

The National Committee for Financial Stability – How to Reform It Wisely?

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■ Introduction

One of the most important lessons among the multitude we learned after disclosing the bank frauds and the bank crisis of 2014-2016 is that the National Committee for Financial Stability (NCFS or the Committee) undoubtedly needs to be reformed thoroughly. Established in 2010, its capacity to prevent and manage the recent bank crises proved to be inefficient. In addition, due to its politicized format and unclear mandate, NCFS was one of the main institutional weaknesses causing instability in the banking system.

The need to reform the Committee has been previously confirmed by the International Monetary Fund (IMF), in its 2014 Financial Sector Assessment Program¹, experts' community² and the Prime Minister Pavel Filip in 2016³. Even though, generally, there is a consensus on the need to reform NCFS, this process has developed quite slowly until now. One of the main actions taken in this respect was the change of the Committee membership in October 2016 in order to decrease its exposure to political influences (the Prime Minister, the Chair of the Parliamentary Committee on Economy, Budget and Finance and the General Secretary of the Government were excluded). Another important measure was the introduction in April 2016 in the Law on NBM of additional powers allowing the Bank to adopt some measures to stabilize the financial sector in times of crisis.

Despite all measures taken by authorities so far, the financial stability framework remains problematic. Thus, the mandate of the current Committee is still unclear, focusing on solving rather than preventing crises, is ambiguous and sometimes overlaps with the powers of other institutions (especially of the NBM). Similarly, NBM mandate on financial stability remains incomplete, because it focuses more on solving financial crises, and less on preventing them. Another issue is that the Committee must define systemic crises, which is a triggering factor for further NBM activities (NBM cannot undertake actions to stabilize the financial system if the Committee fails to notify about the systemic crisis), but criteria underlying this decision are not defined clearly. Finally yet importantly, the macro-prudential supervision, which is a key element for every financial stability framework, has an institutional and regulatory vacuum.

A wise reform of the National Committee for Financial Stability would address the existing gaps on the basis of lessons learned from the previous failures of this institution and from the experience of other EU countries. Particularly, the Committee must concentrate predominantly on preventing financial crises and enhancing the communication and coordination between institutions in charge of the financial stability. Besides, it should not undermine the members' independence and should not have overlapping duties with its members.

This report aims to bring back the subject of financial stability framework in the public space and to ensure a better understanding of this reform by decision makers, opinion leaders and ordinary people. The document is based on the findings that the German Economic team and Expert-Grup made in their study conducted last year⁴, on the principles of the European Systemic Risk Board and on the practices of other states (e.g.: Romania, Bulgaria, Poland, Estonia, Germany, Netherlands), regarding the operation of committees in charge of financial stability. Thus, it makes a summary of the Committee's previous failures and specifies the key principles that must guide the reform of the Committee.

¹ Country Report No. 16/70, http://imf.md/press/1%20Moldova%20-%20IMF%20-%20FSAP_Financial%20System%20Stability%20Assessment_cr1670.pdf

² Berlin Economics and Expert-Grup, http://expert-grup.org/media/k2/attachments/Reformarea_CNSM_ro.pdf

³ <http://gov.md/ro/content/comitetul-national-de-stabilitate-financiara-va-fi-reformat>

⁴ Berlin Economics and Expert-Grup, http://expert-grup.org/media/k2/attachments/Reformarea_CNSM_ro.pdf

■ Previous Mistakes of the National Committee for Financial Stability

Two major gaps in the operation of NCFS caused its failure to prevent and manage efficiently the recent bank crisis:

1. Membership

In 2010, when NCFS was formed, its membership consisted predominantly of politicians. Thus, the Head of the Committee was the Prime Minister, and its Secretariat was ensured by the State Chancellery. The Head of Parliamentary Committee on Budget Economy and Finance was also a member of the Committee. Minister of Finance and Minister of Economy were also part of it. All these positions are, by definition, exposed from a political point of view. At the same time, the apolitical members (Governor of NBM, Head of NCFM and Head of Deposit Guarantee Fund in the Banking System) were in minority. Such a membership was unable to ensure the financial stability, because it depended on the political decisions, and, according to good practices, aspects relating to financial stability have to be discussed without political interference. Therefore, subjects that should be discussed predominantly by experts were actually discussed by politicians, and this affected significantly the activity of this Committee.

NCFS membership was contrary to the EU good practices. The financial stability committees from most EU countries consist of a limited number of institutions, with a minimal political exposure. For example, the membership of the Romanian Committee consists of the Ministry of Public Finance, National Bank of Romania, Financial Supervisory Authority and the Head of the Deposit Guarantee Fund in the Banking System. Bulgaria and Estonia have a similar membership. The same situation is in Poland, but here, other experts can also be invited ad-hoc on the request of the permanent members. Similar committees from more developed countries (like Germany, Netherlands) have similar memberships. Thus, the inclusion of persons who, by definition, are very politically exposed is contrary to the good practices of financial stability architecture due to the risk to adopt decisions conflicting with the objective of these institutions. For example, a committee dominated by politicians will defer until the very last moment the establishment of financial crisis, especially during (pre)electoral or political instability periods.

2. Mandate

NCFS mandate is ambiguous and overlaps with some duties of its members, creating conditions for financial instability. According to the Government Decision No 449 of 02.06.2010, which unfortunately is still in force, the Committee is responsible to manage the extraordinary financial crises, make proposals on the protection of deposits, capitalization and recapitalization of banks, restore credibility of the banking sector and propose different measures to overcome systemic crises. This arsenal of powers create at least 2 problems:

(i) **NCFS focuses more on managing crises and less on preventing them.** Actually, there is a feeling that the Committee is meant to ensure financial stabilisation rather than financial stability. Thus, on the one hand, it does not have the function of anticipation of crises and elimination of systemic risk factors before their materialization, and, on the other hand, the Committee focuses on some duties unfit for such institutions.

(ii) **The overlap in the NCFS' and the members' duties leads to "responsibility vacuum".** A quite interventionist mandate of the Committee allowed it to take decisions on the banking regulation, which, actually, falls under NBM responsibility. Let's remember the NCFS decision taken in August 2015 to

liquidate the 3 banks that previously benefited from preferential liquidity in amount of MDL 14.5 billion granted by NBM and guaranteed by the Government. Overall, taking into account NCFS duties, there was a feeling that it is a financial decision-making body and, respectively, this is its function. The problem is that the State has already all the necessary institutions in charge of taking these decisions: NBM regulates the financial banking system, NCFM – the non-bank financial system, Government is liable for the performance of state-owned financial institutions. Respectively, in times of financial crises, these institutions must take measures to overcome them using minimal costs, and when the financial stability is at risk, they have to prevent its materialisation. But, the emergence of an additional institution responsible for managing the financial crises created uncertainty and, most dangerous, conditions for passing the buck between the institutions. In fact, the systemic crisis creates legal conditions for the situation that can be called “responsibility vacuum” - the member institutions just share information on the existing risks and necessary actions and wait somebody else to take decisions.

NCSF mandate is contrary to the EU good practices. The EU committees for financial stability have a much more limited mandate than in the Republic of Moldova, the same as their membership. Thus, the mandate of committees from Romania, Poland, Bulgaria, Estonia, Germany or Netherlands is only to ensure the exchange of information between member institutions to identify in advance the risks for the financial stability and to overcome systemic crises. These institutions are not responsible for the decision-making at all, because it falls under the exclusive responsibility of the member institutions. Sometimes, committees can make policy recommendations for the member institutions on matters relating to macro-prudential regulations (e.g. adjusting the capital requirements for banks). The later are free to decide whether to implement these recommendations or to explain why they should not be implemented, bearing the full responsibility for this decision. Note that even in these cases, the majority of votes from the Committee belong to apolitical institutions, which have the most common points with the financial stability function (central bank and financial market authority).

■ What should be the key elements of the NCFS reform?

In its actual membership, NCFS represents a key weakness of country's financial stability framework, this is why it has to be reformed thoroughly. The analysis of the legal framework and the activity of this Committee from the past years show that this entity needs an urgent fundamental reform. Compared to the most EU countries, our country faces a large number of gaps in terms of financial stability infrastructure. The failure of NCFS to prevent and manage efficiently the recent bank crisis is a good example in this respect. Example that, without reforms, can occur over again in the future.

NCFS reform must be based on 2 key elements: (i) its previous gaps, analysed in the previous chapter; and (ii) the experience of other countries, predominantly from the EU. In addition, it is important that all the member institutions, other authorities (including the Government and the Parliament), as well as the entire society clearly understand and share a common vision on the importance and function of this Committee.

The Committee shall have advisory duties and facilitate the communication and coordination among members to prevent systemic financial crises. It cannot be a legal entity and cannot have a decision-making power in order to not undermine in any way the role of its members. Instead, NCFS must be a platform to facilitate the exchange of information among the member-institutions on the risks that endanger the financial stability, actions that should be taken by each member, collective analysis of the information on the country's financial stability, identification of potential systemic gaps that fuel risks of financial instability, detection of potential deviations from good practices in the fight against money laundering and other similar activities that can be implemented more efficiently by inter-institutional communication and cooperation.

NBM must play a central role in NCFS. Given that NBM is the main responsible for the maintenance of financial stability and has the necessary expertise in this area, it should ensure the secretariat of the NCFS, while the Governor should be the Head of the Committee. Moreover, besides the NBM governor, all deputy governors must be implicitly members of NCFS. In addition, namely NBM must be the key institution that should offer analytical support to the country's macro-financial situation and risks for the financial stability.

In case of major risks for the financial stability or systemic financial crisis, NCFS can provide recommendations on macro-prudential policy for the member institutions. These recommendations cannot bear a mandatory character and the institutions can choose to either implement them or to explain why they act otherwise ("act or explain" principle). It is important that these recommendations refer strictly to aspects of macro-prudential regulation (e.g. increase in capital buffers when systemic risks are identified or impose lending restrictions when signs of financial destabilization are identified) and to not affect in any way the independence of NBM or NCFM.

The NCFS reform should go along the reformation of the financial stability framework. The effectiveness of NCFS activity will depend on the member institutions' capacities in the financial stability. Thus, the capacities of member institutions, especially of NBM and NCFM, in the area of prevention and management of systemic financial crises also need to be strengthened. They have to have an effective framework to detect in advance the systemic risks on the basis of a complex background of forecasts and predictive indicators, and of internal well-defined processes to apply measures to address systemic risks and financial crises. Last but not least, these institutions must be able to attract

and maintain high qualified and committed staff, offering attractive wage and social packages. This is why, NBM and NCFM must review their wage scales, remuneration schemes for the individual performances of workers, as well as should benefit of more freedom and transparency in this regard.