Gone for good: Banca de Economii was liquidated soon after the crisis

MOLDOVA'S WAKE-UP CALL

After a troubling period littered with fraud allegations and emergency measures, Moldova's banks are seeing a slow return to growth and winning back popular trust. Kit Gillett reports.

In late 2014, an estimated $1bn went missing from the Moldovan banking system. The scale of the fraud would have been large in most countries, but in Moldova, which has a population of just 3.5 million, it was staggering. It amounted to roughly one-eighth of the former Soviet republic's gross domestic product.

In the aftermath, three of the largest banks in the country ceased to exist, political crises ensued, and the economy suffered. A bailout from the government, worth an estimated $870m, was required to rescue depositors, leading to a rapid depreciation of the national currency.

Meanwhile, the governor of the national bank was forced to raise the basic bank rate five times in quick succession, from 4.5% to 17.5%, in order to keep money in the system. Moldova's economic activity contracted in 2015, though only by 0.5%, with trust in the banking and political systems of the country heavily eroded. (Economic activity has since returned to positive – see separate article on page 53).

"Living through the experience, it looked like we didn't know when ground zero was going to come," says Henry Russell, director for financial institutions in Moldova, Ukraine, Belarus and the western Balkans for the European Bank for Reconstruction and Development (EBRD), which has operated in Moldova since 1995.

Since 2015, however, significant efforts have gone into reforming the country's banking sector and restoring trust, both among Moldovans but also among the country's international partners. Many are hoping that the January 2018 purchase of a 39.2% stake in Moldova's third largest lender, Victoriabank, by Banca Transilvania, the second largest bank in Romania by total assets, is a sign of things to come.

THE MISSING BILLION

In the immediate aftermath of the 2014 bank fraud, the National Bank of Moldova (BNM) hired US corporate investigations and compliance firm Kroll to look into the chain of events that led to the money's disappearance.

The findings of Kroll's initial report, which were published on the internet by the speaker of the parliament Andrian Candu in May 2015, showed how apparently unconnected groups managed to purchase controlling stakes in three of the largest banks in Moldova: Unibank, Banca Sociala and Banca de Economii. Then, through a series of transactions, the three maximised the banks' liquidity in order to lend to Moldovan entities, says the report. These funds were transferred offshore and eventually used to pay down existing loans at the banks. The initial report claimed loans were heavily weighted towards companies linked to Moldovan businessman

Ilan Shor. A follow-up summary report, released in December 2007 and published on the BNM website, gives further details of this process and says $600m went to other destinations.

Mr Shor has repeatedly denied any wrongdoing. In an interview with the BBC in June 2015, he denied any connection with Unibank or Banca Sociala but said he served as chairman of Banca de Economii. He blamed the problems on bad loans made by the bank before privatisation and before he took charge. “When we took over the bank [Economii] we were horrified. There was a 7bn lei [$376m] black hole,” he told the BBC.

In December 2017, Mr Shor announced that he had filed a lawsuit against Kroll in the UK. *The Times* reported in November that Mr Shor had hired James Ramsden QC in London to establish his innocence.

The Kroll findings further angered many in Moldova, who questioned how such an allegedly blatant and co-ordinated fraud had been allowed to take place, and whether there were politicians who had turned a blind eye. The BNM announced that it had received the full and final report in early March and would pass it on to the “investigative bodies of the Republic of Moldova”.

NECESSARY REFORM

The banking fraud, and the political crises that followed, which led to the EU, the World Bank and the International Monetary Fund (IMF) temporarily freezing aid to the country, may have helped Moldova in the long run, forcing the country to push real banking sector reforms.

“The situation at the beginning of 2016 was very difficult, one might say critical,” says Sergiu Cioclea, who was appointed governor of the BNM in 2016 after serving almost 18 years at BNP Paribas in various roles across Europe.

Mr Cioclea says that at the time he arrived, trust in the banking sector was broken and that banks had no confidence in the government, which had assumed huge bailout costs after the liquidation of the banks involved.

“Foreign funding, which covered a large part of anticipated budget revenues, was put on hold,” he says. “Yields on government debt surged above 26%, with the duration of the new paper issued by the Ministry of Finance dropping dangerously to three to six months only.

“Given local banks’ large exposure to government securities, the country was heading towards a new phase of a budget

> THE MOST DIFFICULT PHASE OF THE BANKING SECTOR STRENGTHENING, INVOLVING COMPREHENSIVE CHECKS AND ASSET QUALITY REVIEWS ACROSS LOCAL BANKS, IS WELL ADVANCED AND IS COMING TO AN END ***Sergiu Cioclea***

and banking crisis,” he says, adding that the IMF’s decision in 2016, when it agreed to a three-year loan programme worth $183m, helped to stabilise the situation and begin an ambitious banking reform programme.

WEAKNESS UNCOVERED

In the aftermath of the crisis, the three banks involved, which represented 32% of the market in terms of total sector assets and 24% in terms of portfolio, were quickly liquidated, leaving 11 banks operating in Moldova.

The BNM also placed the three largest remaining banks – Victoriabank, Moldova Agroindbank (MAIB) and Moldinconbank, which today account for 65% of total banking sector assets – under special supervision, due to concerns over corporate governance.

One of the immediate goals of the BNM was the removal of non-transparent shareholders. The chain of events that led to the fraud highlighted a systemic weakness in the sector: that by buying up stakes below 5% – the threshold for requiring approval from the central bank – investors were able to take controlling stakes in banks without needing to reveal themselves. In the case of Unibank, by 2012, 21 shareholders each controlled between 4.5% and 4.99% of the bank’s shares.

“The root cause of many of the ills the sector has been suffering is the influence of non-transparent shareholders in several of the major private sector banks,” says Mr Russell.

As well as suspending voting rights, the BNM was able to propose laws, eventually passed by parliament, to freeze shares held by non-transparent shareholders and to cancel attempted sales to non-transparent entities.

In December 2017, the Moldovan authorities amended legislation to allow the state to step in and buy those shares, before selling them on to strategic investors, protecting new stakeholders from any claims by previous owners.

TOEING THE LINE

Local banks have also been required to increase their credit loss provisioning and, most importantly, to take urgent action aimed at reinforcing internal risk management as well as procedures on related-party financing.

In July 2017, a new regulation on internal governance and risk management came into force. Meanwhile, a new law on banking activity, based on Basel III principles and drafted with the assistance of central banks in the Netherlands and Romania, came into force on January 1, 2018. The application of the new law, which will bring Moldova’s banking regulations in line with those of the EU, will be staggered between 2018 and 2020, to give banks time to adjust to the new requirements.

The appointment of Mr Cioclea was, in itself, seen as an important step in the process of cleaning up the banking sector.

“He came with new ideas and best practices from Europe, and he has a team of four deputy governors who are also highly qualified,” says Dumitru Pintea, an economist at Expert-Grup, a think tank based in the Moldovan capital of Chisinau. “Most importantly, we believe they are independent, not like previous governors and their teams, who weren’t independent in their decisions and didn’t do enough to stop the frauds at the time. They couldn’t react to the political pressure.”

REBUILDING TRUST

There is a sense that Moldovans are slowly regaining their trust in the banking sector: according to polls conducted by the Institute for Public Policy, an independent think tank in Chisinau, confidence in the banks increased from a low 15% in 2016 to 26% in 2017.

Deposits in local banks have also »

been rising steadily, according to BNM figures, increasing from 50bn lei in December 2015 to 60bn lei at the end of 2017. Over the same period, local currency deposits rose from 42% of total system deposits to 57%, pointing to a gradual return of trust in the national currency.

Despite the chaos of the past few years, Moldova's banking sector is surprisingly healthy when it comes to asset growth and profits. According to BNM figures, total assets in the system amounted to 79.5bn lei at the end of 2017, up 9.2% year on year, with Tier 1 capital hitting 10.1bn lei, an annual rise of 8.7%.

Total profits of the 11 banks operating in the country amounted to 1.5bn lei in 2017, according to the central bank, up 8.6% year on year, with the largest bank, MAIB, seeing its after-tax profits grow from 406.4m lei in 2016 to 458.2m lei in 2017.

The second largest bank by total assets, Moldindconbank, meanwhile, saw after-tax profits rise from 161.5m lei to 363.8m lei. In fact, only one bank operating in Moldova, Banca Eximbank – Gruppo Veneto Banca, reported losses for 2017, with the top five banks generating 90% of total after-tax profits.

Mobiasbanca, which has grown impressively since being bought by French banking group Société Générale in 2007, saw its after-tax profits drop slightly from 326.5m lei to 270.5m lei in 2017. In recent years, the bank has become the fourth largest bank in Moldova in terms of total assets, and the third largest lender.

"Over the past five years Mobiasbanca has doubled its size and almost trebled its profits, with a 2017 return on equity in excess of 18%, the highest in the sector," says Antoine Gabizon, Mobiasbanca CEO and president of the management board.

NPLS RISING

Expert-Grup's Mr Pintea notes that "the sector is very profitable" because Moldova's banks have a dominant position as the non-banking financial sector is "very small". "The capital market doesn't exist, so only banks can lend to people and firms. That's why they have big profits every year," he says.

Despite all this, there are still areas of concern for Moldova's banking sector. The non-performing loan ratio has been rising steadily, increasing from 9.9% in 2015 to 16.4% at the end of 2016, and 18.4% in 2017.

Credit activity also remains low, and is mostly focused on large corporations, with few small and medium-sized enterprises (SMEs) and retail clients. This has left plenty of money sitting unused in banks.

> THE ROOT CAUSE OF MANY OF THE ILLS THE SECTOR HAS BEEN SUFFERING IS THE INFLUENCE OF NON-TRANSPARENT SHAREHOLDERS IN SEVERAL OF THE MAJOR PRIVATE SECTOR BANKS ***Henry Russell***

"Currently the banking sector has too much liquidity," says Serghei Cebotari, chairman of the management board at MAIB, who adds that the liquidity rate is more than 50%, significantly higher than the mandatory reserves of 40%.

The overall level of loans to total assets in the banking sector stood at less than 45% at the end of 2017, according to BNM figures, with a system-wide capital adequacy ratio of 31%.

ENTER BANCA TRANSILVANIA

The recent purchase of a sizeable stake in Victoriabank by Banca Transilvania, which is considered the first direct investment in the Moldovan financial sector by a major strategic investor since Société Générale's 2007 purchase of Mobiasbanca, has been heralded as an important development.

"For the first time in a long time we can point to one of these banks having been cleansed of any non-transparent shareholders," says the EBRD's Mr Russell. He also suggests that this could create new dynamics in the banking sector, with an increase in competition, better services and access to finance for SMEs, and a more level playing field with positive competitive dynamics. "It's possible that many [experts] will see this as a potential watershed moment," he adds.

Together with the EBRD, which owns 27.5% of the bank, Banca Transilvania now owns 66.7% of Victoriabank. In February, the Romanian lender said it would start the mandatory public tender offer for the remaining minority stakeholders.

"It was a good fit for our business model – we are very much focused on retail customers, microfinance, SME lending – and this is what Moldova needs for its medium-term development," says Omer Tetik, chief executive of Banca Transilvania.

"It wasn't a fast decision. We [had] been analysing the country for a few years, and had been in contact with the national bank, authorities, and we had seen the enormous efforts and improvements.

"We saw it as an opportunity, and felt we should act now," he says, adding that the initial focus will be on establishing good governance and risk management, and only after that will the team develop an ambitious and aggressive development plan.

MAIB HOPE

The sale of Victoriabank could also bode well for the future sale of the blocked shares in MAIB and Moldinconbank, which represent 41% and 64% of the banks' shares, respectively.

"The issue that needs to be resolved is the block of 41.09% of shares [in our bank] that has been put up for sale at the stock exchange," says MAIB's Mr Cebotari. "In terms of the quality of the bank, I can say the bank is in very good shape, well capitalised, has a very good image, and meets and operates in line with Basel III principles."

Due diligence on MAIB has been carried out by a number of international financial institutes and private funds, according to Mr Cebotari, with the current deadline for the sale set for September, "so I hope this year our shares will be sold", he says.

"The banking sector needs these three banks to work," says Francis Malige, managing director for eastern Europe and the Caucasus at the EBRD. "They are the three largest in the country and you can't continue operating [in a country] where two of the three largest banks are under supervision and with uncertainty over where the shareholding is going to be in the near future."

A RAY OF LIGHT?

Despite the positive steps taken in recent years, much remains to be done, and trust is likely to take a long time to return. Political uncertainties in Moldova could always reverse the positive steps that have been made recently. Still, for the moment, those involved in the sector can perhaps breathe a sigh of relief.

"The most difficult phase of the banking sector strengthening, involving comprehensive checks and asset quality reviews across local banks, is well advanced and is coming to an end," says Mr Cioclea.

Looking back on the past few years, some see the banking scandal as a sad wake-up call for the country. As the EBRD's Mr Russell says: "It's depressing that it took such a collapse for anyone to take action." TB