Romanian banks, one office of a Greek bank and few minority participation of financial investors.

Banks are tiered according to their minimum share capital into three license classes: **C** - MLD 32mm (\$2.9mm); **B** - MLD 24mm (\$2.2mm); **A** - MLD 12mm (\$1.1mm). Banks with a C or B license could conduct international operations.

Capital markets activities are only permitted with C banking authorization.

The Moldova banking system is fragmented and the gap between the market shares of the four ex-state banks and those of the private banks has been narrowing. Banks have low capital levels and modest retail deposit bases, which constrains their business development and puts pressure on liquidity. Only one bank has over \$10 mm in capital. A process of consolidation of the sector has begun. This is affecting only the smaller banks and takes the form of controlled liquidation by the NBM.

REGULATION:

Moldova has a sound framework of prudential regulations, which is one the most advanced in the CIS. However, the system lacks a deposit insurance scheme, which could make the system mere vulnerable to runs on the banks.

Banks are regulated and supervised by the NBM. The regulatory system was developed with technical assistance from the IMF and USAID. Its main norms are in line with, or – concerning capital adequacy and loan provisions – even stricter than Basle prudential norms. Some of the most striking requirements are financial reporting according to IAS, in force since January 1998; capital adequacy ratios prudently set above the Basle minimum – the capital adequacy of banks is to increase progressively up to 12% until year 2000; and, loan loss provisioning on a gross loan basic, i.c. Without taking into consideration loan collateral. The later is stricter than IAS norms, taking into account the difficulties of valuing and realizing collateral in an emerging market. In common with many other countries in the region, banking supervision needs strengthening. The supervision department is under – resourced and has high turnover of staff as its employees are attracted by higher private sector salaries.

BANKING SERVICES:

Banking opportunities is scare, which prompts most banks to avoid specialization. Corporate banking is the main source of revenues, whereas retail banking plays primarily a funding role. The involvement of banks in financial service such as capital markets, leasing, factoring, or insurance is low. Weak IT system act as a constraint for developing the range and improving the quality of services available. The top tire private banks have been able to gain some advantage over the ex – state banks in this area.

Corporate banking activities dominated by durational working capital finance and trade related services. As a majority of Moldova's exports are directed to Russia, the main correspondent relationships are with domestic Russia foreign banks domiciled in Russia. Longer – term investment credit is available only, from a few Moldovan banks and in hard currency. The funding is provided under lines of credit from multilateral financial institution.

The retail culture in Moldova is only beginning to develop. The economy cash based, with few of the population using the banking system for day-to-day payments or credit. Term deposit are the typical retail product. The reserve of the population towards the banking system is explained by its low disposable income levels and memory of lost Sberbank savings upon the collapse of the USSR. Consumer and housing loans are on offer, but the low wealth of the population constrains demand. Domestic and international plastic cards are available, but only a few thousands have been issued. The first cash dispensers were introduced in 1998. Two banks plan to introduce payroll amid in 1999.

The main risk to asset quality is the high concentration of agriculture-related exposures in most banks' portfolios. There is also the risk that, if the currency of Moldova depreciates suddenly, the repayment record on hard currency loans will deteriorate. Encouraged by the stability of the local currency over the

last two years, companies have taken hard currency loans. These loans are not always directed for export oriented projects and thus are not naturally hedged against currency fluctuations.

As in other CIS countries, connected lending, and, to a lesser extent, state interference is present. Most private banks belong to groups of commercial companies and as such could be subject to pressures from their corporate shareholders to grant preferential credits. Although the state has disposed of its majority stakes in banks, there is some indication that it countries to interfere in the banking system. Two of the ex state-owned banks are still preferred vehicles for directed credits, although backed by a state guarantee, to the agricultural and defense sector.

LIQUIDITY:

Liquidity is a vulnerable point for Moldovan banks. Retail deposits are low and volatile. We estimate retail deposits funded only 20% of total bank assets as of mid 1998. Due to a shortage of liquid instruments to manage their liquidity, banks invest in short maturity T-Bills and habitually resort to repo refinancing with NBM. Following the collapse of the secondary T-Bills market after the Russian crisis, the NBM introduced paper with two or three day's maturity to increase the liquidity of the system.

FINANCIAL ACTIVITIES OF COMMERCIAL BANKS WITH DIFFERENT TYPES OF LICENSES

According to the Law of the Republic of Moldova "On Financial Institutions" the financial activities of a bank shall be as follows:

- Receiving deposits (in the form of demand or time deposits etc.) bearing interest or not;
- Extending credit (consumer and mortgage credit, factoring, with or without recourse, financing of commercial transactions etc.)
- Borrowing funds, buying and selling for their own account or for account of customers (excluding underwriting) of:
 - money market instruments (checks, bills of exchange and certificate of deposit etc.
 - futures and options relating to debt securities or interest rates;
 - exchange and interest rate instruments;
 - debt securities
- providing payment and collection services;
- issuing and administering means of payment (payment cards, travelers' checks and bankers' drafts etc.);
- money (including foreign currency) buying and selling;
- financial leasing;
- providing credit reference services
- providing services as a financial agent or consultant not including services described in subparagraphs 3 (a) and (b);
- operations (dealing) in foreign currencies, in contracts for the future sale of foreign currencies;
- providing trust services (investment and administration of funds received in trust), safekeeping and administration of securities and other valuables etc.;
- providing services as an investment portfolio manager or investment adviser;
- underwriting and distribution of debt and equity securities and dealing in equity securities;
- such other financial activities as approved by the National Bank.