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FINANCIAL SECTOR ASSESSMENT

MOLDOVA

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THE WORLD BANK GROUP

A joint IMF-World Bank mission visited Moldova from February 17 to March 5, 2014 to conduct an assessment under the Financial Sector Assessment Program (FSAP). This report summarizes the main findings of the mission, identifies key financial sector vulnerabilities and financial sector development issues, and provides policy recommendations.[1]

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GLOSSARY

AIPS	Automated Interbank Payment System
AML/CFT	Anti-money laundering and combating the financing of terrorism
BCP	Basel Core Principles
BES	Book Entry System
BRSD	Banking Regulation and Supervision Department
CAR	Capital Adequacy Ratio
CEO	Chief Executive Officer
CIS	Commonwealth of Independent States
CML	Capital Market Law
CPSS-IOSCO	Committee on Payment and Settlement Systems/International Organization of Securities Commissions
CSD	Central Securities Depository
DGF	Deposit Guarantee Fund
DvP	Delivery versus Payment
ELA	Emergency Liquidity Assistance
EU	European Union
FMI	Financial Market Infrastructure
FX	Foreign exchange
GDP	Gross Domestic Product
GRAM	Global Risk Assessment Matrix
ICP	Insurance Core Principle
IFRS	International Financial Reporting Standards
JSC	Joint Stock Company
LCR	Liquidity Coverage Ratio
LFI	Law on Financial Institutions
LNBM	Law of the National Bank of Moldova
LNCFM	Law of the National Commission for Financial Markets
MDL	Moldovan lei
MOJ	Ministry of Justice
MSE	Moldova Stock Exchange
NBM	National Bank of Moldova
NCFM	National Commission for Financial Markets
NCFS	National Committee for Financial Stability
NPL	Nonperforming loan
NSD	National Securities Depository
RWA	Risk-Weighted Asset
UBO	Ultimate Beneficial Owner
USD	United States Dollar

OVERALL ASSESSMENT AND SUMMARY OF MAIN RECOMMENDATIONS

Although Moldova has made some important advances since the 2008 FSAP Update, risks to banking sector stability have become severe. On the positive side, inflation has been brought down to single digits, the payment system has been upgraded, and important enhancements have been made to financial sector regulation and supervision. Moreover, stress tests also appear to suggest that bank balance sheets would be resilient to a range of adverse shocks. However, large credit concentration, concealed connected lending, questionable cross-border exposures, and important data gaps mean that these tests likely significantly understate the system's vulnerability. Fraud, non-transparent ownership, weak governance, and weaknesses in regulatory powers and enforcement further exacerbate these risks and would limit the scope for an effective policy response to shocks.

There is an urgent need, therefore, to improve transparency and governance in the banking system. Some ultimate beneficial owners (UBOs) disguise their control in order to circumvent central bank vetting processes and to conceal connected lending by banks. Governance structures and internal oversight processes are not well developed, blurring the roles and responsibilities of owners, board members, and management, and so put at risk safe banking operations. Risk management is especially poorly developed. Insufficient regulatory standards have contributed to poor risk management in banks. The pattern of some (particularly cross-border) financial transactions suggests a serious risk of money laundering.

The independence and effectiveness of the regulatory bodies also needs to be substantially strengthened. Enforcement has been seriously hampered by a series of court challenges, including Constitutional Court rulings, that have allowed the suspension of supervisory actions. Moreover, National Bank of Moldova (NBM, banking supervision) and the National Commission for Financial Markets (NCFM, nonbank supervision) board members and staff do not have sufficient protection against lawsuits while discharging their duties in good faith. The authorities have been working for some time with advice from the World Bank and IMF in an effort to address weaknesses in the legal system, and amendments to the NBM Law in December 2013 try to establish a legal framework to avoid the suspension of most NBM decisions and provide for a special court-based procedure for any such suspension. However, more is needed to restore NBM's and NCFM's powers. But, while the government is supportive of reform, it is unclear how quickly parliamentary approval of the necessary amendments may be obtained. As a result, the authorities have been unable to address fraudulent raider attacks on banks' shareholders, limit large bank exposures, or address serious weaknesses in the privately run securities registries. In addition, NBM's independence is further weakened because NBM regulations must be registered by the Ministry of Justice, which performs a legal revision, leading sometimes to substantial changes. That said, there is a range of instruments available to the regulators to address problems and violations of regulatory obligations, and more forceful actions could have been taken, particularly in the case of persistent deficiencies.

The crisis management framework is weak, and cooperation between regulatory authorities requires strengthening. A National Committee for Financial Stability (NCFS) was set up in 2010 to bring together key stakeholders in financial sector stability, though its remit is focused on crisis management. The NCFS lacks focus and is not forward looking. It proved useful in addressing problems which arose in 2012 in Banca de Economii (BEM), but there is little evidence of contingency planning and testing of processes and powers. Coordination between the member agencies is limited. There are also significant gaps and deficiencies in the statutory powers required for cost-effective bank crisis resolution. If systemic pressures were to emerge, it would be critical for the NCFS to ensure a focus on managing the situation in a coordinated and collegial manner.

There is room also to strengthen the financial safety net. The Deposit Guarantee Fund (DGF) is reasonably funded for the current level of coverage, which is the lowest in Europe, at MDL 6,000 (about USD 450). But the DGF lacks the capacity for rapid payout in anything other than small cases, and the lack of established funding lines could impede DGF's ability to make rapid payouts. The DGF also needs better access to sufficient and timely data for more rapid and accurate payouts. In addition, there are some small financial entities supervised by the NCFM that accept deposits which are not insured.

Although the banking sector appears to be well capitalized and liquid, important pockets of weakness remain and vulnerabilities may be masked by fraud or misreporting. Reported nonperforming loans (NPLs) for some banks are remarkably high, while in other cases a reduction in NPLs may reflect regulatory arbitrage rather than a substantive reduction in risk. Large exposures in some cases exceed regulatory norms by a wide margin. Additionally, liquidity risk is hard to measure because the high reported level of liquid assets appears unreliable – e.g., some liquid assets placed outside Moldova may be encumbered through undisclosed side agreements.

The two securities settlement systems are in need of updating, though plans to take this reform forward are not finalized. The corporate securities registry system displays serious governance and infrastructural weaknesses. Settlement of government and central bank securities, as well as equities, is delivery versus payment (DVP) in central bank money. But the settlement systems are old and ill-suited to any expansion of trade. Registration of equities is split among eleven private registries, which run manual systems (in some cases with no reliable data backup) and are vulnerable to fraud and abuse of data. The recently adopted law on capital markets does not provide a forceful or timely framework for addressing these shortcomings.

The insurance sector is small and almost entirely restricted to motor insurance. There have been few new entrants to the market for some years, and anticompetitive practices deter entry and growth. The NCFM is keen to move to risk-based supervision. This is a worthwhile goal, but resource constraints suggest it will be a difficult challenge.

Weaknesses in the insolvency and creditor/debtor regime create uncertainty and may deter some stakeholders from engaging in financial transactions. Access to finance is consequently an important constraint to entrepreneurial activity. There is no rescue culture for distressed enterprises, and the system may incentivize administrators to liquidate rather than reorganize. The use of restructuring techniques which could support long-term business rehabilitation if debtors experience financial distress is limited.

The team's key recommendations are summarized in Table 1. Especially in light of the weaknesses described above and recent geopolitical uncertainties, urgent action is needed to address these and mitigate the risks to which the financial system appears to be exposed.

Table 1. Key Recommendations[2]

Recommendation	Responsible Parties	Time Frame	Priority
Financial Stability Framework			
Amend the LNBM and LNCFM, and other legislation as required, to provide NBM and NCFM with the ability to enforce supervisory and regulatory actions in a timely manner	NBM, NCFM	ST	High
Establish a formal body e.g. a Council of National Regulators to conduct a system-wide financial stability assessment.	Financial regulatory authorities	MT	Medium
Bank Governance			
Re-evaluate bank shareholders to ensure disclosure of ultimate UBOs; and ensure continuous monitoring of owners and UBOs.	NBM	ST	High
Amend the LFI and the JSC Laws to enumerate the distinct roles of owners, board members, and senior management.	NBM, MOF	ST	High
Require that bank board directors sign attestations annually, affirming that the bank complies with all prudential requirements and has effective risk management systems and controls in place.	NBM	MT	Medium
Banking Supervision			
Amend the NBM Law to provide full legal protection and assistance to all NBM employees in case of lawsuits for actions in good faith.	NBM	ST	High
Amend the NBM law to remove MoJ power to amend the content of regulations.	NBM	ST	High
Progressively increase intensity of supervision and severity of corrective actions, including fines and restrictions, against banks in the case of persistent violation of laws and regulations.	NBM	MT	Medium
Increase intensity of AML/CFT surveillance in banks by performing more targeted on-site inspections in key areas.	NBM	ST	Medium
Crisis resolution			
Develop a comprehensive financial crisis resolution contingency plan, and identify necessary amendments to the legislation.	NCFS members	ST	High
Implement resolvability assessments, and recovery and resolution plans, for at least the systemically important financial institutions.	NCFS members	ST	High

[2] Additional recommendations for each section are presented in the technical notes and reports on standards and codes that have also been prepared as part of this FSAP Update. Short-term indicates action should be taken within 6 months; Medium-term indicates action should be taken within 6-24 months. Where legislative change is required, it is understood that Parliament needs to approve such changes; in these cases the “responsible party” in this table are expected to initiate the process.

Develop a program of capacity-building on crisis resolution, including strengthened coordination arrangements.	NCFS members	ST	High
Deposit Insurance System			
Clarify legislation to assure the DGF has earlier access to detailed depositor information and to allow it to verify such information on-site.	DGF, MOF	MT	Medium
Enhance funding by developing a target fund methodology; provide a line-of-credit to the DGF from the MOF; and include the NBM as an additional source of back-up funding for the DGF.	DGF, MOF, NBM	MT	Medium
Insurance Supervision			
Take forward implementation of a risk-based approach to insurance supervision.	NCFM	ST-MT	Medium
Develop key elements of group supervision, particularly with agencies outside Moldova.	NCFM	ST	Medium
Complete the resolution regime by finalizing the arrangements for the compensation scheme.	NCFM	MT	Medium
Financial Market Infrastructure			
Amend the LNCFM to provide the NCFM with all necessary regulatory and supervisory powers to ensure the integrity and transparency of all share registrations and transfers, and then consolidate the corporate securities registration function into an appropriately regulated and governed central securities depository.	NCFM	ST	High
Insolvency and Creditor/Debtor Regime			
Assign insolvency cases to designated members of the Court of Appeals who are specially trained in the management of insolvency cases.	Council of Magistracy, Supreme Court of Justice, MoJ	MT	Medium
Encourage early filing of insolvency proceedings and facilitate restructuring by developing the rules on directors' duties, removing barriers on insolvency filing by creditors, introducing clear conditions for obtaining and incentivizing the granting of new finance, and allowing for the extension of deadlines for the development of restructuring strategies.	Ministry of Economy	MT	Medium
Endorse workout guidelines and encourage their use by lenders.	NBM	MT	Medium

I. FINANCIAL SYSTEM STRUCTURE

1. **The Moldovan economy has undergone a number of political and macroeconomic challenges in recent years.** In 2008-2009 the economy was hit by external and political shocks, from which it started to recover in 2010, notably due to a combination of sound macroeconomic policies and structural reforms. Real GDP has expanded by 8.9 percent in 2013, mostly led by exports, private consumption, and investment. The unemployment rate is low (around 5.1 percent), and inflation (5.2 percent in December 2013) is within the NBM's target range of 5 percent ±1.5 percent. With nominal exchange rate depreciation (9 percent since end-2012), the MDL has depreciated by 1 percent in real terms.

2. **The Moldovan economy remains highly vulnerable to developments in the economies of its trading partners and reliant on remittances and donor support.** Remittances from Moldovan workers abroad are around 24 percent of GDP (on a declining trend), and donor support to the budget is equivalent to 10 percent of total spending (Figure 1). In per capita GDP terms, Moldova remains the poorest country in Europe.

3. **The financial system is dominated by the banking sector, which appears to be controlled by a small number of individuals.** There are 14 commercial banks (four foreign) with assets equivalent to about 70 percent of GDP – small compared with neighboring peers. Five of the six largest banks reportedly form two de facto groups, and have a combined 60-70 percent share of the banking system. Similarly, these individuals reportedly control much of the nonbank financial sector – insurance companies, securities registries, etc. – facilitating raider attacks on financial and nonfinancial companies. Total deposits (mainly by individuals) have grown by 90 percent since 2009, while credit (mainly to trade) has grown by about 45 percent (Figure 2A), more slowly than nominal GDP. Credit expansion is much lower when the very large lending growth of one problematic bank is excluded (Figure 2B). FX assets and liabilities account for around 45 percent of balance sheet totals. Since end-2011, cross-border financial linkages have increased dramatically and have become more complex (Figure 3). During this period, foreign placements by Moldovan banks more than doubled to 11 percent of GDP – with most of this growth occurring in 2013 – while their liabilities increased more slowly, to 10 percent of GDP.

4. **Nonbank financial institutions and markets are still small and underdeveloped.** The insurance sector is small at 3.5 percent of total financial sector assets and is growing only in line with GDP. Insurance premiums, compared to GDP, stood at 1.2 percent. Assets held by insurers account for just 2.4 percent of GDP. The total premium of MDL 1 billion (USD 90 million) in 2012 is heavily oriented to nonlife insurance (93.4 percent), predominantly compulsory motor insurance, leaving a very nascent life insurance sector. Two of the 16 authorized insurance firms account for half of the market. Microfinance institutions and some small deposit-taking credit associations—regulated by the NCFM—are increasing in number but their reach and size is not growing. As of December 2013, there were 83 microfinance institutions and 338 licensed

savings and credit associations. Their relative size remains stagnant at slightly over 2 percent of GDP.

5. **The capital market is small, and the Moldova Stock Exchange is controlled by the banks and is illiquid.** Turnover in 2013 represented less than 1 percent of GDP, and market capitalization was around 6.7 percent of GDP. Domestic government debt is around 5 percent of GDP,[3] and government securities are limited to short-term issues, with a maximum maturity of two years. The secondary market is thin; banks are the primary dealers and investors in this market. There are no significant private investment undertakings. A second stock exchange, the Chisinau Stock Exchange, was set up by some private sector firms and licensed in 2012 but has yet to commence operations.

II. FINANCIAL STABILITY RISK

A. Legal System

6. **A Constitutional Court ruling from December 2012 critically constrains the NCFM's supervisory powers.** The ruling permits any court to suspend NCFM's decisions pending a final court decision, and a number of NCFM regulatory actions have been suspended since then. No progress has been made to date on legislative amendments prepared by the NCFM.

7. **A similar Constitutional Court ruling on October 1, 2013, curbed the NBM's powers to effectively carry out its functions.**[4] The ruling permitted any court to suspend key actions and decisions of the NBM before final settlement of the case, with two exemptions, namely the acts issued by the NBM on the withdrawal of banking license and the measures imposed by the NBM during the bank liquidation process.

8. **In December 2013, Parliament approved amendments which partly restore some of the powers of the NBM affected by the Constitutional Court ruling.** These amendments are intended to strike a balance between the effectiveness of NBM's actions, particularly as a monetary authority, and its accountability through judicial review. Key provisions include (i) limiting the basis of court review of issues related to monetary and foreign exchange policy to questions on compliance with procedures; (ii) requiring evidence and proof of irreparable damage before seeking the suspension of NBM acts; (iii) establishing an internal appeal process within NBM to deal with appeals against NBM's actions; (iv) establishing that cases against NBM can be filed only in Chisinau; and (iv) allowing for the suspension of NBM decisions only in extreme cases. Thus the amendments establish a legal framework to avoid the immediate suspension of NBM decisions at the request of the plaintiff and provide for a special court-based procedure for any such suspension.

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[3] Total government debt stands at some 23.4 percent of GDP.

[4] The Constitutional Court ruling declared Article 11(4) of the Law on National Bank of Moldova (LNBM) unconstitutional. Article 11(4) says: "Until the final settlement of the case by the court, the enforcement of the NBM acts … shall not be suspended."

9. **However, a number of issues remain unaddressed, hindering the NBM's effective regulatory and supervisory actions.** These include (i) need for procedural consistency and clarity on preliminary appeal of NBM decisions; (ii) need for clarity on scope of the judicial review process, particularly relating to NBM supervisory decisions, so that the courts focus on the legality of NBM actions, rather than contesting the substance; (iii) allocation of the burden of proof to the plaintiff; (iv) need for detailed procedures of appeal of the administrative authorities' normative decisions to shorten the current unlimited timeframe; and (v) limitation of court powers to issue an injunction to prevent the adoption of a decision by the NBM. While the government in principle supports the legislative changes necessary to restore the NBM's powers, it is unclear if timely Parliamentary approval of the necessary amendments will be obtained.

B. Bank Governance

10. **The identity of the UBOs of some of the largest banks in Moldova is unclear, and the control that these UBOs reportedly exert over these banks appears not to be in the best interests of the banks' other stakeholders, including minority shareholders, depositors, and the public**. Many bank ownership structures are unduly complex, using shell companies, often offshore, to disguise the identity of the UBOs. Major changes in the ownership structure of the largest banks in the past two years have been accomplished by acquisition of voting shares in parcels below the 5 percent threshold for regulatory consent, as well as through fraudulent "raider attacks" that hijack the interests of existing bank shareholders.

11. **Ownership changes have also resulted in nontransparent changes in board members and CEOs.** Controlling shareholders – through the new management – are in some cases promoting imprudent activities, notably exceptional balance sheet growth funded by high-cost deposits, including interbank placements channeled via offshore banks. There are indications that a substantial portion of this funding has gone to finance owners' related-party transactions which – as the UBOs' identity is disguised – cannot be identified as such under NBM regulations. These transactions have introduced additional risk into some of the key banks in the system.

12. **The roles and responsibilities of ownership, internal oversight (board), and management are substantially blurred, resulting in unclear accountability and reduced effectiveness of governance**. All banks interviewed by the FSAP mission indicated that the controlling shareholders nominate and appoints board members, creating boards that have as their primary goal representation of the shareholders and no acknowledgement of the interests of the depositors, the public, and taxpayers despite fiduciary duty imposed by the LFI. The ambiguity of the UBOs and their nontransparent actions masks the board member nomination processes. There are no independent board members, and the minimum number of three directors is unusually low. Furthermore, the controlling shareholder typically appoints the CEO, who is vested with substantial decision-making authority, providing a channel for direct access by the controlling shareholder.

13. **Boards lack independence, and are not well qualified to oversee financial institution operations.** Some board members, as well as executive management, may hold board or executive positions in other institutions that may create a conflict of interest, and few have substantial financial institution experience. Members are appointed for a term of four years, but in contrast to good international practice which limits terms, they can be renewed an unlimited number of times, allowing perpetual board members.

14. **Having failed to put appropriate governance structures in place, boards also do not fulfill their proper role of strategic planning, oversight or risk management.** Planning is insufficiently focused on risk and risk control as evidenced by the under-development of critical functions such as compliance, independent risk management, and internal audit. Neither board audit committees nor other board committees, such as board risk committees, are in place. The risk management mechanisms necessary to identify, measure and report existing and potential risks are not formalized and are not effectively independent. Boards are not made explicitly responsible, by law, for the truthfulness and integrity of their banks' financial reporting.

15. **Internal audit functions lack independence and are not adequately resourced.** Although auditors meet with the board, none indicated that they regularly meet without management present. Consistently, audit departments are understaffed, and in many cases, auditors lack training. In addition, while most banks have compliance (or methodology) departments, they are not effective or structured consistent with international principles.

C. Asset Quality

16. **The sector wide average rate of NPLs, at 11.6 percent at the end of 2013, is trending down but disguises a wide variation in individual bank portfolios.** Specific banks, including systemic institutions, have NPL ratios exceeding 60 percent of total loans. Additionally, very sharp volatility in NPLs has been witnessed in certain banks, and active management of distressed portfolios appears to be minimal. Despite the Insolvency Law of 2012, which sought to encourage restructurings, the insolvency culture remains weak and the general tendency is to reschedule or enforce. Foreclosure, when it occurs, is a prolonged process. An NBM regulation requires collateralized lending except for enhanced creditworthiness, leading to overall incentives that promote poor credit practices including both weak underwriting and rescheduling.

17. **The impact of NPLs on capital adequacy is hard to estimate, and may be greater than indicated in reported statistics, but there are mitigating factors**. The NBM has introduced IFRS but continues to require additional supervisory provisions to take account of expected future losses. The coverage ratio of provisions against NPLs was 83.4 percent at end 2013, compared with a ratio of 48.4 percent required under IFRS. The difference between the levels of provisioning is deducted from banks' regulatory capital, and collateral (other than cash collateral) is not taken into account when estimating required provisioning. However, incorrect use of low risk weights for loans secured on residential property and numerous cases of loan misclassification undermine the reported capital adequacy figures. Moreover, weak governance

allows a significant degree of connected lending by banks, some of which is to insubstantial shell companies, while large exposure limits are breached, giving rise to concentration risk. Finally, very large deposits are placed cross-border in obscure transactions. A notionally overnight deposit may be placed cross-border in one bank, and reappear as a term deposit in a sister bank in Moldova, while the original deposit may in practice be encumbered, e.g., by being pledged as cash collateral against loans to connected companies. Moreover, such deposits may combine fictitious creation of 'liquid' assets, tax evasion, and money laundering.

18. **Dollarization is not a particular concern at present.** The proportion of FX assets and liabilities on commercial bank balance sheets has been stable over the last six years. FX loans – predominantly provided to businesses with cross-border trade or to individuals with demonstrable FX inflows from remittances – ranged from 40 to 46 percent during this period and FX deposits from 44 to 54 percent. The continuing high level of remittances and sufficient level of foreign exchange reserves mitigate the risks of FX lending – the annual level of remittances is roughly the same as the stock of FX loans. It will be important for the NBM to ensure that banks maintain vigilance and do not provide FX or FX linked loans unless the borrower has a reliable FX income. It will also be important to ensure that FX assets placed in banks abroad are freely available: there are indications that some balances, while notionally overnight deposits, are in fact encumbered.

D. Insurance Sector

19. **The insurance market has consolidated and improved its financial strength since the 2007 Law on Insurance was introduced.** The number of insurers has decreased – from 28 to 16 – in the nonlife sector and is now at levels closer to international benchmarks for more sustained competition and development. Capital and solvency requirements based on the "Solvency I" regime have been introduced and enforced. Reported technical provisions have improved in strength. However, actual concentration may be greater than reported, as unidentified UBOs obscure the picture. Anti-competitive behavior has particularly been alleged in the motor third party liability segment. Consolidation in the nonlife market has resulted in higher capital and better provisioning, but profitability and efficiency remain weak as economies of scale are still to be achieved. Compulsory motor insurance represents over 60 percent of nonlife premiums. Comparative statistics highlight a poor development performance. As a result, the sector plays only a limited role in economic development more broadly.

20. **The small size and absence of development of the insurance sector implies no material systemic risk.** Insurer investments in the banking sector appear manageable compared to capital levels. Cash and bank deposits represent just 3 percent of life insurance assets and 9 percent of nonlife assets, but ownership linkages with the unknown bank UBOs are widely suspected. It will be important to address governance and transparency issues before the sector grows substantially.

E. FMI risks

21. **The opaque share registry system creates conditions for raider attacks and has compromised the effective regulation of banks and insurance firms.** The securities records of joint stock companies are scattered across 11 registrars, which operate independently and are weakly supervised. Registrars can manually intervene to change share ownership, making them prone to unauthorized creation and deletion. Securities are recorded on the proprietary computer systems of each registrar, and there is no regular backup or reconciliation of data. On-site inspections by NCFM are infrequent, occurring every three years. Reforms to replace independent registrars with a central depository have failed to date but there are attempts to reform the Capital Market Law (CML), mandating the transfer of the registries of securities of Public Interest Entities (PIEs) to a central securities depository (CSD). Adoption by parliament is targeted by mid-2014. To strengthen oversight, a new database system is being developed by the NCFM to provide daily backups of all corporate securities transactions, once the legislation is passed.

22. **Legal uncertainty for the settlement of government and central bank securities is being addressed through new draft laws.** Specific legal provisions are needed to protect finality, collateral, and netting arrangements in case of insolvency proceedings and investors' rights in the Book-Entry System (BES). The adoption of such laws is important, although currently trade volume is low. There are plans to allow trading of government bonds onto the MSE, though trading on the Bloomberg platform will continue.

23. **Liquidity and general business risks are apparent at the National Securities Depository (NSD), which require greater oversight.** Liquidity risk arises as settlement is based on T+3, although there has been no participant default since operations started in 1998. The size of the guarantee fund (fixed at MDL 30,000 per participant) appears to be insufficient to handle potential settlement risks. A history of losses by the NSD suggests little scope to raise funds for investment in new infrastructure, and there appears to be no comprehensive risk management framework in place. Operational disruptions could impact liquidity for participants in the Real-Time Gross Settlement System (Automated Interbank Payment System (AIPS)), where the cash leg is settled.

24. **Regulatory fragmentation between NBM and NCFM could undermine the effective oversight of FMIs.** The authorities need to adopt and apply consistently the CPSS-IOSCO Principles for FMIs, and allocate or share responsibilities according to their mandates and competencies. A joint committee should be established for this purpose to deepen regulatory cooperation under the existing memorandum of understanding.

III. Stress Testing

25. **The formal results of the stress tests discussed below need to be treated with caution.** Data quality, and the existence of unidentified UBOs which leads to the potential for unidentified concentration risk and connected lending, undermines the stress test findings.

26. **Stress tests found that potential credit risk losses on the loan book represent the most important risk factor captured by the stress tests.** Top-down stress tests found that NPLs (and loan migrations) are sensitive to macroeconomic conditions, and FX risk is still important. Potential loan losses due to credit risk were estimated to range from MDL 1.7bn (2 percent of GDP) to MDL 5bn (7.5 percent of GDP). Other sources of credit risk remain contained. Floating rate lending practices limit vulnerability to interest rate movements; exchange rate risk and other sources of market risk appear to be contained.

27. **Concentration risks are high in specific segments of the banking sector.** Overall, sensitivity analysis shows that the potential losses remain manageable at the system level, but a couple of banks could become insolvent if a small number of their largest exposures were to default, and the difficulties in identifying UBOs suggests that risks arising from large exposures to related parties may be unidentified and understated.

28. **Vulnerabilities for one group of three banks include large concentration risk, significant cross-border interbank exposures, and questionable quality of some liquid assets.** Nevertheless, while this group of banks is highly interconnected among themselves, they present low interconnectedness with other domestic banks, and potential losses are likely to have limited direct spillovers to the rest of the banking system, although indirect contagion effects may be unpredictable. A few domestic banks exhibit large exposures to banks outside Moldova. Should these placements become impaired (e.g., if they represent cash collateral against weak credits), certain domestic banks could become insolvent. These losses would be contained within the banks in question, but spillover risks through other channels (e.g., depositor confidence) could be significant.

29. **Most bank liquidity positions appear to be sound, but there are important exceptions.** Liquidity stress tests show that the banking system as a whole has ample liquidity, with the system-wide liquidity coverage ratio exceeding 100 percent. However, some banks are dependent on large scale cross-border interbank placements making them vulnerable to a potential shock.

IV. Effective Supervision

A. Conditions for Effective Supervision

30. **Certain fundamental conditions for effective supervision in the financial sector are not in place in Moldova.** Such conditions include the rule of law, market discipline, safety nets and resolution capacity, and financial stability architecture. Failure to provide these conditions undermines the actions and effectiveness of the supervisory authorities (the NBM and the NCFM) and weakens overall financial stability in Moldova.

31. **There is an absence of the impartial and predictable rule of law.** A range of issues contribute to grave concerns relating both to framework and practices. Market participants, government officials and stakeholders have raised concerns about the levels of corruption in the

judiciary.[5] Court rulings against the supervisory authorities have overturned or suspended enforcement actions and decisions. Constitutional Court rulings in 2012 and 2013 (see paragraphs 6 and 7) also have a substantial impact on the effectiveness of supervisory actions. Legal certainty is further undermined by weaknesses in the financial legislation and regulation relating to lack of clarity in drafting as well as gaps in coverage. One notable deficiency in the legislation concerns the lack of legal protection afforded to the staff of the NBM and NCFM in pursuit of their duties.

32. **Institutional architecture to support system-wide financial stability is not fully in place.** The National Committee for Financial Stability (NCFS) was created in June 2010, tasked with defining and managing crisis events, but there is not yet an effective and fully operational framework for financial stability policy formulation. While changes to the mandate of the NCFS may be needed, it is important that the members of the NCFS and the technical subcommittee, as appropriate, can make independent decisions related to their areas and functions as designated in legislation.

33. **Crisis coordination should be supplemented by consistent system-wide assessments during non-crisis periods.** Some stability analysis is carried out at individual institutions, including the NBM and NCFM, but transparency and coordination between individual authorities and institutions need to be enhanced. A specific body, for example, a Council of National Regulators chaired by the NBM, should be granted a mandate to perform system-wide financial stability assessments.

B. Banking Supervision

34. **The NBM has made significant progress in reinforcing its prudential and supervisory framework and has taken several initiatives to address a number of key recommendations from the 2008 FSAP.** Interviews with NBM staff showed a strong professionalism within the Banking Regulation and Supervision Department (BRSD) and a high degree of awareness of deficiencies in the banking sector. The quality of internal analysis is outstanding, and the inspection reports are also noteworthy. However, effective banking supervision is still handicapped by a series of external and internal factors.

35. **The NBM has designed two successive medium-term strategies since 2008 to set a forward-looking approach for supervision.** Moldova is also in the process of transitioning from Basel I to Basel II and has tightened capital requirements to increase banks' resilience. In the context of an Association Agreement to be signed with the European Union,[6] the NBM plans to implement the standard approach for credit, market, and operational risk under Basel II as well as other elements of Basel III.

[5] Moldova is ranked 102 out 177 countries according to Transparency International.

[6] European Neighborhood and Partnership Instrument, "Strengthening the NBM's capacity in the field of banking regulation and supervision in the context of Basel III requirements."

36. **The NBM has enhanced both regulations and practice of on-site supervision.** The NBM has also adopted new regulations and recommendations in key areas. The stress-testing framework has been improved, and regulations on asset classification and equity holdings in banks were enhanced as well as recommendations on anti-money laundering and combating the financing of terrorism (AML/CFT). Banks' accounting and reporting standards have benefited from the recent adoption of IRFS. Efforts have been made to increase transparency in banks' ownership and control structure, to devise methodologies for identifying vulnerabilities in the banking sector and for conducting AML/CFT on-site inspections.[7]

37. **Efforts have been made to increase the level of transparency in banks' ownership and control structure**. As recommended by the last FSAP, the NBM through its full-scope on-site inspections, has paid due consideration to transparency in bank ownership structure and concomitantly required banks to publish a significant amount of data. NBM inspectors have checked whether banks have set up proper internal control mechanisms to (i) identify people exerting significant influence, and (ii) determine ownership structures as well as sources of contributed capital.

38. **On the other hand, NBM powers have been seriously hampered in many respects.** The Ministry of Justice's (MOJ's) practice of amending NBM regulations undermines the NBM's autonomy and creates delays, sometimes up to a year. NBM recommendations are not binding instruments. Further, as noted above, all actions and decisions of the NBM, with the exception of revocation of license and measures imposed during the bank liquidation process, can be challenged in court and suspended pending a final decision on the case. Despite amendments to the LNBM, there are still concerns about the capacity of the NBM to take prompt corrective measures in the area of supervision, not least given the recent suspension of parts of the NBM's revised regulation on large exposures.

39. **The law needs to provide greater independence and protection to the NBM.** The conditions for dismissing the governor and other board members are unclear, and the LNBM permits political interference. NBM board members and employees, including staff appointed as a bank's liquidator, have insufficient protection against lawsuits while discharging their duties in good faith. Lastly, staff do not receive any legal assistance in case of lawsuits. Draft legislation to address this issue is with parliament, but there is no indication when or if it will be passed.

40. **Enforcement of prudential regulations should be more forceful, and the current legal regime contains serious limitations and flaws.** While the NBM has adopted several measures as a result of multiple infringements over recent years, it has not acted forcefully when faced with persistent deficiencies in the same institutions, although this may reflect inhibitions due to lack of effective legal protection. Existing legal sanctions may not be dissuasive enough, particularly when it comes to fines. Lastly, the timescale for action is inappropriately short.

[7] With the technical assistance of the U.S. Treasury.

Under the NBM law[8] the NBM must pursue sanctions within 3 years of the violation and the process must be completed within 6 months.

41. **Non-transparency of banks' ownership and control structure is a major concern with cascading effects in several areas**. Despite enhanced regulations, internal processes, and reporting mechanisms most recent changes in ownership of Moldovan banks have been conducted in an opaque manner and were not subject to NBM scrutiny. As a result, undisclosed "raiders" acting in concert have been able to acquire or accumulate significant controlling stakes in banks which can impact the nature of the banks' business and, potentially, their safety and soundness. Supervision of related party lending and large exposure limits cannot be effective if the identity of the UBOs is disguised and banks may be exposed to excessive concentration risks.

42. **The risk management culture is weak and insufficiently supported by regulatory standards, and compliance functions in banks are almost nonexistent.** Although the NBM has issued some regulations addressing elements of risk management, there are notable gaps, such as market risk and an over-arching risk management framework. Practice within banks is variable and the quality of implementation is doubtful. In some banks the disciplines of internal audit, compliance, and risk management appear to be conflated, and it can be unclear who takes responsibility for monitoring or managing risk. The independence and effectiveness of internal audit has also been questioned. The poor risk environment leads to problematic issues in relation to asset quality in a number of banks, including aggressive lending to high-risk borrowers, such as start up entities with little or no financial track record. Similar concerns about risk management exist for other financial institutions, particularly in the insurance sector.

43. **Banks' accounting and reporting standards have also been improved through the recent adoption of IFRS**. In February 2008, the Government adopted Decision No. 238/29.02.2008 requiring the use of IFRS in the Republic of Moldova. Banks have started to implement IFRS and submit to the NBM their financial statements using the FINREP (the EU standardized EU financial reporting) templates since January 1, 2012.

44. **Moldova has made important efforts to address issues related to money laundering and terrorist financing, but the situation warrants intensified scrutiny.** The approval by the Parliament of the National Strategy to combat ML/TF is a significant step forward, but the AML/CFT unit of the NBM seems to be understaffed, and difficulties in identifying UBOs together with weak compliance functions expose the financial sector to significant integrity and money laundering risks. Two issues demand maximum attention: cross-border transactions and transactions with Transnistria[9] – flows of funds of MDL 1 trillion and MDL 2 billion, respectively, have been identified. In each case, tax evasion and potential for AML/CFT abuse is

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[8] Art. 75²(4)

[9] Transnistria is a region of Moldova designated as an autonomous territorial unit with special legal status but unrecognized by any United Nations member state. From an AML/CFT standpoint, the region is a black hole that led the authorities to declare every transaction between Moldovan and Transnistrian banks to be suspicious.

high. Against this background, it is essential to increase the intensity of AML/CFT surveillance in banks including targeted on-site inspections.

45. **Banking supervision would benefit from increased resources.** Given the demands of problematic banks and future efforts needed to migrate the banking system to EU requirements and Basel II/III standards, current staffing and skill levels are insufficient. Moreover, in the absence of a clear and sufficient budget allocated to supervision, effective forward planning is frustrated.

C. Insurance Supervision

46. **The 2007 Law on Insurance and the transfer of supervision to NCFM has strengthened regulation but much remains to be done.** Few of the Insurance Core Principles (ICPs) are fully or largely observed, with better performance in the establishment of the NCFM, licensing, oversight of intermediaries, and consumer protection. Shortcomings arise from a lack of effective regulatory powers, lack of transparency in ownership impacting supervision of change of control, limited cooperation and coordination especially with respect to the supervision of groups, and risk management and governance.

47. **The restoration of the NCFM's powers to supervise the insurance sector and other sectors under its authority, without undue court suspension, is crucial and urgent.** Ensuring the credibility of the regulatory regime will rely on transparent and sustained enforcement of laws and regulations. The sector's transparency, risk management capacity, public awareness, and trust all require improvement.

48. **The insurance law is dependent on enabling regulations.** NCFM initiatives have strengthened the solvency and provisioning requirements and practices of insurers, reinforced the role of actuarial advice, improved financial reporting, and introduced IFRS. The NCFM's progress, however, also reflects the constraints in conditions (discussed in the section on Conditions for Effective Supervision, above), the nature, scale and complexity of the sector, and sector capacity.

49. **The planned transition to risk-based supervision would address many current shortcomings.** The NCFM has recently made a decision to move from a pure compliance approach to a more risk-based methodology. Implementation will need to be phased, given the technical capacity constraints, but improvements in supervision of governance, internal controls, suitability of key persons, risk management, and capital assessment, would seem to be areas for early gains.

50. **Group supervision, particularly operational level cooperation and communication with other supervisors, is a priority.** The NCFM has few MOUs with supervisors outside Moldova and does not proactively engage with such supervisors despite the growing number

complexity of ownership structures with non-domestic linkages. The NCFM could benefit from closer cooperation with other supervisors.

51. **Although the resolution and wind-up processes are working, the arrangements for the compensation scheme remain incomplete.** The insurance law includes provision for a compensation scheme which has not yet been implemented. Completing this element of the regime should improve trust in the sector.

V. CRISIS MANAGEMENT AND SAFETY NETS

A. Financial Stability Framework and Crisis Management

52. **Moldova has made progress in strengthening its financial crisis resolution framework.** The NCFS was established in June 2010 by the Government to promote a coordinated framework for responding to a financial crisis. It is chaired by the Prime Minister and comprises: the Government; the Parliamentary Commission on Economy, Budget and Finance; the NBM; Ministry of Finance (MOF); the Ministry of the Economy; the Deposit Guarantee Fund (DGF); and the NCFM.

53. **Some of the laws required for bank crisis resolution are in place.** In particular, the LFI provides the NBM with a range of powers. These include the ability to place a bank under special supervision, the power to give binding directions to a bank in certain circumstances, and the ability to appoint a special administrator to assume control of a bank. Once a bank is in administration, the NBM has a number of resolution options, including facilitating recapitalization, transferring some or all of its business to another bank, and liquidation.

54. **Nevertheless, there are gaps and deficiencies in the framework which warrant high priority attention.** These fall into three broad categories: legal powers; crisis resolution strategies and procedures; and cross-agency crisis resolution capacity and coordination. Moreover, the concentration of large (de facto connected) banks gives rise to a potential too big to fail problem, compounded by the lack of viable alternatives to government-funded bailout under existing resolution arrangements.

B. Legal Powers

55. **Deficiencies in the LFI limit the options for responding to a banking crisis and potentially hinder timely resolution.** Although the LFI empowers the NBM to issue directions to a bank, there is uncertainty as to the scope of the direction power, including the NBM's ability to require a bank to restructure its business to enable a least-cost resolution (e.g., through pre-positioning for the separation of systemically important business functions). Moreover the direction powers apply only to banks, not their subsidiaries. The same limitation applies to the powers of a special administrator. This could impede a timely and effectively group resolution if important business functions are located in subsidiaries. The inability to appoint a special

administrator to a subsidiary also means that the moratorium protection under administration does not apply to subsidiaries.

56. **There is uncertainty in the scope and protections associated with business transfer powers.** Although the LFI permits the transfer of business for a bank under administration, it is unclear whether the power applies to all of a bank's contractual rights and obligations, IT systems, and staffing contracts. There is also uncertainty as to whether a transfer of business could trigger rights of termination of contracts by counterparties, given that there is no statutory override to such contractual provisions.[10] Indeed, there is a considerable risk that the appointment of a special administrator would trigger the termination or close-out of financial contracts and the exercise of set-off rights by counterparties.

57. **A major concern relates to the risk of judicial challenges to the exercise of resolution powers.** This is particularly the case with the exercise of direction powers, the appointment of a special administrator, and the restructuring of a bank under administration.

58. **There are other significant deficiencies in legal powers for resolution.** It is unclear that the NBM, or MOF, has the legal authority to establish a bridge bank or any other legal entity for resolution purposes. Moreover, the LFI includes no specific power to implement a bail-in; nor are there statutory powers to enable the government to provide funding, guarantees, or indemnities quickly (without prior Parliamentary approval). These deficiencies further impede the ability to implement an effective and timely resolution.

C. Crisis resolution strategies and procedures

59. **Although the NBM has made progress, there are substantial gaps in crisis resolution strategies and procedures.** To date, general resolution options have not been adequately identified. Resolvability assessments of systemically important banks have not yet been undertaken, and there are no bank-specific resolution plans in place. No internal guidance has been developed to assist in the rapid assessment of bank solvency, although the NBM's stress testing methodology would be of some assistance in this context. While the NBM has issued guidance on providing liquidity support to banks, there has been little consideration given to the legal and procedural aspects necessary to enable the NBM to take collateral.

60. **A contingency plan for crisis resolution covering all elements of the resolution process is urgently needed.** This plan needs to include solvency assessments, systemic impact assessment of different resolution options, resolvability assessments, and bank-specific resolution plans. It also requires a renewed focus by the NBM on banks' recovery plans and banks' capacity to implement recovery actions quickly and credibly in the event of a banking crisis.

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[10] The preferred approach, consistent with the FSA Key Attributes, is for early termination rights to be subject to a temporary stay (no more than two days).

61. **Each relevant agency needs to take responsibility for and develop resolution plans for its respective area of responsibility.** The MOF would be responsible in particular for recapitalization, funding, or guarantee arrangements provided by the government. The DGF needs to strengthen its plans to facilitate prompt pay-out and to access funding from the MOF if required. The NCFM needs to have resolution plans to enable it to respond quickly and decisively to the distress or failure of institutions under its jurisdiction. All of these resolution plans need to be coordinated under the framework provided by the NCFS.

D. Coordination and capacity building

62. **The NCFS MOU provides a helpful framework for coordination, but there is a need for further capacity-building on crisis resolution across the agencies.** Some progress towards developing a coordinated approach to resolution has been made through the meetings of the NCFS Technical Sub-Committee. However, a much more intensive process of regular, collegial interagency coordination is needed at senior management and working levels. A crisis simulation exercise held across some member agencies after the FSAP mission should be followed by the development of a program of regular crisis testing, both within each agency and across the all agencies via the NCFS.

E. Deposit Insurance

63. **The DGF, established in 2004, has dealt effectively with two recent bank failures.** It has a paybox mandate focused on depositor reimbursement, although it may also provide financial assistance on a least-cost basis. Membership is compulsory for all banks, but coverage is limited to MDL 6,000 (USD 445) per individual depositor per bank; foreign currency deposits as well as MDL deposits are covered. A variety of funding mechanisms is in place and a fund equal to 7.1 percent of insured deposits has been accumulated.

64. **The DGF is well managed, but more thorough governance reviews and strategic planning processes would be beneficial.** There is no formal process to review on a regular basis the extent to which the DGF is meeting its public policy objectives, and strategic planning is limited. In addition, the operating budget of the DGF is very small providing little room to enhance operational capacity or expand training and development opportunities for staff.

65. **The coverage limit should be raised to increase depositor protection and better contribute to financial stability.** The coverage limit, defined in law, is very low (i.e., covering 63 percent of individual depositors and 8 percent of the total value of deposits). Prior to changing the coverage limit, a thorough analysis should be undertaken on the impact of raising coverage on (i) the proportion of depositors and the total value of deposits covered; (ii) fund adequacy; and (iii) required premiums. Any increase in coverage should come after the banks complete paying – expected in 2015 – special assessment obligations related to an existing bank resolution.

66. **The DGF should develop a target fund methodology and greater assurance of back-up funding.** The DGF utilizes an ex-ante funding model with the ability to charge ex post assessments. The existing fund size appears adequate and would allow for the payout of the six smallest banks combined or a single medium-sized bank. However, there is no methodology to establish target funding ratios. Emergency back-up liquidity funding can be obtained from special premium assessments on banks or borrowing from the MOF, which requires parliamentary approval. Consideration should be given to (i) providing the DGF with a pre-defined line-of-credit from the MOF; and (ii) amending the DGF and NBM laws to include the NBM as an additional source of emergency liquidity back-up funding.

67. **The DGF and those working on its behalf require legal protection and appropriate codes of conduct/ethics.** Conflict-of-interest codes for DGF staff need to be made comprehensive.

68. **Enhanced information sharing would improve payout performance.** Information sharing and coordination arrangements (through legislation and MOUs) have been developed between the DGF and the NBM. The reimbursement period, which in practice ranges from 17-30 days for the majority of depositors, could be reduced by legal clarifications to provide the DGF with access to more detailed information on individual depositors and the ability to verify such information on-site. In addition, the DGF Law should be amended to allow the DGF to share information related to deposit insurance with insurers in other jurisdictions, subject to appropriate confidentiality provisions.

69. **The creditor ranking of the DGF in an insolvency is too low.** The DGF has a lower status as a creditor in an insolvency than other depositors and unsecured creditors, leading to low or nonexistent recoveries for the DGF from failed banks.

VI. DEVELOPMENT AND MARKET STRUCTURE

A. Financial Market Infrastructure

70. **The legal framework for FMIs needs to be strengthened.** Apart from efforts to adopt settlement finality and financial collateral rules in line with international standards, there is also a need to fully dematerialize the transfer of corporate securities rather than require the intervention of the registrar.

71. **CSD reform efforts require a strategy and should include a cost analysis.** A four-part approach could be considered, starting with the establishment of a Working Group on CSD Reform, co-chaired by the NBM and NCFM, formed under the National Payments Council (NPC). Second, a cost analysis should assess the economic feasibility of different approaches to a single CSD. Third, the financial and risk management and capital adequacy of the private sector should be assessed. Finally, the working group should develop a well sequenced reform strategy, approved by the NPC, to guide implementation and minimize industry impact.

72. **The planned transfer of corporate securities into a single depository is an incremental change that should aim for full consolidation.** The NCFM plans, using CML amendments, to consolidate the registration system for corporate securities issued by PIEs and traded on the stock exchange into a single depository. The exclusion of nonpublic interest entities (i.e. over half of all registered joint stock companies) from mandatory transfer to the new CSD hampers efforts to prevent fraud risks. The NCFM should weigh the benefits of detecting fraud against the cost of moving additional securities to the planned new CSD. In the interim, the authorities could strengthen oversight by increasing the frequency of registrar inspections.

73. **Loss-sharing mechanisms should be considered in the move from a registrars-based system to a fully dematerialized system for all securities' transfers.** As the process of reconciling securities records could reveal possible data inconsistencies (e.g., more securities recorded than securities effectively issued), loss-sharing arrangements could appropriately be organized ex ante, whether using pro-rata loss allocation or the investors' protection fund.

B. Insolvency and Creditor/Debtor Regime

74. **Most lending by financial institutions is based on secured lending, primarily security in real property.** The mortgage regime is generally adequate and effective, but lending tends to be based primarily on collateral value rather than on the viability of the borrower. There is little unsecured credit available for enterprises. In fact, loans are often over collateralized, reducing available credit and increasing the incentives for lenders to rely primarily on their collateral for repayment rather than to support restructuring efforts.

75. **Secured lending based on movables is deficient, restricting credit to enterprises.** Problems with the share registries, as described in other parts of this report, severely constrain the use of pledges over shares. The regime for security interests in movable assets is not trusted, with lenders reluctant to take security over pools of movable assets. It is also relatively easy for debtors to frustrate enforcement against movable assets, using court challenges. The current project to reform the Law on Pledge presents an opportunity to solve a number of technical issues in this area, in particular improving the registration system and introducing more efficient enforcement mechanisms.

76. **A credit history bureau is in operation in Moldova since 2011 but it requires improvement.** The recently established credit reporting bureau does not cover non-bank lenders, utilities, and other service providers, and there are also concerns about the reliability and comprehensiveness of the data provided to the bureau.

77. **There is limited use of out-of-court collective restructuring tools.** While lenders are willing to reschedule problem loans with their own borrowers as an alternative to enforcement, other forms of restructuring are rarely considered, and collective action tools are almost never used. A rescue culture has yet to emerge. It would be useful to consider endorsing workout guidelines and encouraging their use by lenders.

78. **The insolvency regime is now more modern, but it has implementation problems, and some aspects of the law may require strengthening.** For example, fictitious claims are sometimes created to initiate an insolvency process in order to take control of debtors or their assets. Additionally, the streamlining of the appellate process may have gone too far, as some matters that significantly affect creditor rights are not appealable, denying parties due process. Other notable issues include (i) cumbersome commencement criteria for insolvency filing by creditors,[11] (ii) the stay on accrual of interest on over-secured claims,[12] and (iii) the structure and implementation of the transaction avoidance rules.[13] It will be useful as an immediate measure to establish means to monitor the application of the law to assess whether its aims are being met. In the medium term, consideration should be given to strengthening certain aspects of the framework where problems are already apparent.

79. **The insolvency framework as applied in practice does not sufficiently facilitate restructurings and going concern sales.** The provisions on debtors' duties fail to encourage filing at times of imminent (but before actual) insolvency. During the insolvency process, administrators may have too little time both to complete administrative tasks and propose a restructuring strategy. The general practice is still to liquidate assets piecemeal, and the rules in the law affecting the decisions regarding asset dispositions and restructurings tend to support that practice. The lack of robust rules for obtaining and incentivizing post-petition financing make restructurings less likely as well.

80. **The judicial system for managing insolvency proceedings is not perceived as reliable.** As a result of the restructuring of the court system, insolvency matters are now assigned to the generalist Courts of Appeal, creating a lack of confidence in the courts' expertise to properly manage such cases. A trained, skilled, and appropriately regulated judiciary is essential to encourage market players to make use of the insolvency system. Assigning insolvency proceedings to a subset of specially trained Court of Appeal judges should be considered.

81. **Public access to court records is not transparent.** The insolvency process should be more transparent to the public, both to inspire confidence in the integrity of the process and to allow market players an opportunity to participate. Currently, only participants have access to the case file and to hearing recordings. Third parties who might be able to provide rescue

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[11] Art. 20 of the Law on Insolvency requires that a creditor present a copy of an irrevocable court (or arbitration or empowered authority) judgment which is subject to execution. Obtaining such a judgment can be a lengthy and cumbersome process.

[12] The accrual of interest for secured creditors is stopped throughout the moratorium period (i.e., the stay on enforcement), and there is no provision regarding post-petition payment of interest up to the value of the collateral.

[13] The periods envisaged to avoid certain operations can be too long (3 years for a transaction at an undervalue), damaging security of tenure in market operations. For other types of acts, the time to set aside the transactions might be too short (4 months for undue preferences or for the creation of security for previously unsecured loans), and there are some additional uncertainties (including with regard to transactions with related persons). Also, the provisions are not often used in practice, at least partly because administrators might lack the resources to pursue such actions.

financing, or who might be interested in making purchase offers for the enterprise as a going concern, do not have such access. Changes to the rules regarding what matters are open for public review (such as plan proposals and asset lists) would help to address this issue.

82. **The system for judicial appointment and supervision lacks adequate assurances for integrity and credibility.** Judicial selection at the Court of Appeal level is entirely internal, as is the regulation of judicial conduct. While this system maintains judicial independence, it can also lead (and has led) to allegations of protectionism. Merit selection panels that include non-judge members should be established. A more objective system of judicial discipline should be enacted. All members of the judiciary should be obligated to refer for criminal investigation any judicial conduct that gives probable cause to believe that a crime has been committed, regardless how it comes to their attention.

83. **Administrators and liquidators lack sufficient independence, training, and supervision.** Administrators are selected by the petitioning party, creating a potential for bias and abuse. Many lack the training to operate a business, a necessary qualification to maximize recoveries for creditors. The insolvency law should afford administrators an adequate structure and the financial resources to attempt going concern sales or restructurings of viable entities. Administrators should also be licensed, properly trained, and supervised.

Appendix I. Figures

Figure 1

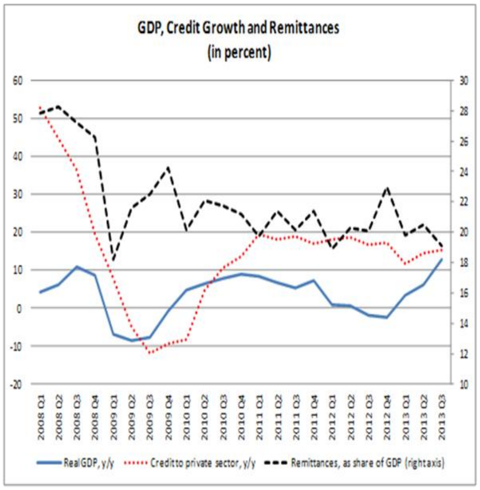


Figure 2A

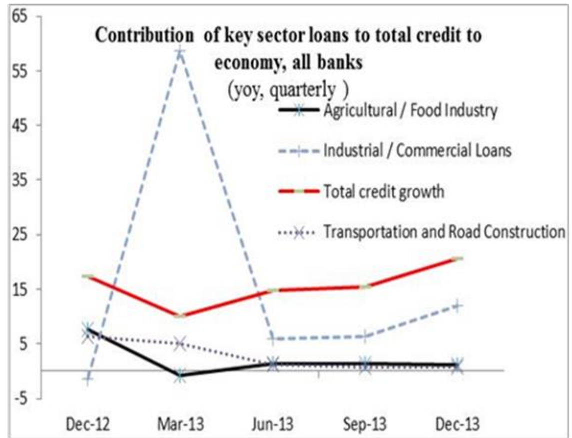


Figure 2B

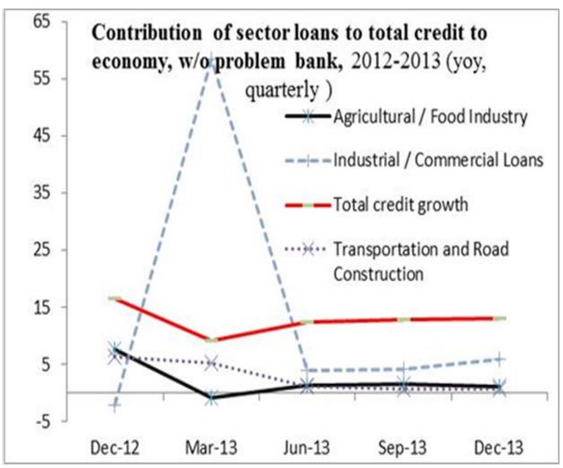
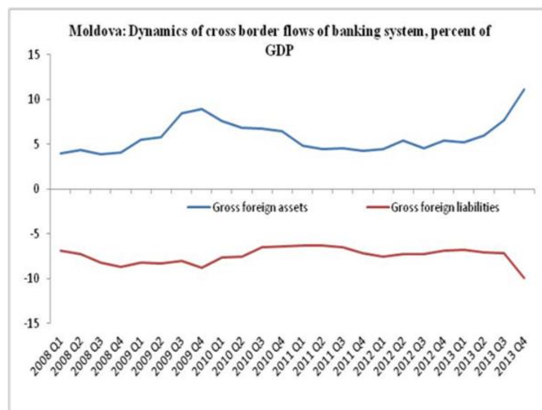


Figure 3



Appendix II. Tables

Table 2: Financial Soundness Indicators, 2009–13

	Dec.09	Dec.10	Dec.11	Dec.12	Mar.13	Jun.13	Sep.13	Dec.13
Size								
Number of banks	15.0	15.0	15.0	14.0	14.0	14.0	14.0	14.0
Total bank assets (billions of lei)	39.9	42.3	47.7	58.3	59.9	63.5	69.1	76.18
Total bank loans (percent of GDP)	37.1	35.5	36.2	39.6	35.3	38.1	39.4	42.53
Total bank assets (percent of GDP)	66.1	58.9	57.9	66.1	60.4	64.0	69.7	76.82
Capital adequacy								
Total regulatory capital (billions of lei)	6.6	6.8	7.5	7.0	7.6	7.4	7.8	8.2
Capital adequacy ratio	32.3	30.1	30.4	24.8	25.4	23.3	23.3	23.38
Liquidity								
Liquid assets (billions of lei)	15.3	14.4	15.8	19.2	19.8	19.8	22.3	25.72
Total deposits (billions of lei)	24.4	28.7	32.6	39.8	40.5	43.6	46.1	51.89
Liquidity ratio (liquid assets in percent of total deposits)	62.6	50.3	48.5	48.2	49.0	45.4	48.4	49.56
Liquid assets in total assets	38.3	34.2	33.2	32.9	33.1	31.2	32.3	33.8
Asset quality								
Gross loans (billions of lei)	22.4	25.5	29.8	35.0	35.0	37.8	39.1	42.18
Nonperforming loans (billions of lei)	3.7	3.4	3.2	5.1	4.6	4.8	4.9	4.9
Substandard	2.2	2.3	2.4	1.7	1.6	1.4	1.4	1.6
Doubtful	1.4	1.0	0.7	2.2	1.5	1.6	1.5	1.2
Loss	0.1	0.1	0.1	1.1	1.5	1.8	1.9	2.1
Loan loss provisions (billions of lei)	2.2	2.1	2.1	3.7	3.7	3.9	4.0	4.1
Nonperforming loans as a share of total loans	16.3	13.3	10.7	14.5	13.0	12.7	12.4	11.6
Substandard	9.6	8.9	8.0	5.0	4.5	3.7	3.7	3.7
Doubtful	6.5	3.9	2.2	6.4	4.3	4.2	3.8	3.0
Loss	0.2	0.6	0.5	3.2	4.3	4.8	4.9	4.9
Provisions to non-performing loans	59.2	63.2	65.0	73.5	80.4	80.5	82.3	83.6
Loan-loss provisioning/gross loans	9.7	8.4	6.9	10.7	10.5	10.2	10.2	9.7
Profitability								
Return on equity	-2.1	3.0	11.5	5.6	10.9	9.3	10.5	9.4
Return on assets	-0.4	0.5	2.0	1.1	1.9	1.6	1.8	1.6
Foreign currency assets and liabilities								
Total liabilities (billions of lei)	33.0	35.0	39.6	48.1	49.8	52.8	57.9	64.8
Foreign currency liabilities (billions of lei)	17.1	17.7	20.0	23.5	24.0	25.5	29.3	33.0
Foreign currency denominated liabilities in total liabilities	51.7	50.7	50.4	48.9	48.2	48.3	50.6	51.0
Foreign currency denominated assets	0.0	17.2	19.3	23.8	24.4	26.2	28.9	34.1
Foreign currency denominated assets in total assests	40.2	40.8	40.5	40.9	40.7	41.3	41.9	44.7
Foreign currency deposits in total deposits	49.3	45.6	42.2	40.2	40.3	39.1	43.1	44.7
Foreign currency denominated loans in total loans	44.7	42.3	44.5	42.6	43.4	42.9	42.8	40.4

Source: National Bank of Moldova.

GDP (million MDL)	60,430	71,849	82,349	88,228	99,173	99,173	99,173	99,173

Table 3. Moldova: Selected Economic Indicators, 2009–19 1/

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
					Prel.	Projection					
I. Real sector indicators	(Percent change, unless otherwise indicated)										
Gross domestic product											
Real growth rate	-6.0	7.1	6.8	-0.7	8.9	2.2	3.5	4.0	4.0	4.0	4.0
Agricultural	-9.9	7.4	5.2	-20.1	40.6	0.0	4.0	4.0	4.0	4.0	4.0
Non-agricultural	-5.6	7.1	7.0	2.0	4.9	2.5	3.4	4.0	4.0	4.0	4.0
Demand	-15.1	9.2	8.3	0.4	6.2	2.1	2.4	2.6	3.2	3.2	3.3
Consumption	-6.9	7.3	7.5	0.9	5.2	2.8	3.0	2.8	3.1	3.2	3.2
Private	-8.0	9.6	9.4	1.0	6.5	1.9	1.9	2.6	2.9	3.1	3.1
Public	-2.0	-1.1	-0.7	0.6	-0.8	7.2	8.3	3.5	3.7	3.9	4.0
Gross capital formation	-30.9	17.2	13.0	1.8	3.3	3.8	2.2	1.5	4.0	2.7	3.4
Private	-32.1	18.5	11.3	-3.9	-3.7	0.5	1.0	3.5	4.0	4.0	4.0
Public	-26.4	12.4	19.3	21.6	22.4	11.0	4.5	-2.2	4.1	0.2	2.2
Nominal GDP (billions of Moldovan lei)	60.4	71.9	82.3	88.2	99.9	108.7	118.8	130.6	143.3	156.6	171.1
Nominal GDP (billions of U.S. dollars)	5.4	5.8	7.0	7.3	7.9	7.6	8.1	8.7	9.2	9.8	10.4
Consumer price index (average)	0.0	7.4	7.6	4.6	4.6	5.7	6.0	6.3	5.8	5.3	5.0
Consumer price index (end of period)	0.4	8.1	7.8	4.0	5.2	5.4	6.5	6.0	5.5	5.0	5.0
GDP deflator	2.2	11.1	7.3	7.9	4.0	6.5	5.6	5.7	5.5	5.1	5.0
Average monthly wage (Moldovan lei)	2,748	2,972	3,194	3,478	3,765	4,080	4,450	4,880	5,330	5,820	6,355
Average monthly wage (U.S. dollars)	247	240	272	287	299	286	304	325	344	364	387
Unemployment rate (annual average, percent)	6.4	7.4	6.7	5.6	5.1	6.0	5.8	5.6	5.5	5.5	5.5
Saving-investment balance	(Percent of GDP)										
Foreign saving	9.5	9.6	12.3	7.7	5.5	7.4	8.2	8.1	8.0	7.9	7.7
National saving	13.1	13.0	11.0	16.0	17.1	16.0	14.8	14.3	14.4	14.3	14.3
Private	14.8	10.4	8.1	11.7	11.7	10.6	11.5	11.7	12.1	11.9	11.9
Public	-1.7	2.6	2.9	4.3	5.3	5.4	3.3	2.6	2.4	2.3	2.4
Gross investment	22.6	22.6	23.3	23.6	22.6	23.3	23.0	22.4	22.4	22.2	22.0
Private	17.6	17.9	18.1	17.4	15.5	15.5	15.1	15.0	15.0	15.0	15.0
Public	5.0	4.8	5.2	6.3	7.1	7.9	7.9	7.4	7.4	7.2	7.1
II. Fiscal indicators (general government)											
Primary balance	-5.1	-1.8	-1.6	-1.4	-1.3	-1.9	-3.9	-4.0	-4.0	-3.7	-3.4
Overall balance	-6.3	-2.5	-2.4	-2.2	-1.8	-2.6	-4.6	-4.8	-5.1	-4.8	-4.7
Stock of public and publicly guaranteed debt	32.4	30.5	29.0	31.1	29.9	31.8	32.8	34.7	36.7	39.4	41.5
III. Financial indicators	(Percent change, unless otherwise indicated)										
Broad money (M3)	3.2	13.4	10.6	20.8	26.5	15.9	16.4	...	...	...	...
Velocity (GDP/end-period M3; ratio)	1.8	1.9	2.0	1.8	1.6	1.5	1.4	...	...	...	...
Reserve money	-10.1	15.9	18.4	22.9	31.9	13.4	14.0	...	...	...	...
Credit to the economy	-4.9	12.7	15.0	16.1	18.8	11.3	11.4	...	...	...	...
Credit to the economy, percent of GDP	39.5	37.4	37.6	40.7	42.7	43.7	44.6	...	...	...	...
IV. External sector indicators	(Millions of U.S. dollars, unless otherwise indicated)										
Current account balance	-516	-559	-863	-559	-438	-564	-662	-700	-737	-774	-806
Current account balance (percent of GDP)	-9.5	-9.6	-12.3	-7.7	-5.5	-7.4	-8.2	-8.1	-8.0	-7.9	-7.7
Remittances and compensation of employees (net)	1,124	1,273	1,549	1,745	1,913	1,864	1,839	1,892	1,950	2,010	2,073
Gross official reserves	1,480	1,718	1,965	2,515	2,820	2,751	2,621	2,599	2,551	2,511	2,409
Gross official reserves (months of imports)	3.9	3.4	3.9	4.7	5.0	4.7	4.3	4.0	3.7	3.4	3.1
Exchange rate (Moldovan lei per USD, period avge)	11.1	12.4	11.7	12.1	12.6	...	...	...	...	...	...
Exchange rate (Moldovan lei per USD, end of period)	12.3	12.2	11.7	12.1	13.1	...	...	...	...	...	...
Real effective exch.rate (average, percent change)	5.4	-7.4	5.3	4.5	-3.4	-3.5	0.4	0.8	0.3	0.0	0.0
External debt (percent of GDP) 2/	80.2	82.0	77.6	82.5	83.6	90.0	87.8	86.2	84.9	84.2	82.3
Debt service (percent of exports of goods and services)	20.1	17.6	15.7	15.6	17.5	18.6	19.5	22.5	21.2	22.4	24.1

Sources: Moldovan authorities; and IMF staff estimates.

1/ Data exclude Transnistria.

2/ Includes private and public and publicly guaranteed debt.

Appendix III. Risk Assessment Matrix

Source of Risks	Relative Likelihood	Impact if Realized	Policy Response
1. **Protracted period of slower European growth**	**Medium** Negative surprise on potential growth	**High** Lower export demand (from EU and CIS), falling remittances and other financial flows (e.g., trade credits) would induce a recession, exchange rate pressures, and banking sector difficulties	• Let the exchange rate adjust to facilitate absorption of the external shock • Ensure banking system does not become overexposed to exchange rate risk • Ensure banking sector credit is not over-reliant on external flows for repayment.
2. **Lower than anticipated emerging market growth potential (in particular in CIS)**	**Medium** Earlier maturing of the cycle and incomplete structural reforms in Russia and Ukraine could have spillovers to Moldova		
3. **Deterioration of Moldova's banking system soundness**	**Medium/High** Reemergence of problems at Banca de Economii, soaring system-wide NPLs, and/or new raider attacks can undermine the banking system soundness	**High** Credit supply would dwindle, and the government might need to intervene to prevent or resolve bank failures	• Enforce shareholder and beneficial ownership transparency and suitability requirements • For banks in trouble, intervene in large systemically important ones and liquidate small ones
4. **Political cycle**	**High** Intensifying political competition ahead of the 2014 parliamentary elections could lead to populist initiatives and delays or reversal of structural reforms	**Medium** Deteriorating growth prospects and business climate would harm investment and competitiveness	• Ensure key financial sector structural and legal reforms are not delayed.