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Recommendations on country/transfer risk management system by the banks of the Republic of Moldova, approved by the DCA of the NBM no. 188 of July 13, 2006

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Recommendations
on country/transfer risk management system by the banks of the Republic of Moldova

1. Basis

Recommendations on country/transfer risk management by the banks of the Republic of Moldova (hereinafter referred to as the Recommendations) are elaborated pursuant to the authorities of the National Bank of Moldova as stipulated in Articles 11 and 44 of the Law on the National Bank of Moldova and Articles 1, 17, 25, 29, 33, 34, 40 of the Law on Financial Institutions.

2. Scope

The following Recommendations are elaborated in order to provide banks with minimum principles, to be taken into consideration by banks at the elaboration of own country/transfer risk management systems. The Recommendations provide the basic framework for country/transfer risk identification, assessment, monitoring and control. Banks shall incorporate the country/transfer risk management systems within the overall risk management framework. Recommendations details are not exhaustive, but are intended to provide the basis for banks' policies and procedures. The Recommendations determine the specific organizational procedure of internal control systems related to country/transfer risk management.

3. Application

The Recommendations shall apply to all banks with cross-border and foreign currency exposures. Such exposures include: cash, placements, correspondent accounts, investments, loans and other balance and off-balance sheet assets, as well as financing sources.

4. Definitions

4.1 Country Risk – the risk that economical, social and political events and conditions within a foreign country will affect the bank's activity.

4.2 Transfer Risk – the risk that a foreign entity will be unable to convert its local currency income into the currency needed to honor its financial obligation because of the absence or unavailability of this currency as a result of certain restrictions imposed by the respective country.

5. Accountability by Bank Management

The Bank's Executive Board shall be responsible for periodical approval and review, at least once per year, of an adequate internal control system related to country/transfer risk management. Maintenance of such system represent an efficient instrument, which shall assist the bank in avoiding the implication in excessive risks, resulted from the bank's external activity.

The Bank's Executive Board shall be responsible for the adequate implementation of the country/transfer risk management system.

6. Elements of country/transfer risk management system

Within the elaboration of country/transfer risk management system, banks shall aim at achieving at least the following

objectives:

- Supervision by the bank's board;
- Risk management policy and procedures;
- Risk assessment and reporting procedures;
- Processes of country risk analysis and rating of individual countries;
- Determination of exposure limits for countries, currencies and entities within countries;
- Regular evaluation of conditions in individual countries;
- Adequate internal control mechanisms.

6.2 Supervision by Board of Directors

The Board of Directors shall be responsible for:

1. Approval and review of bank's policies regarding bank's international activities in accordance with strategic goals and risk exposure of the bank;
2. Approval and review of exposure limits for individual countries, regions, currencies;
3. Monitoring of bank's activity compliance with the policy of country/transfer risk management, inclusive risks evolutions, based on the information provided by the Executive Body, Internal Audit, External Audit...etc.

6.3 Policy and Procedures to Govern the Risk

The Bank Board shall be responsible for the elaboration and execution of a policy that shall include clearly defined procedures for country/transfer risk management. The Board shall define the roles and responsibilities within country/transfer risk management of persons and committees the bank's organizational structure. The delineation should separate business transaction involving such risks from management of assumed exposures. Implementation of the policy should imply as follows:

1. Determination of exposure limits for individual countries/regions and currencies;
 2. Duties and responsibilities by persons involved in decision-making on country/transfer risk management;
 3. Definition of authorized activities, investments and instruments and establishment of acceptable and unacceptable ones.
- The Executive Board should inform the subdivisions and relevant staff on promoted policy, standards and procedures.

6.4 Risk identification, evaluation, monitoring and reporting

1. Procedures used to measure exposures to countries/regions and currencies shall be consistent with the character and scope of the bank's external activities. The level of detail and sophistication should be sufficient to identify all significant exposures and should provide sufficient information to enable performance of a risk analysis. Procedures shall incorporate all exposures of the bank and bank's consolidated group to a particular country/region or currency.

2. The reporting system shall regularly provide to the management of the bank information on the cross-border exposures of the bank. Reports to the bank management shall be of a structure and frequency adequate to the level of operations and exposures incurred.

3. The reporting and evaluation procedures shall at least enable the bank management to monitor the exposures relative to:

3.1 Re-allocation of risk (e.g. from a borrower to a sovereign guarantor), which represents the possibility that the final location of the risk in an exposure may be in a country different from the country of the committed party to the bank.

Therefore, banks' systems should enable monitoring exposures according to:

- a) the country of the committed party (i.e. the country of residence of the borrower, correspondent, counterparty, etc.)
- b) the country in which the risk is finally located (e.g. that of a guarantor to whom the risk is transferred).

3.2 Consolidation of all exposures bank-wide and within the bank's consolidated group as well as exposures of client groups. Procedures should provide compiling of exposures and should enable the bank's management to monitor as follows:

- a) total exposures within the bank of a consolidated client group to individual countries and currencies;
- b) total exposures of the bank to and within its foreign subsidiaries and branches;
- c) total exposures of the bank and its branches and subsidiaries to individual members of a consolidated group.

3.3 Monitoring by country, region, currency, and other features of relevant importance for the bank.

The exposure of a bank to an individual country/currency includes all balance sheet and off-balance sheet accounts of the bank relative to clients residing in a given country. Accounts might be monitored according to several aspects, such as

- a) balance sheet and off-balance sheet amounts
- b) residual maturity
- c) contractual maturity
- d) type of client (country, bank, non-banking legal person, natural person)

6.5. Process of country/transfer Risk Analysis and Rating

The extent of analysis to be performed by a bank relative to country/transfer risk exposures depends upon the size and potential impact of such exposures. The following aspects of the country risk analysis should be proportional to these considerations.

1.1. The analysis should contain at least the following:

a) Examination of political Risk Indicators, to measure stability,

- Government stability,
- Social and economic conditions,
- Investment environment,
- Internal conflicts within the country,
- External conflict of the country;

b) Economic Risk Indicators to assess overall economic strength, include

- GDP per capita
- GDP growth
- Inflation rate
- State budgeted deficit
- The ration of balance of payments current account to GDP

c) Financial Risk Indicators, to evaluate ability to repay external obligations, include

- External debt to GDP ratio
- Debt service to annual exports ratio
- Balance of payments current account to annual exports ratio
- Foreign exchange reserves to cover imports (in months)
- Exchange rate stability

1.2. The analysis of a particular country should be performed at least once per year, or more frequently if country monitoring discloses events or conditions that might influence an adverse change in the country/transfer risk profile

1.3. The analysis should be sufficiently documented, and its conclusions sent to appropriate organizational units that would be affected by the risk in order to adjust the limits relative to exposures, if necessary.

2. The result of the country risk analysis should be the assignment to a country of a sovereign rating grade that reflects the perceived risk profile. The grade should be used as basis for determining exposure limits.

3. Bank may wish to use the assessments and ratings of reputable agencies such as Standard & Poor's, Moody's, Fitch or others. Data also can be obtained from International Monetary Fund and World Bank publications and websites, the International Country Risk Guide published by the PRS Group or the International Risk and Payment Review published by Dun & Bradstreet. However, these sources should be used to complement the bank's own assessment rather than serve as a full substitute for it.

6.6 Determination of Exposure Limits by country, currencies and entities within the countries

1. Based upon the analysis of individual countries, a bank shall set exposure limits for countries and currency transactions. The limits shall reflect:

- a) the bank's strategy/goals for its international activities;
- b) the risk tolerance to a country/region
- c) awareness of opportunities to trade in the relevant country
- d) international needs of the bank's domestic clients

2. The bank's country/transfer risk management system should provide that the exposure limits be submitted by the Executive Body for approval to the Bank Board and further for notification to respective entities and staff. Limits should be reviewed regularly. The Bank Board and the Executive Body should be informed on exceptions and reasons for thereof.

3. Banks shall establish country exposure limits, within which, depending on relevant needs may limit the risk by economic sector, entity, and product as appropriate to the bank's business operations.

6.7. Regular Evaluation of Conditions in Individual Countries

The frequency of evaluation of a country's risk profile shall be based upon the nature and volume of bank's exposures to that country. For smaller exposures or countries that are highly transparent, heavier reliance may be placed upon the analyses of external ratings agencies. However, review of conditions and limits should be no less frequently than annually.

6.8. Internal Control Systems

A bank shall ensure that an internal control system is in place to determine compliance with the requirements of the bank's country/transfer risk management policies and procedures, as well as to provide an evaluation of its effectiveness.

7. Final provisions

7.1. Banks shall, until January 1, 2007, improve the internal control systems taking into considerations the provisions of these Recommendations.

7.2. These Recommendations shall come into force at the date of publication in the Official Monitor of the Republic of Moldova.

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