

**DEVELOPMENT OF PRUDENTIAL SUPERVISION – STRATEGIC OBJECTIVE  
FOR NATIONAL BANK OF MOLDOVA**

*Marin URSU<sup>1</sup>, PhD Student,  
Academy of Economic Studies of Moldova*

*Currently, NBM does not have a well defined role in maintaining financial stability, but it has responsibilities in this area through regulation and prudential supervision of the banking sector. With this publication we aim to analyze the legal and regulatory framework governing financial stability and banking supervision in Moldova and offer solutions to improve them. In the context of current issues related to the critical situation in the banking sector, including the loss of credibility among the population and the development partners of Moldova, the development of oversight function should be an objective of strategic importance for the NBM*

**Key words:** bank, National Bank of Moldova, efficiency, financial stability, bank supervision.

*În prezent, BNM nu are un rol bine definit în menținerea stabilității financiare, dar aceasta are responsabilități în acest domeniu prin reglementarea și supravegherea prudentă a sectorului bancar. Odată cu publicarea acestui articol ne propunem să analizăm cadrul legal și de reglementare care guvernează stabilitatea financiară și supravegherea bancară în Republica Moldova și de a oferi soluții pentru a le ameliora. În contextul problemelor actuale cu privire la situația critică din sectorul bancar, inclusiv pierderea încrederii în rândul populației și partenerilor de dezvoltare ai Republicii Moldova, dezvoltarea funcției de supraveghere ar trebui să fie un obiectiv de importanță strategică pentru BNM.*

**Cuvinte-cheie:** bancă, Banca Națională a Moldovei, eficiență, stabilitate financiară, supraveghere bancară.

*В настоящее время НБМ не имеет четко определенную роль в поддержании финансовой стабильности, но имеет обязанности в этой области путем регулирования и разумного надзора банковского сектора. С публикацией этой статьи мы намерены проанализировать нормативно-правовую базу, регулирующей финансовую стабильность и банковский надзор в Республике Молдова и предлагать решения для ее улучшения. В контексте сегодняшних проблем, связанных с критической ситуации в банковском секторе, в том числе потери доверия среди населения и партнеров по развитию Республики Молдова, развитие функции надзора должно стать целью стратегического значение для ВМ.*

**Ключевые слова:** банк, Национальный банк Молдовы, эффективность, финансовая устойчивость, банковского надзора.

**JEL Classification:** B26, D53, E58.

**Introduction.** The supervision issue of financial markets in general, and the bank market in particular has been a top issue. The global crisis that affected the financial sector since 2007 was the consequence of excessive risk and negative developments in the financial markets. In this regard, the supervisory authorities have developed a series of methods and techniques to detect, monitor and predict risk. In the current context, to improve the stability of the banking system and prevent systemic risk, it needed a fundamental revision of existing prudential regulations embodied in Basel III. This new agreement brings more clarity in the banking and financial addresses a wider range of risks, providing better regulation.

Based on these findings, we aim through this publication at analyzing legislative and regulatory framework that is regulated financial stability and banking supervision in Moldova and prospects and formulate solutions to improve them.

**Critical analysis of the domain investigated.** In accordance with Art. 4 of the Law on the National Bank, its primary objective is to achieve and maintain price stability. In addition to ensuring and

---

<sup>1</sup> © Marin URSU, ursu@yahoo.com

maintaining price stability, the NBM has other secondary macroeconomic objectives, including growth and employment. They, however, need to be pursued so that they do not affect the fundamental objective of the NBM.

Although currently NBM doesn't have a well-defined from legally in maintaining financial stability, NBM has, however, responsibilities implicit in this field through regulation and prudential supervision of the banking sector, oversight of payment systems, providing liquidity through its role of lender of last resort for banks, in exceptional cases.

#### **Own opinion on the problem and the results obtained during research**

In order to eliminate conflicts between the objective of price stability and financial stability, the author believes that NBM should follow:

- Increased the efficiency of regulation and supervision;
- Ensure the transparency of financial institutions, in particular by disclosing information related to lending practices and attracting deposits and other services;
- Exchanging information with national supervisory institutions and the development of stress tests at different levels;
- Streamlining and transparency of monetary policy.

In response to the global financial crisis, national authorities have initiated a comprehensive reconsideration of the regulatory framework in the financial domain, including the banking sector. Implementation of Basel III brings a necessary and important contribution to strengthening banks' resilience and growth regulation. However, regulatory reforms by themselves cannot ensure the soundness and stability of financial institutions, which must be supported by effective supervision.

Based on the best abilities, supervisory authorities intervene to fix problems that could lead to the failure of individual financial institutions. At the same time, their ability to prevent failures depends on external developments, available resources, and risk tolerance of the supervisory authority and the bodies to which the latter is responsible. Another factor which complicates the work of surveillance, is finding that as the regulation is more insistent on correction of the behavior of financial institutions, the more likely it is that they will be determined to transfer their activities related to risk in the unregulated segments of the financial sector.

Effective supervision should complement regulation. The emphasis in maintaining financial stability must be moved towards effective supervision. As the economic recovery progresses, new risks may arise. It is therefore important that supervisors be prepared to quickly and effectively identify, assess and mitigate them when they threaten to create vulnerabilities in the financial system.

There is no single definition of effectiveness of supervision. The regulation provides the overall framework, which depends on the discretion of the institution expert overseeing. The IMF noted that adequate supervision is intrusive, sceptical, proactive, comprehensive, adaptable and reliable [9].

The basic principles of the Basel Committee for Banking Supervision represent an effective international standard for bank supervision. First published in September 1997, the Basel Core Principles were revised in October 2006 and September 2012, to reflect the main lessons derived from the financial crisis and necessary developments in banking supervision. The revised principles are set at risk-based approach and monitoring activities implemented on time.

These issues are reflected in the efforts to strengthen supervisory practices and risk management with more intense supervision of systemically important banks, applying the supervision at system level and macro perspective and increased focus on early interventions and crisis management. In addition, renewed principles were supplemented to express the significance of sound corporate governance, greater emphasis being placed on public disclosure and transparency of banks in promoting market discipline.

In figure 1 the author presents the conceptual and methodological scheme for effective banking supervision. Of all the principles of effective banking supervision shown in fig.1 the author considers as critical for the banking system in Moldova Principle 1 on skills, responsibilities and objectives of banking supervision and Principle 2 on the independence, accountability, resources and legal protection for supervising authorities. Effective supervision is also dependent on the willingness of supervisors to act and their ability to exercise their judgments, these factors are subjective. Viñals and Fiechter stressed that supervisory approaches and skills will become more challenging once the regulatory framework will become more detailed and complex [9].

The financial crisis had a significant impact on supervisory practices. In addition to regulatory reforms, worldwide national supervisory authorities have reconsidered their strategies of supervision.

Supervisors apply a more forward approach with more attention paid to strategic and qualitative elements. Traditional elements of capital buffers and liquidity requirements continue to play a central role in banking supervision, and are significantly strengthened as a response to the financial crisis. In addition, supervisors applied a proactive approach, for example by requiring stress tests of banking and supervision, and capital planning and liquidity. At the same time, supervisors are increasingly interested in aspects of the financial institution that could provide information on whether the business model and strategy of the institution are sustainable in the long term. They are particularly concerned about behavioural aspect, the cultural aspects of corporate governance of financial institutions. Also, supervisors are paying more attention to risk governance framework of financial institutions, including the board, risk management function within the institution and independent assessment of risk governance [8]. These qualitative elements allow supervisors to identify potential sources of future problems at the initial stage and mitigate risks before they affect the soundness of an institution or financial integrity.

Supervisory practices were renewed. Supervisors reviewed their supervisory approaches and redesigned their set of tools for the prudential supervision. In addition to specific supervision of financial institutions, supervisory authorities increasingly use common global approach to cross-sector analysis of financial/banking as a whole. This is reflected in the increased use of benchmarking exercises and thematic reviews.

One approach to overcome the individual institutions allows supervisors to better identify trends in the banking sector, detect anomalies and analyze potential risks to financial stability.

The scope of supervision was extended. Several segments of the financial sector were drawn into the scope of regulation. For example, new regulations were drafted at the level of supervisors for hedge funds, own private equity entities and credit rating agencies. Furthermore, various initiatives have been developed to extend supervision in to the shadow of banking sector, although in some countries, this is still under implementation.

Macro-prudential supervision has obtained a stronger role. An important conclusion derived from the financial crisis was that financial institutions are more interconnected and real economy than previously considered and that the stability of the financial market as a whole is a separate element, which must be explicitly considered [2]. Central banks and supervisors have developed a macro-prudential pillar separately in their supervisory processes, often expressed in creating new macro-prudential authorities. They also developed new macro-prudential tools such as countercyclical buffer under the supervision of Basel III.

Several national jurisdictions have initiated organizational changes. Since the financial crisis, central banks have obtained a more pronounced in the surveillance process (either directly or indirectly), creating a greater move towards stronger consolidation between sectors [6].

A major change in supervising was the transition to European supervision, being created European Supervisory Authority and, in November 2014, the single supervisory mechanism that brings prudential supervision in the euro area under the responsibility of the ECB.

Ideally, monitoring cycle is embedded in a coherent, continuous and comprehensive (as shown in Figure 1). Key elements of a surveillance cycle is based on surveillance strategy that includes:

- Clarity on the objectives of monitoring ("what we want to achieve?"), Translated into activities through a structured planning process;
- Impact Assessment ("how can we find out if our activities contribute to achieving our goals?");
- Responsibility ("how can we demonstrate our key stakeholders that surveillance was effective?").

Supervisory effectiveness can be assessed more objectively when the supervisory authorities have a well-defined strategy that clearly articulates and prioritises objectives [8].

In all jurisdictions, the safety and soundness of banks and the banking system is reflected in some form, in general objective, strategic monitoring. The overall objective of supervision is determined by the supervisor's mandate, which is often established by law and has a strategic perspective in the long term. Basel core principles for effective banking supervision provides a coherent framework:

- An effective system of banking supervision has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups;
- The main objective for banking supervision is to promote safety and soundness of banks and the banking system;
- If the banking supervisor has assigned more responsibilities, they are subordinated to the primary objective and must not in conflict with it.

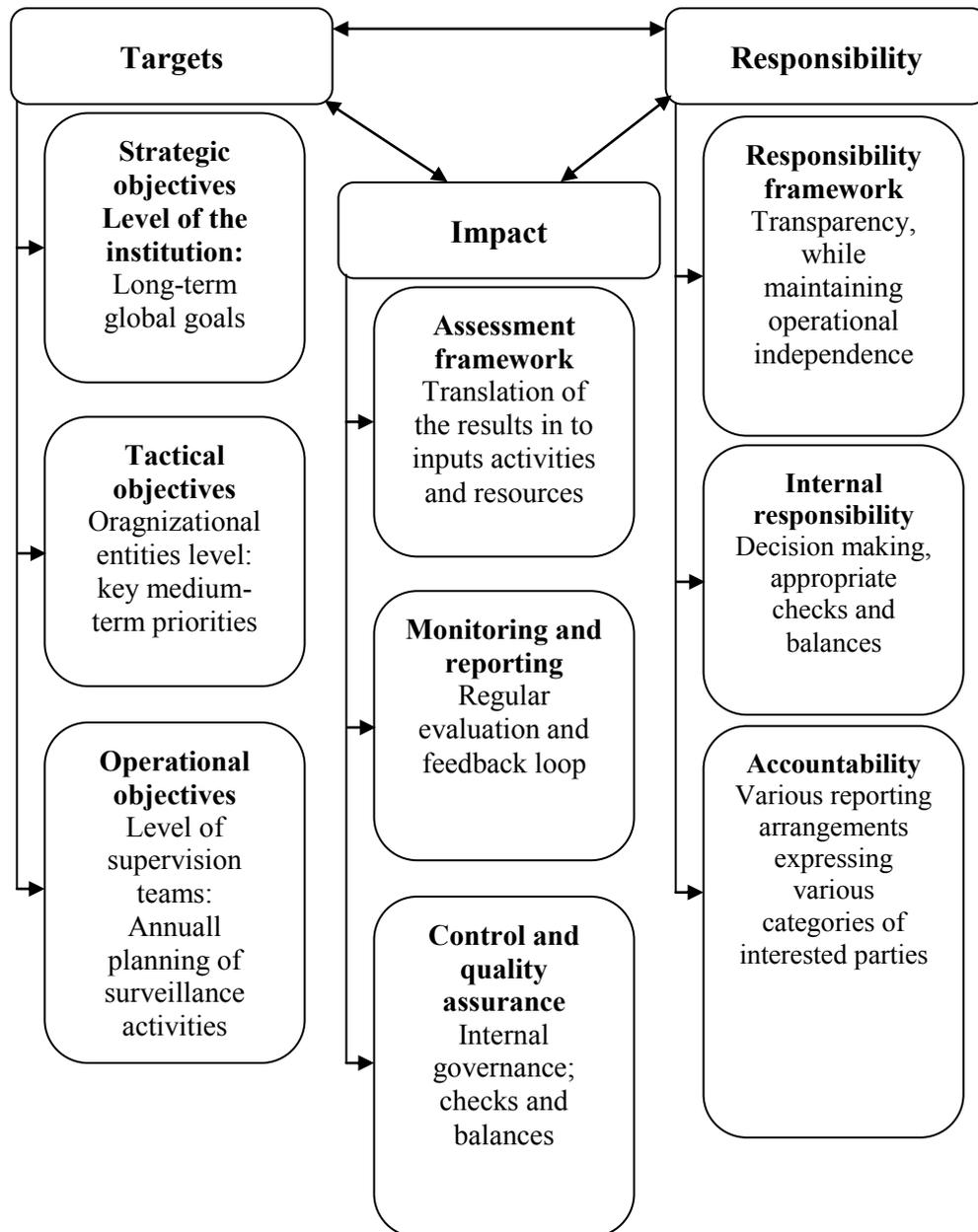


Fig. 1. Surveillance strategy

*Sursa: Developed by the author [8].*

Supervisors may have the freedom to further refine their strategic objectives and usually have some degree of freedom to formulate strategies supervision. To support the impact assessment and strengthen oversight responsibility, some supervisors have benefited from a process that translates the general objectives of supervision.

Basel Core Principles establish that:

- The supervisory authority has a coherent process for planning and execution of surveillance activities on-site and off-site. There are policies and processes to ensure that such activities are conducted on a thorough and consistent with the responsibilities, objectives and clear outcomes.

A coherent framework of oversight within the organization can facilitate the transformation of long-term goals in everyday surveillance. A coherent framework can be more useful objectives, thus enhancing efficacy. A structured process of planning and control can help to establish priorities. This can be done in several ways.

Supervisors may be more effective if they clearly communicate their goals to stakeholders. Despite the differences in implementation, it is particularly important for supervisors to provide clarity on their goals.

Basel Core Principles state that public oversight authority and meet its objectives through a transparent framework for its tasks in relation to these objectives.

By clearly defining the effects supervisors want to obtain, supervisors not only direct oversight process and provides a clear focus to final results relevant, they also provide clarity supervised institutions on what is expected of and shall contribute to an efficient dialogue and a better prioritization of actions. Finally, define the desired effects is a prerequisite for any analysis of the impact and accountability.

**Conclusions.** In response to the global financial crisis, standards bodies and national banking supervisory authorities initiated a broad reconsideration of the regulatory framework in the financial, banking default. In recent years, supervisors have revised and strengthened their policy and practice. Surveillance has become more comprehensive and intrusive considering additional dimensions associated with banking. Supervisory authorities have also taken steps to get a larger perspective on the impact of their activities.

Of all the Basic Principles of the Basel Committee for Banking Supervision efficient, the author considers to be of critical importance to the banking system in Moldova Principle 1 on skills, responsibilities and objectives of banking supervision and Principle 2 on the independence, accountability, resources and legal protection supervisors.

Starting with an analysis of international experience in banking supervision and based on the Basic Principles of the Basel Committee for Banking Supervision efficient author recommends:

- Define and implement the concept of banking supervision National Bank effective if the Moldovan banking system development and implementation methodology for assessing the effectiveness of bank supervision by NBM;

- Taking over the supervisory practice NBM prospective approaches, paying attention to strategic and qualitative elements. Meanwhile, traditional elements quantitative must be strengthened;

- Strengthening surveillance NBM practice and risk management with greater intensity surveillance of systemically important banks, supervision of system implementation and macro perspective and increased focus on early intervention and crisis management;

- Strengthen banking supervision, so that it can express the significance of sound corporate governance, greater emphasis being placed on public disclosure and transparency of banks to promote market discipline;

- Effective communication with stakeholders from NBM on its activity in the field of banking supervision;

- NBM accountability for the quality of banking supervision.

## REFERENCES

1. BLACK, J. The rise, fall and fate of principles-based regulation. In: A. KERN, N. MOLONEY, N. (ed.). Law reform and financial markets. Cheltenham-Northampton: Edward Elgar Publishing, 2011, pp. 3-35 [accesat 11 martie 2016]. Disponibil: <http://www.elgar.com/shop/eep/preview/book/isbn/9780857936639/>
2. DE LAROSIÈRE, J. *The high-level group on financial supervision in the EU*: report. European Commission. Brussels, 2009, 25 february. 78 p. [accesat 23 februarie 2016]. Disponibil: [http://ec.europa.eu/internal\\_market/finances/docs/de\\_larosiere\\_report\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf)
3. HALDANE, A. The dog and the Frisbee. In: The changing policy landscape: symposium, 31 august 2012. Wyoming, 2012 [accesat 16 ianuarie 2016]. Disponibil: <http://www.bis.org/review/r120905a.pdf>
4. HILBERS, P., RAAIJMAKERS, K., RIJSBERGEN, D., DE VRIES, F. Measuring the effects of financial sector supervision. DNB Working Paper no. 388. Amsterdam, 2013 [accesat 12 martie 2016]. Disponibil: [http://www.dnb.nl/binaries/Working%20Paper%20388\\_tcm46-295726.pdf](http://www.dnb.nl/binaries/Working%20Paper%20388_tcm46-295726.pdf)
5. KELLERMANN, A. J., DE HAAN, J., DE VRIES, F. *Financial Supervision in the 21st Century*. Nederlandsche Bank. Amsterdam, 2013. ISBN 978-3-642-36732-8 [accesat 21 ianuarie 2016]. Disponibil: <https://www.hks.harvard.edu/fs/msparrow/documents-in%20use/Financial%20Supervision%20in%20the%2021st%20Century--front%20matter.pdf>
6. EUROPEAN CENTRAL BANK. Recent developments in supervisory structures in the EU member states (2007–2010). 2010, october [accesat 16 martie 2016]. Disponibil:

- [https://www.ecb.europa.eu/pub/pdf/other/report\\_on\\_supervisory\\_structures2010en.pdf](https://www.ecb.europa.eu/pub/pdf/other/report_on_supervisory_structures2010en.pdf)
7. BASEL COMMITTEE ON BANKING SUPERVISION. Report on the impact and accountability of banking supervision. Bank for International Settlements. 2015 [accesat 27 ianuarie 2016]. Disponibil: <http://www.bis.org/bcbs/publ/d326.pdf>
  8. FINANCIAL STABILITY BOARD. Thematic Review on Supervisory Frameworks and Approaches for SIBs: Peer Review Report. 2015, 25 may [accesat 14 februarie 2016]. Disponibil: <http://www.fsb.org/wp-content/uploads/Thematic-Review-on-Supervisory-Approaches-to-SIBs.pdf>
  9. VIÑALS, J., FIECHTER, J. The Making of Good Supervision: Learning to Say “No”. IMF Staff Position Note. 2010, 18 may [accesat 11 ianuarie 2016]. Disponibil: <https://www.imf.org/external/pubs/ft/spn/2010/spn1008.pdf>

***Recommended for publication: 27.05.2016***