

# REPUBLIC OF MOLDOVA

## FINANCIAL SECTOR ASSESSMENT PROGRAM

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# TECHNICAL NOTE

## BANK CRISIS RESOLUTION

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This Technical Note was prepared in the context of a joint IMF-World Bank Financial Sector Assessment Program (FSAP) mission in the Republic of Moldova during February 2014, led by Simon Gray, IMF, and Brett Coleman, World Bank, and overseen by the Monetary and Capital Markets Department, IMF, and the Finance and Private Sector Development Vice Presidency, World Bank. The note contains the technical analysis and detailed information underpinning the FSAP assessment's findings and recommendations. Further information on the FSAP program can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>.

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## EXECUTIVE SUMMARY<sup>1</sup>

### **An important aspect of the FSAP mission was the review of the bank crisis resolution framework in Moldova.**

There are several characteristics of vulnerabilities in the banking system which suggest the need for the authorities to give a high priority to crisis resolution preparedness. Notable in this context is the concentrated nature of the banking system, being dominated by 6 domestic banks (4 of which are relatively large): the 6 banks, which de facto appear to form 2 groups of banks (involving 5 of the 6 largest domestic banks) having combined market share of 60-70 percent of banking system assets. In the case of two of these banks there is a significant large exposure risk, with aggregate large exposures being well in excess of the banks' capital. These banks also have relatively large exposure risk to foreign banks. Moreover, stress testing undertaken for the FSAP suggests a potential vulnerability to credit risks, particularly as regards foreign currency denominated loans.

**The effective concentration of large banks into two groups gives rise to a potential too big to fail problem.** This is compounded by the lack of viable alternatives to government-funded bail-out under existing resolution arrangements and the potential for contagion. Although inter-bank exposures are low, the failure of one or more large banks has considerable potential to trigger contagion through adverse impacts on depositor confidence. This risk is exacerbated by the low deposit insurance cap of MDL 6,000.

### **Moldova has made progress in strengthening its financial crisis resolution framework.**

Significant in this respect was the establishment on June 2, 2010, of the National Committee for Financial Stability (NCFS). The NCFS was established by the Government to promote a coordinated framework for responding to a financial crisis. It is chaired by the Prime Minister and comprises all the government agencies responsible for financial stability and crisis resolution: the Government; the Parliamentary Commission on Economy, Budget and Finance; the National Bank of Moldova (NBM); Ministry of Finance (MOF); Ministry of Economy (MOE), Deposit Guarantee Fund (DGF); and the National Commission for Financial Markets (NCFM). A Technical Sub-Committee chaired by the Minister of Finance has been established to develop a coordinated approach to financial crisis resolution. An MOU has been established by the NCFS, setting out guiding principles of crisis resolution and the responsibilities of each member agency. In addition to this cross-agency framework, the NBM has established an internal committee on financial stability chaired by the Deputy Governor to coordinate the NBM's crisis resolution policies and procedures.

**Some of the laws required for bank crisis resolution are in place.** In particular, the Law on Financial Institutions provides the NBM with a range of powers to deal with bank distress situations. These include the ability to place a bank under special supervision to assist in identifying a bank's difficulties and formulating response options, 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.

<sup>1</sup> This Technical Note has been prepared by Geof Mortlock, consultant to the IMF.

Once a bank is under special administration, the NBM has powers to undertake a number of resolution options, including facilitating its recapitalization, transferring some or all of its business to another bank, and preparing the failed bank for liquidation. Deposit insurance arrangements under the oversight of the DGF provide protection to retail depositors, albeit only to a very low level of deposit.

**Notwithstanding these arrangements, there are many gaps and deficiencies in the bank resolution 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.

### **Legal powers**

**There are several deficiencies in the law which would limit the options for responding to a banking crisis and potentially hinder the implementation of timely resolution.** Although the Law on Financial Institutions 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 make business structure changes to enable a least-cost resolution (e.g., through pre-positioning for the separation of systemically important business functions). While the NBM can require a bank to remove directors and management, it is not empowered to appoint directors or management of its choice unless a special administrator has been appointed. Moreover the direction powers apply only to banks and do not extend to their subsidiaries or to a holding company. The same limitation exists in relation to bank special administration—i.e., special administration cannot be applied to subsidiaries or a holding company of a bank. This could impede a timely and effective group resolution where important business functions are located in subsidiaries or a holding company. For example, it would not be possible to transfer essential business functions from a subsidiary or a holding company to a bridge bank or other bridge entity. The inability to appoint a special administrator to a subsidiary or holding company also means that the moratorium protection under administration does not apply to subsidiaries or holding companies.

**There is uncertainty in the scope and protections associated with business transfer powers.** Although the law permits the transfer of business for a bank under administration, it is not clear 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. The same uncertainty arises in the appointment of a special administrator. Indeed, under current law, there is a considerable risk of the appointment of a special administrator triggering the termination or close-out of financial contracts and the exercise of set-off rights by counterparties.

**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 an administrator and the restructuring of a bank under administration. As with most of the legal powers

available to the NBM, a judicial challenge creates the possibility of the courts suspending the exercise of powers for up to three months (with the potential for extension by the courts). This represents a serious threat to effective bank resolution, particularly given the incentives that shareholders and other stakeholders may have to challenge the actions of the NBM in a bank resolution. (It is understood that the Government has submitted a Bill to Parliament to address this issue.)

**There are other significant deficiencies in legal powers for resolution.** These include a significant doubt that the NBM has the legal authority to establish a bridge bank or any other legal entity for resolution purposes (such as an asset management vehicle). Discussions with the MOF suggested that there is also uncertainty as to whether the MOF could establish legal entities for resolution purposes, such as bridge entities or asset management vehicles. Other gaps in the law include no specific power to implement a bail-in and the absence of statutory powers to enable the Government to provide funding, guarantees or indemnities quickly (without the need to obtain Parliamentary approval). These deficiencies further impede the ability to implement an effective and timely resolution. Although no analysis was undertaken of the legal powers applicable to the resolution of financial market infrastructure, insurers and other financial institutions, it seems likely that there are even greater weaknesses in resolution powers in respect of these categories of financial institution.

### **Crisis resolution strategies and procedures**

**Although progress has been made in developing guidance on crisis resolution within the NBM, there are substantial gaps in crisis resolution strategies and procedures.** The NBM has developed guidance on some elements of crisis resolution. However, to date, no attempt has been made to undertake resolvability assessments of the banks identified as being systemically important or to develop resolution plans for those banks. 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 for that purpose. There is also a substantial deficiency in the scope and depth of planning for different resolution options at a generic level. For example, there are no plans, either within the NBM or MOF, for least-cost recapitalization strategies for the systemically important banks, consideration of bridge bank resolution or the management of group resolution. While the NBM has developed guidance on providing liquidity support to banks, there has been little consideration given to the legal processes required and pre-positioning needed by banks to enable the NBM to take collateral over parts of a bank's loan portfolio within a short timeframe.

**There is a pressing need to develop a contingency plan for crisis resolution covering all elements of the resolution process.** This needs to include solvency assessment, 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, in particular, banks' capacity to implement recovery actions quickly and credibly in the event of a banking crisis.

**The contingency plan is not solely the responsibility of the NBM.** Each relevant agency needs to develop resolution plans for their respective areas of responsibility. This is particularly the case with the MOF in respect of recapitalization arrangements if funded or underwritten by the government, and the provision of government funding and guarantees. The DGF also needs to review and strengthen its plans for facilitating prompt pay-out and access to funding from the MOF if required. It also needs to have back-up arrangements if a bank chosen as the paying agent is unable to perform the paying agent function due to its own difficulties. The NCFM needs to have resolution plans to enable it to respond quickly and decisively to the distress or failure of insurers and other financial institutions under its jurisdiction. All of these resolution plans need to be coordinated to the extent of cross-dependencies and linkages between the different agencies, both bilaterally and multilaterally under the framework provided by the NCFS. It is important for the government agencies to coordinate effectively in the development of a whole-of-government contingency plan.

### **Coordination and capacity building**

**The NCFS MOU provides a helpful framework for coordination between the relevant agencies.**

Some progress towards developing a coordinated approach to resolution has been made through the meetings of the NCFS Technical Sub-Committee. However, the FSAP mission was left with the impression that there has been relatively little substantive coordination between the agencies—both bilaterally and multilaterally—on the details of crisis resolution planning. A much more intensive process of regular, collegial inter-agency coordination is needed at senior management and working levels if a truly coordinated approach to resolution is to be achieved.

**Cross-border coordination requires development.** Currently, there are no resolution-orientated MOUs between the NBM and the home resolution authorities of foreign banks operating in Moldova. Similarly, there are no MOUs or similar arrangements between the MOF and its counterparts in the parent bank jurisdictions. The absence of these arrangements impedes the development of a coordinated approach to cross-border resolution, including the implementation of home/host authority resolution plans for the foreign banks operating in Moldova. It is suggested that the authorities—both the NBM and MOF—give attention to these matters, with a view to establishing a framework for cross-border coordination on crisis resolution in respect of each of the foreign banks.

**There is also a need for capacity-building on crisis resolution across the agencies.** No member agencies of the NCFS have held senior-level workshops on crisis resolution strategies and procedures or undertaken significant staff training on resolution. Moreover, at the time the FSAP was conducted, no agency had undertaken a crisis simulation exercise. These are areas that warrant high priority attention, especially in the NBM, MOF, DGF, and NCFM. A crisis resolution exercise should be held across all member agencies as soon as practicable as part of the capacity-building process. This should be followed by the development of a program of regular crisis testing, both within each agency and across the agencies via the NCFS. Cross-border resolution testing could usefully be considered at a later stage.

## Recommendations

The authorities are encouraged to consider the following recommendations:

|           | <b>Recommendation</b>  | <b>Priority</b> | <b>Timeframe</b>       |
|-----------|--|-----------------|------------------------|
| <b>1.</b> | The Law on NBM be amended to include in Article 4 an objective relating to the promotion of financial stability. If this amendment is made, it is suggested that the NBM could usefully develop and publish information on how it interprets financial stability and seeks to meet the statutory objective.  | High            | As soon as possible    |
| <b>2.</b> | The Law on NBM be amended to include in Article 5 a specific reference to the NBM being responsible for the resolution of banks. The Law should set out the objectives for resolution—e.g., maintaining the stability of, and confidence in, the financial system, and protecting depositors.  | High            | As soon as possible    |
| <b>3.</b> | The Law on NBM be amended to make the NBM, its staff and agents immune from liability for any actions taken (or omitted to be taken) in the context of bank resolution, other than where the actions (or decisions not to act) were taken in bad faith or with fraudulent intent. Similar provisions should be provided in the laws governing the DGF and NCFM and their staff and agents.   | High            | As soon as possible    |
| <b>4.</b> | The Law on NBM be amended or clarified to empower the NBM to issue indemnities to its staff and agents to protect them against legal costs, fees and other financial expenses which could be incurred in connection with legal processes or judicial challenges. A similar provision should be included in the laws governing the DGF and the NCFM.  | High            | As soon as possible    |
| <b>5.</b> | The NBM, as lead resolution authority, strengthen its capacity for crisis resolution, including through the development of more comprehensive guidance on crisis resolution processes and procedures, holding senior-level workshops on scenario-based resolution strategies, undertaking regular staff training and holding internal and cross-agency crisis resolution exercises. The MOF, NCFM and DGF also need to take similar actions to build their policies and procedures for crisis resolution pertaining to their respective areas of responsibility. | High            | As soon as possible    |
| <b>6.</b> | The NBM strengthen its Committee on Financial Stability by establishing a working group drawn from all relevant areas of the NBM to develop detailed crisis resolution plans that  | High            | As soon as practicable |

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|------------|--|---|--|
|            | facilitate a whole-of-central bank approach to crisis resolution.  |   |  |
| <b>7.</b>  | The NBM, MOF, NCFM and DGF develop closer working relationships with each other, with a view to establishing more closely coordinated cross-agency crisis resolution arrangements.   | High  | As soon as practicable   |
| <b>8.</b>  | The NBM take a stronger leadership role in the NCFS Technical Sub-Committee with respect to the strategic and technical aspects of bank crisis resolution, including in respect of developing a whole-of-government approach to contingency planning, more comprehensive guidance on bank resolution options, capacity building cross-agency workshops and holding regular cross-agency crisis resolution exercises. It may be appropriate for the Governor of the NBM to chair the NCFS Technical Sub-Committee and for the Minister of Finance to cease to be a member of the Sub-Committee (being replaced by the Head of the MOF). | High  | As soon as practicable   |
| <b>9.</b>  | The NBM ensure that banks are pre-positioned to facilitate collateralised loans secured against their loan portfolios to enable rapid provision of liquidity in a crisis.  | High  | As soon as practicable   |
| <b>10.</b> | Consideration be given to the legal amendments recommended in paragraph 30 of this Technical Note in respect of resolution powers. These should be assessed as a matter of priority for bank resolution powers. As a lower priority, a similar review of resolution powers should be undertaken in respect of the powers available to resolve insurers, savings institutions and FMIs.   | High - for bank resolution powers<br><br>Medium - for other financial institution resolution powers | As soon as practicable for bank resolution powers<br><br>Medium-term for other financial institution resolution powers |
| <b>11.</b> | The NBM review each bank's recovery plan on a regular basis, assess pre-positioning requirements and require each bank to conduct regular recovery plan testing and to report the results of the testing to the NBM.   | High  | As soon as practicable   |
| <b>12.</b> | The NBM develop resolvability assessments for all systemically important banks and keep these under regular review.  | High  | As soon as practicable   |



|            |   |        |                        |
|------------|---|--------|------------------------|
| <b>13.</b> | The NBM review its existing arrangements to detect emerging stress in banks and in the financial system, with a view to establishing a reliable set of early warning indicators.  | High   | As soon as practicable |
| <b>14.</b> | The NBM review its framework for undertaking solvency assessments of banks, particularly under acute time pressure, and undertake periodic testing of these arrangements.   | High   | As soon as practicable |
| <b>15.</b> | The NBM, in close liaison with the MOF, DGF, NCFM and NCFS, develop bank resolution strategies, including a contingency plan for dealing with major bank failures and other threats to financial system stability. Bank-specific resolution plans should be developed in conjunction with this.   | High   | As soon as practicable |
| <b>16.</b> | The NCFM, in close liaison with the NCFS, MOF and NBM, develop insurance and other financial institution resolution strategies and resolution plans. Institution-specific resolution plans should be developed for at least the large financial institutions.   | Medium | Medium-term            |
| <b>17.</b> | The coordination and cooperation arrangements between the NCFS agencies be considerably strengthened, both multilaterally and bilaterally, having regard to the suggestions in this Technical Note.   | High   | As soon as practicable |
| <b>18.</b> | The NBM establish MOUs with home supervisory and resolution authorities for the banks operating in Moldova, and develop a coordinated approach to cross-border crisis resolution, in close coordination with the MOF. To the extent relevant, consideration should be given to developing a coordinated approach to cross-border crisis resolution for other financial institutions with significant cross-border operations. | Medium | Medium-term            |
| <b>19.</b> | The NBM and NCFS undertake regular crisis simulation exercises to test and refine bank crisis resolution strategies and bank-specific resolution plans, with banks and other external parties being role-played by NBM and other NCFS member agency staff. The NCFM, in liaison with the NCFS, undertake similar crisis simulation exercises to test and refine non-bank financial institution crisis resolution strategies.  | High   | As soon as practicable |
| <b>20.</b> | The MOF and NCFS undertake an assessment of crisis resolution funding arrangements, potentially including pre-appropriated funding lines via the MOF, and possibly a financial stability fund, with a view to establishing robust, cost-effective funding arrangements that can be drawn on   | High   | As soon as practicable |

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|  | quickly in a crisis, and which provide the option of recovering any taxpayer-funded outlays. |  |  |
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## INTRODUCTION

1. **The FSAP mission to Moldova included an assessment of the financial crisis resolution framework, focusing on bank resolution arrangements.** The FSAP did not include an assessment of crisis resolution arrangements in respect of insurance, Financial Market Infrastructure (FMI) or other types of financial institutions. However, many of the findings and recommendations made in this report in relation to bank crisis resolution are also likely to be pertinent to other parts of the financial sector. Accordingly, the authorities are encouraged to draw on this Technical Note to assist them in reviewing the crisis resolution framework applicable to insurance, FMI and other categories of financial institution.
2. **The assessment was undertaken having regard to the principles set out in the Financial Stability Board's (FSB's) *Key Attributes of Effective Resolution Regimes for Financial Institutions (Key Attributes)*.** However, the FSAP mission was not tasked with conducting a formal assessment against the Key Attributes. Rather, the scope of the assessment was to evaluate the key elements of the resolution framework and identify areas of possible gaps or deficiencies, focusing on just the most salient aspects of the resolution framework. The Key Attributes were used as a broad set of reference points where appropriate.
3. **For the purpose of the crisis resolution aspects of the FSAP, the mission team met with officials from the government agencies with responsibility for aspects of crisis resolution - the National Bank of Moldova (NBM), the Ministry of Finance (MOF) and the Deposit Guarantee Fund (DGF).** The team also met with the Secretary-General of the Government in his capacity as a member of National Committee for Financial Stability (NCFS) and a senior representative of the NCFS. In addition, the team held meetings with a number of banks, the Banks Association and a representative of one of the main law firms in Chisinau.
4. **In undertaking this assessment, the mission reviewed relevant legislation applicable to bank crisis resolution, particularly the Law on Financial Institutions and the Law on the National Bank of Moldova.** It also reviewed the government decree establishing the NCFS and the MOU established for members of the NCFS.

## A. Existing Resolution Arrangements in Moldova—Overview

### 5. **Moldova has a number of the elements needed for resolving bank distress or failure.**

An important development in this regard was the establishment of the NCFS by the Government on June 2, 2010, in Government Decision No. 449. This is a committee established for the purpose of managing a systemic crisis. It is chaired by the Prime Minister and comprises all the government agencies responsible for financial stability and crisis resolution, being: the Government; the Parliamentary Commission on Economy, Budget and Finance; the NBM; Ministry of Economy (MOE); MOF; DGF; and NCFM. A Technical Sub-Committee chaired by the Minister of Finance has been established to develop a coordinated approach to financial crisis resolution. A MOU has been established by the NCFS, setting out guiding principles of crisis resolution and the responsibilities of each member agency. In addition to this cross-agency framework, the NBM has established an internal committee on financial stability chaired by the Deputy Governor to coordinate the NBM's crisis resolution policies and procedures.

### 6. **According to the government decree establishing the NCFS, and the MOU, the responsibilities of the NCFS include:**

- managing an extraordinary financial crisis;
- defining a systemic crisis;
- presenting to the Government proposals for policies and procedures on deposit protection and bank recapitalization;
- establishing communications between the authorities in managing a systemic financial crisis;
- issuing official statements in the crisis resolution process (e.g., to reduce the risk of misinformation);
- restoring credibility in the banking system;
- agreeing on the strategic responsibilities of each member agency in crisis resolution; and
- proposing measures as appropriate to respond to an extraordinary financial crisis.

### 7. **The MOU for the NCFS sets out some high-level principles for crisis resolution.** In summary, these relate to the need for:

- clear delineation of responsibilities of each agency and coordination between the agencies;
- timely analysis of information relating to potential risks to the stability of the financial system;
- development and implementation of comprehensive measures for ensuring an effective response to a crisis;
- implementing a crisis resolution that meets the objective of least cost to the taxpayer;
- open communication with stakeholders in relation to any response to a crisis; and
- effective exchange of information between each member agency of the NCFS.

### 8. **Notwithstanding the NCFS framework, there appears to be little practical coordination between the agencies on crisis resolution.** Some meetings have occurred at both NCFS and Technical Sub-Committee levels, but it appears that these have been confined mainly to high-level

discussions, rather than detailed crisis resolution planning. As noted later in this Technical Note, there needs to be a much closer coordination between the agencies at both bilateral and multilateral levels, and with a focus on the details of a crisis resolution contingency plan.

**9. The NBM is the agency with principal responsibility for bank crisis resolution.** It is equipped with a number of powers under the Law on Financial Institutions (Law on FI), supported by the Law on the National Bank of Moldova (Law on NBM), to respond to a bank distress or crisis situation. These include powers enabling it to:

- place a bank under special supervision for the purpose of assessing the bank’s financial condition and making recommendations to senior management of the NBM on possible remedial actions;
- issue directions of a binding nature to a bank, which could include requirements to remove directors or management, to suspend activities and transactions, to dispose of subsidiaries and take other actions of a remedial nature;
- appoint a special administrator to assume control of a bank (including to assume the powers of shareholders and the board of directors of the bank), whereby the administrator is under the control of the NBM;
- implement a restructuring of a bank while under special administration, including to facilitate its recapitalization or the transfer of some or all of its business to another bank;
- provide liquidity support to a solvent bank; and
- provide liquidity support to the banking sector as a whole, both in domestic currency and foreign currency (in the latter case subject to monetary policy and foreign exchange reserve constraints).

**10. As noted in the section of this Technical Note on legal powers, there are significant gaps and deficiencies in the powers available to the NBM to implement a bank resolution.** The FSAP mission team recommends that these be remedied by the Government as a matter of high priority.

**11. Notwithstanding that the Law on FI confers bank resolution powers on the NBM, the Law on NBM does not set out a clear statutory purpose for the NBM in respect of the pursuit of financial stability or the resolution of bank crises.** Article 4 of the Law on NBM sets out the objectives of the NBM. The primary objective of the NBM is to ensure and maintain price stability. Article 4 states that: “without prejudice to the primary objective, the National Bank shall promote and maintain a financial system based on market principles and shall support the general economic policy of the state”. It is noteworthy that the Law on NBM is silent on an explicit objective of promoting the stability of the financial system. Moreover, the Law on NBM provides no formal statement of responsibility for the NBM in relation to the resolution of financial distress in banks. Nor does it specify the purpose for which this responsibility should be exercised—e.g., for the purpose of maintaining the stability of the financial system and protecting depositors. It is suggested that consideration be given to amending the Law on NBM to include in Article 4 specific

objectives of this nature. The inclusion of a financial stability objective is as relevant for banking supervision as for bank crisis resolution.

**12. Equally, Article 5 of the Law on NBM (which specifies the tasks of the NBM) is silent on the role of NBM as a resolution authority.** It is suggested that Article 5 be amended to include explicit reference to the bank resolution function.

**13. The NBM has undertaken a number of measures which will assist in the resolution of banks.** These include the identification of systemically important banks, requiring banks to develop contingency plans (i.e., recovery plans) and developing internal guidance on aspects of crisis resolution. However, much remains to be done to ensure that the NBM has the policies, procedures and capacity to resolve banks effectively in a manner consistent with maintaining the stability of the financial system and achieving least-cost resolution. In particular, there is a need for the NBM to undertake resolvability assessments for the systemically important banks, to prepare resolution plans for each of these banks, to develop more comprehensive guidance on resolution options (including bail-in and bridge bank options), and to consider the means by which banking group resolutions could be implemented. The NBM also needs to establish a program of capacity building on crisis resolution, including through regular workshops for senior management on scenario-based resolution strategies, staff training and bank crisis simulation exercises. These are discussed more comprehensively later in the Technical Note.

**14. The MOF also has major responsibilities for crisis resolution.** In particular, it is responsible for advising the Government on the fiscal implications and funding needs of bank recapitalization or other forms of government support (where all other options have been assessed but are not available). It is also responsible for determining the form and terms on which any government funding is required. Similarly, the MOF has responsibility to ensure that the DGF can access additional funding if it has a shortfall in its own funds to meet depositor pay-outs or deposit account transfers. The MOF also has an important role in advising on resolution policies which minimize or avoid the need for public funding.

**15. Considerable further work is needed in all of these areas.** Currently, insufficient preparation has been given to the means by which government funding could be rapidly provided in the event that it is required, or the terms on which this could be done to minimize risks to the taxpayer. Moreover, there has been insufficient thought given to the options for avoiding or minimizing the need for government support in a resolution, particularly as regards bail-in options. It is suggested that the MOF focus its attention on all of these areas in close coordination with the NBM. It is also suggested that the MOF build its capacity on crisis resolution matters through a combination of scenario-based workshops for senior management, staff training and crisis simulation exercises, in coordination with the NBM and NCFM.

**16. The DGF provides the mechanism by which depositors would be paid out in the event a bank becomes insolvent and is liquidated.** However, the current level of the deposit insurance cap, at MDL 6,000, is low, both in terms of the coverage of household deposits and by international standards (after adjusting for factors like per capita GDP). It is unlikely to be sufficient to provide

confidence to depositors in a banking crisis and therefore reduce contagion via retail bank runs. Moreover, the current level of the fund is insufficient to make pay-outs for more than just the small banks or one medium-sized bank. It would be unable to pay out or fund a deposit account transfer in the case of multiple small/medium bank failures or large failures without recourse to the MOF or the NBM.<sup>2</sup> At present, there is no pre-established funding line to enable these funds to be provided quickly. This is a matter that requires high priority attention by the DGF, MOF and NBM, with a view to establishing a credit line with the MOF and possibly with the NBM.

**17. The DGF also needs to further develop its capacity for prompt pay-outs.** The current target period for pay-out (of around one month following the closure of a bank) would create significant disruption for affected depositors and could weaken confidence in the deposit insurance scheme. The aim should be to achieve pay-outs within one week of the closure of a bank if possible. The preferable option is to provide more or less immediate depositor access to their deposit accounts by transferring them to another bank or a bridge bank. For prompt pay-out or deposit account transfer to be feasible it will require pre-positioning in banks, such as establishing the means to quickly and accurately identify eligible deposit accounts and the amount protected per deposit on a “single customer view” basis. It would also require the development of the procedures required to exercise business transfer powers to transfer the protected balances of deposit accounts, and the accounts and associated IT systems, to another bank or bridge bank. These are matters which would benefit from high priority attention by the DGF and NBM.

## B. Resolution Authority—NBM

**18. The NBM is the resolution authority for banks in Moldova.** As discussed earlier in this Technical Note, the NBM is equipped with many of the powers required for crisis resolution, although there are many gaps and deficiencies. The Law on NBM should be amended to provide an explicit statutory responsibility for bank resolution and to set out the resolution objectives—essentially to maintain the stability of the financial system and to protect depositors. In addition, consideration could be given to including in the Law on NBM other objectives relevant to resolution, such as seeking to maintain confidence in the financial system and seeking to minimize public costs associated with a bank resolution.

**19. Although the Law on FI contains many resolution powers, there are significant gaps and deficiencies.** These would considerably impede the ability of the NBM to resolve banks quickly, decisively and effectively. The absence of some powers, such as bridge bank powers and powers of bail-in, would also limit the range of resolution options available to the NBM. These are discussed in detail in the next section of this Technical Note.

**20. Aside from legal powers, a resolution authority also needs to have appropriate legal protections for the authority itself, its staff and agents to be able to implement a bank resolution.** Under current law, the protections available to the NBM itself and the staff of the NBM

<sup>2</sup> This is common; but underscores the need for contingency funding plans by the MOF.

are limited. A considerable risk exists that the NBM and staff involved in resolution actions could be subject to legal actions, potentially including significant civil or criminal sanctions. These risks could well impede the ability to undertake bank resolution, especially where the actions are contentious and prone to legal challenge. In those circumstances, staff of the NBM may be unwilling to accept appointment as a special administrator or liquidator of a bank. Equally, it may be difficult to engage external parties for these roles or even as advisers to the NBM or to a special administrator. It is therefore strongly recommended that the Law on NBM be amended to make the NBM, its staff and agents immune from liability for any actions taken (or omitted to be taken) in the context of bank resolution, other than where the actions (or decisions not to act) were taken in bad faith. It may also be appropriate to confer a power on the NBM and DGF to issue indemnities to staff and agents involved in resolution, covering them for any legal costs, fines or fees that could arise in legal processes.

**21. It is essential that a resolution authority have staff with expertise on crisis resolution issues, together with comprehensive internal guidance on resolution policies and procedures.**

The NBM has staff with considerable ability in banking supervision and financial stability issues. However, it was not clear to the mission team that the NBM has invested significantly in building internal capacity on bank crisis resolution. It has established a senior-level internal committee to coordinate preparation for a banking crisis. However, it was not evident that this committee was particularly active in the development of crisis resolution preparedness or that it involved staff at less senior levels. No resolvability assessments have yet been undertaken for the systemically important banks and no bank-specific resolution plans have been prepared. Internal guidance has been developed on some aspects of bank crisis resolution, but this mainly focuses on procedural arrangements and liquidation. Little has yet been developed on alternative resolution options, such as least-cost bridge bank or bail-in options. It is suggested that the NBM strengthen its capacity in this area by developing resolvability assessments and comprehensive guidance on resolution options.

**22. There is also a need to strengthen the understanding of bank resolution issues and build capacity in this area in the NBM.** It is suggested that the NBM invest more resources in undertaking regular workshops for senior management on crisis resolution, including scenario-based “walk-through” exercises which seek to identify how particular crisis scenarios would be responded to by the NBM. These workshops, held on a regular basis, could be expected to help senior management refine their approach to crisis resolution for different scenarios and be better prepared for a crisis response. These workshops should be accompanied by wider staff training on crisis resolution, as part of a regular program on crisis resolution capacity-building.

**23. In addition, it is suggested that the NBM undertake a regular program of crisis simulation exercises involving all relevant senior management (including the Governor) and lower-level staff.** The program should seek to test for different elements of crisis resolution, including:

- solvency assessment (under acute time pressure);
- systemic impact assessment, including the systemic impact of different resolution options;
- scenario-based responses to different types of bank crisis;
- appointment of a special administrator and determination of the nature of the directions the NBM would give to the administrator;
- design and implementation of least-cost recapitalization;
- establishment of a bridge bank and transfer of business to a bridge bank;
- provision of liquidity support to solvent banks experiencing liquidity difficulties;
- coordination with other agencies (especially the MOF and DGF) and the NCFS;
- cross-border coordination; and
- management of public communications, both reactive and proactive.

**24. A whole-of-central bank approach is needed.** The response to a banking crisis involves most parts of a central bank, including banking supervision staff, a dedicated crisis resolution team, payment system staff, legal advisers, communications staff, staff involved in providing liquidity to banks and monetary policy staff. It might also involve staff responsible for the management of foreign exchange reserves. It is therefore essential that a whole-of-bank approach be taken to the planning for crisis resolution. Although the NBM committee on financial stability involves senior-level staff from most areas of the NBM, it does not seem to involve staff at lower levels, such as through cross-department working groups on crisis resolution. The mission team got the impression that there is considerable scope to improve coordination between the departments in the NBM, with closer coordination and cross-fertilization of ideas. It is therefore suggested that a working-level cross-department committee be established to facilitate detailed crisis resolution planning, taking a whole-of-bank approach, with close oversight by the financial stability committee.

**25. Closer coordination with the MOF and other agencies is necessary.** As discussed elsewhere in this Technical Note, there is a need for much closer coordination between the NBM, MOF, NCFM and DGF on crisis resolution planning. The level of coordination currently taking place, both bilaterally and multilaterally, is insufficient. As a result, neither the NBM nor the other agencies, or the NCFS as a whole, are adequately prepared to respond to a major systemic crisis.

**26. In particular, the NBM needs to work closely with the MOF.** This is needed to assess and develop the options for least-cost crisis resolution, including bail-in and the possibility of establishing a dedicated financial stability fund for resolution funding purposes or pre-approved resolution funding from the government. The NBM also needs to work closely with the MOF on the design of the recapitalization process, the terms of capital instruments, the funding arrangements if government-funded recapitalization are required, and the form and nature of control the government may wish to have over a bank to which it has provided support.

**27. The NBM and DGF also need to have a close working relationship.** This is especially important in the development of plans for what the NBM would need to do to prepare a bank for liquidation to enable rapid and accurate pay-out, including what pre-positioning may be needed to enable a bank in liquidation to calculate deposit balances on a single customer view basis. There



also needs to be a close coordination between the NBM and the DGF on the contingency arrangements to be applied if the paying agent bank chosen by the DGF happened to be in difficulty at the time when pay-outs were required in respect of failed banks. Close coordination is also required in respect of public communications—i.e., what statements are made by the NBM and DGF, respectively, to depositors, and the communication channels used for that purpose.

**28. Greater leadership is needed from the NBM in the NCFS Technical Sub-Committee.** As the lead resolution authority, the NBM needs to take a greater leadership role in the NCFS Technical Sub-Committee on most of the technical and strategic considerations in planning for crisis resolution. It is suggested that the NBM increase its efforts in this regard, including in respect of the development of a crisis resolution contingency plan, cross-agency coordination, cross-agency workshops, and organizing and running crisis simulation exercises. In this context, it may be appropriate for the Governor of the NBM to chair the Technical Sub-Committee, and for the Minister of Finance to cease to be a member of the Sub-Committee, thereby giving it a more technical focus. The Head of the MOF would appropriately be a member of the Sub-Committee.

**29. The NBM has the ability to provide liquidity to a bank, taking collateral.** This is provided for in the Law on NBM. In most crisis situations, however, it is likely that the NBM would need to take collateral in the form of parts of a bank's loan book. It is therefore suggested that the NBM ensure that it has the legal procedures in place to take collateral over a bank's loan portfolio rapidly (e.g., within 24 hours) and that banks are pre-positioned to facilitate this. This may include the pre-identification of bank assets for collateral purposes and the development of portfolios of loans eligible for sale and repurchase for liquidity support purposes.

## C. Resolution Powers

**30. Although the Law on FI provides the NBM with a range of powers to implement a bank resolution, there are many gaps and deficiencies in these laws.** These would significantly impede the options, speed and certainty with which a bank resolution could be implemented. In particular, the following gaps and deficiencies have been identified. It is recommended that these be addressed as a matter of high priority.

- a. **Appointing directors and management.** The NBM can remove directors and management of a bank, but cannot require the immediate appointment of specified persons as directors or management (by-passing shareholder consent) through the use of its direction powers unless a bank has been placed into special administration). In a crisis situation, it is important that the NBM has unequivocal power to appoint directors and management of its choosing without the need for any shareholder or board consent processes, and without the need to invoke special administration. The same power should desirably apply in respect of a holding company and subsidiaries of a bank.
- b. **Maintaining continuity of essential services.** It is not sufficiently clear in the Law on FI that the NBM can ensure continuity of essential services and functions by requiring other companies in

the same group to continue to provide essential services to the entity in resolution, any successor or an acquiring entity, or by ensuring that the residual entity in resolution can temporarily provide such services to a successor or an acquiring entity; or procuring necessary services from unaffiliated third parties. These matters should be put beyond doubt through amendments to the Law on FI.

- c. **Issuing directions to bank subsidiaries and holding companies.** Under current law, the NBM has no ability to issue directions to subsidiaries or a holding company of a bank. It could seek to do this indirectly by directing a bank to require its subsidiaries to undertake specified actions, but there is a risk of delays or obstruction by the board and management of the subsidiary in question. It is suggested that the NBM should have specific statutory power to issue directions to subsidiaries and a holding company of a bank of a similar nature in scope to those it can issue to a bank.
- d. **Appointing a special administrator to bank subsidiaries and a holding company.** Under current law, the NBM cannot appoint a special administrator to subsidiaries or a holding company of a bank. This could impede the implementation of an effective bank resolution, especially where essential functions are performed by subsidiaries or a holding company. Although the special administrator could seek to exercise control of subsidiaries through shareholder powers, there is a significant risk of board or management obstruction or of judicial challenges from creditors of the subsidiaries. It is therefore suggested that the special administration power be extended to all subsidiaries and a holding company of a bank.
- e. **By-passing shareholder approval.** The Law on FI requires a special administrator to seek shareholder approval to some elements of a bank resolution, such as the transfer of business to another party or the issuance of particular categories of capital instruments. Although the law seems to contemplate that the special administrator can override shareholders if they oppose these initiatives, it is not sufficiently clear on this matter. Moreover, there is a risk of delays and judicial challenges, especially if the special administrator is first required to go through a shareholder consent process. It is therefore suggested that the Law on FI be amended to enable a special administrator to by-pass shareholder consent processes and override the rights of shareholders of the firm in resolution, including requirements for approval by shareholders of particular transactions, in order to permit a merger, acquisition, sale of substantial business operations, recapitalization or other measures to restructure the bank.
- f. **Transfer of business outside special administration.** The Law on FI empowers the transfer of business from a bank in special administration to another bank. However, it does not empower the transfer of business without first placing a bank into special administration. Given that special administration may not always be the preferred option (e.g., for reasons of speed or risk of judicial challenge, or through causing adverse market reaction), we suggest that consideration be given to empowering the NBM to implement a business transfer without first having to appoint a special administrator.

- g. **Scope of business transfer power.** Whether business transfer is achieved under special administration or otherwise, it is not sufficiently clear in the Law on FI that the power to transfer business includes all legal rights and obligations of a bank, including, for example, IT functionality and staff contracts. It is suggested that this be made clear in the law.
- h. **Transferring the business of subsidiaries (of a bank and holding company) and a holding company of a bank.** There is no power in the law to transfer the business of a bank holding company or subsidiaries of either to another entity. This could impede the ability to implement a resolution, particularly where important business functions are located in subsidiaries or a holding company. It is therefore suggested that the Law on FI be amended to enable the transfer of some or all of the business of a bank holding company and subsidiary of a bank or holding company to another entity, including to a bridge entity established for the purpose.
- i. **Risk of contractual termination and set-offs.** The Law on FI does not make it clear that the appointment of a special administrator or the transfer of business (or any other act of resolution) are not grounds for the termination of contracts or the exercise of rights of set-off under financial contracts the bank or its subsidiaries have entered into. This creates a significant risk of counterparties exercising contractual rights of termination where events of default include such matters as the appointment of an administrator, the transfer of business to a new entity or other resolution actions. It is suggested that the Law on FI be amended to make it clear that special administration, business transfer or other resolution actions taken by the NBM do not constitute rights of termination or set-off, notwithstanding any contractual provisions in financial contractions, provided that, within a specified period (e.g., 48 hours) the financial contracts in question are being honored in accordance with their contractual terms.
- j. **Bridge bank powers.** There is no explicit power in the Law on FI to enable the NBM to establish a bridge bank. This is an important gap in the resolution framework, given that a bridge bank may well be required as part of an open resolution and potentially as part of a closed resolution. It is therefore suggested that the law be amended to explicitly empower the NBM to establish a bridge bank and to enable this to be done rapidly (e.g., within 24 hours). This may require a provision to fast-track the normal joint stock company registration procedures. It may also require an amendment to the Law on FI to make it clear that the NBM can issue a license to a bridge bank immediately on its establishment if it is satisfied that the bank has the financial capacity, governance, risk management and operational arrangements to undertake prudently the business transferred to it, even if not all normal licensing requirements have been met. The powers would also include the ability to appoint and remove directors and management of the bridge entity, to establish and amend the entity's constitution, and to issue binding directions to the entity.
- k. **Establishing other entities for resolution purposes.** Similarly, there is no explicit provision in the Law on FI to empower the NBM to establish a company for the purpose of acquiring other business of a bank or any of its subsidiaries or holding company, such as an asset management vehicle. Given that this may be required as part of a resolution process (e.g., to transfer impaired

assets or nonsystemic business to a special purpose vehicle), it is suggested that this be made clear in the Law on FI. The powers would also include the ability to appoint and remove directors and management of the bridge entity, to establish and amend the entity's constitution, and to issue binding directions to the entity.

- l. **Bail-in.** There is no provision in the Law on FI to implement a bail-in (i.e., where specified tranches of debt of a failed or distressed bank are converted to equity or some other form of capital, or written down in value, to assist in the recapitalization of the bank or the capitalization of a bridge bank). This is a substantial gap in the resolution framework, given that bail-in is an option that the authorities should have in order to minimize taxpayer risk and moral hazard. It is therefore recommended that an explicit bail-in power be included in the Law on FI. The power should be designed having regard to the principles on bail-in set out in the FSB Key Attributes and should take into account the EU Bank Recovery and Resolution Directive.
  
- m. **Moratorium.** The existing moratorium provision in the Law on FI associated with the appointment of a special administrator is for a fixed period of two months. This warrants further consideration. For example, it may be necessary to consider having a provision which, at least in respect of derivatives contracts and similar financial instruments, limits the moratorium to a short period (e.g., up to 48 hours). A longer period, such as two months, creates a significant risk of bank counterparties, whether in Moldova or in another country, declining to undertake derivatives business with banks licensed in Moldova, given that most derivatives contracts (such as those governed by standard ISDA master agreements) enable close-out upon the appointment of an administrator or similar event. Counterparties may be hesitant to enter into such contracts with banks if they believe that a lengthy moratorium may apply. A reasonable compromise might therefore be one in which the appointment of a special administrator or business transfer does not constitute grounds for close-out/termination, and that a moratorium of up to 48 hours suspends any actions by counterparties, but where the right of close-out/termination is restored after 48 hours if the contracts are not being honored in accordance with their contractual terms. The law should also prevent close-out or set-off where, within the 48 hour period, the contracts in question have been transferred to an appropriately capitalized bridge bank and will continue to be honored in accordance with their contractual terms.
  
- n. **No creditor/shareholder worse-off.** There is inadequate provision in the Law on FI that ensures that no creditor or shareholder will be rendered worse off under a resolution than had the bank been liquidated under conventional insolvency law. It is suggested that consideration be given to the adoption of a provision in the law to give effect to this principle. This would be consistent with the Key Attributes and would lower the risk of judicial challenges by providing an ex post compensation process to ensure that no creditors are disadvantaged compared to the result that would have applied under a conventional liquidation.
  
- o. **Risk of judicial challenge and suspension of resolution actions.** Under current law, many of the powers exercised by the NBM can be challenged in the court. This can lead to the court suspending the exercise of powers for several months. This applies to most resolution powers,

including the issuance of directions to a bank, the appointment of a special administrator and the transfer of business. Given the need for speed and certainty in bank resolution, these judicial risks are serious impediments to resolution. It is therefore strongly recommended that the law be changed to exempt any resolution powers from such challenge, but that there be scope for ex post compensation arrangements under the “no creditor/shareholder worse off” principle.<sup>3</sup>

**31. Although the powers referred to in paragraph 30 and its sub-paragraphs are designed with banks in mind, many of them are equally applicable to other types of financial institution resolution, including the resolution of insurers, non-bank deposit-taking institutions, non-bank credit providers and FMIs, with appropriate modifications.** It is therefore suggested that the authorities consider the appropriateness of the matters discussed in paragraph 30, and its sub-paragraphs, for application to other categories of financial institution.

#### **D. Recovery Planning, Resolvability Assessments, and Resolution Planning**

**32. The NBM has required banks to establish recovery plans.** These are required to be updated annually. We understand that the banking supervision department of the NBM undertakes regular reviews of the recovery plans. However, we are unsure of the extent of this review. It is important that the NBM take all reasonable steps to ensure that the recovery plans are comprehensive and cover all of the recovery steps needed to ensure that a bank could restore itself to financial soundness in a timeframe that is credible and which minimizes the risk of loss of depositor and counterparty confidence.

**33. In this context, the NBM should assess the viability of each bank’s recovery plan.** This is needed both in terms of the range of recovery actions covered in the plan (including recapitalization, access to private liquidity support, parent support where applicable, and stakeholder communications) and in the pre-positioning undertaken by banks to ensure that the plan can be actioned. In the latter regard, it is important that the banks are pre-positioned for the issuance of capital instruments through the preparation of documentation, indicative terms sheets for capital instruments, capital-raising strategies, documentation needed for underwriting of capital issuance, documentation for making loan portfolios available for liquidity support, etc.

**34. It is also important for the NBM to determine what actions it and other government agencies need to take to assist the banks in the implementation of their recovery plans.** For example, this might include any fast-tracking of regulatory approvals for capital issuance, exemptions from normal stock exchange listing requirements for seeking shareholder approval to capital-raising, and legal processes in the NBM needed to enable it to either enter into a sale and repurchase agreement or to take collateral via a bank’s loan portfolio. The NBM may also need to consider what temporary dispensations from prudential requirements might be needed to enable a

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<sup>3</sup> The government has now put to Parliament a proposed law which would give the NBM and NCFM appropriate powers. Currently, all NCFM actions, including license revocation on grounds of fraud, can be suspended by court action. At least one registrar has frustrated NCFM action on this point and is still operating.

bank to implement recovery actions (e.g., a temporary relaxation of capital requirements and large exposure limits for a defined period pending the implementation of recovery actions).

**35. Private sources of capital injection.** In the context of recovery plans, the NBM should re-assess the ability and willingness of major shareholders to inject further capital. This should include an assessment of the quality and location of assets underlying any capital injection that the NBM would consider acceptable. Capital injection should desirably take the form of cash consideration or government securities, but any alternative should take the form of low-risk assets which are legally and operationally situated in Moldova (and therefore able to be controlled by a special administrator should the need arise). The NBM also needs to consider other potential sources of private capital for banks, such as the ability to obtain the capital by arranging for the sale of shares in the distressed bank to another local bank, a foreign bank or an institutional investor—subject obviously to ensuring that any such capital-raising does not unduly exacerbate the market concentration of banks, increase contagion risk or undermine corporate governance and risk management of the bank in question.

**36. Banks should be asked to regularly test their recovery plans.** Unless recovery plans are tested on a regular basis there is a significant risk that they will not be reliable when needed. Accordingly, the NBM should require banks to conduct regular testing of recovery plans, under the oversight of the NBM. This could be part of an ongoing program of crisis simulation exercises that banks are required to undertake to enhance their capacity to respond to a range of crisis scenarios.

**37. Resolvability assessments.** The NBM should undertake regular resolvability assessments of all the systemically important banks. The resolvability assessment should identify the resolution options for each of the banks on the basis of achieving a least-cost resolution which meet system stability objectives. The resolvability assessments should include such matters as:

- Assessing the principal businesses and the services that are core to the bank's franchise value, and identifying the critical financial and economic functions it performs for the financial system and the nonfinancial sectors.
- Mapping of essential and systemically important functions and corporate structures, and an assessment of how legal and corporate structures relate to principal business lines and critical and core functions.
- Assessing the extent to which key operational functions, such as payment operations, trade settlements and custodial functions are outsourced to other group entities or third party service providers. Consideration should be given to how robust are the existing Service Level Agreements in ensuring that the key operational functions will continue to be provided to a bridge institution or surviving parts of a resolved bank when necessary.

- Assessing any obstacles to separating systemically critical functions from the rest of the bank in a resolution and for ensuring their continuity.
- Assessing whether the bank being resolved could retain membership of FMIs and whether, if a bridge entity is formed, it could access FMIs.
- Assessing whether banks have in place arrangements that facilitate the transfer of payment operations to a bridge institution or third party purchaser.
- Assessing whether the appointment of an administrator or the transfer of business to another entity could trigger events of default by counterparties.

**38. Bank-specific resolution plans and resolution strategies.** It is important that bank-specific resolution plans are prepared for at least the systemically important banks. These would be informed by the resolvability assessments and should draw on resolution strategies developed by the NBM. The resolution strategies and bank-specific resolution plans could include at least the following options:

- **Recapitalizing a bank** (especially if it is still solvent) through either a rights issue to existing shareholders, possibly underwritten by the government on commercial terms, or through an issue of shares direct to the government or another party and with appropriate dilution of existing shareholder value based on the valuation of the bank. If recapitalization is required with government funding, then consideration should be given to the terms on which that may occur, with a view to minimizing taxpayer risk, ensuring appropriate dilution of existing shareholders and facilitating cost-effective and timely sale of the government's shareholding in due course. Options might include preference shares or subordinated debt which meets Basel III loss absorption requirements.
- **Establishing a bridge bank under temporary government ownership.** This could involve transferring all of the business to the bridge bank or just systemically important business. Impaired assets could be left in the failed bank, transferred to the bridge bank (at market value) or transferred to an asset management vehicle (at market value). The resolution plan should include consideration of the form and terms of capital injection, with a view to protecting taxpayer risk, diluting existing shareholders in a manner consistent with assessed value of the bank and facilitating sale of the bank once stabilized.
- **Implementing a bail-in.** Although existing law in Moldova does not permit a bail-in, at least in terms of directly converting debt to equity or writing down debt, it might be possible to implement a form of bail-in by retaining some tranches of debt (e.g., subordinated debt and senior unsecured bonds, and potentially uninsured deposits) in a failing bank and transferring remaining debt and assets to a bridge bank. The bridge bank would then be capitalized through

the issuance of shares to the government, funded through a combination of the net asset position established in the bridge bank as a result of partial debt transfer and new capital injection. Creditors left in the failed bank would be compensated if required under the “no creditor worse off” principle.

- **Consideration should also be given to the mechanics** and pre-positioning needed to transfer the deposit book and unimpaired assets, together with required payments and IT functionality, to another existing bank if it were willing to assume the business at market value. This would require consideration of the funding needed if there were a shortfall in assets to match the liabilities transferred.

**39. Resolution strategies and bank-specific resolution plans need to be developed in close liaison between the NBM and MOF, with input from the DGF and NCFM.** They should be coordinated across the NCFS in accordance with the MOU established for this purpose.

**40. Resolution strategies and plans need to be subject to workshopping, training, and testing.** The development of a resolution strategy and bank-specific resolution plans requires an iterative process through senior-level workshopping, both within the NBM and with the other agencies in the NCFS. This will assist to refine the plans into “living” documents that are more likely to be capable of implementation than if the plans remain “on the shelf.” They also need to be tested regularly through crisis simulation exercises.

## E. Resolution Funding Arrangements

**41. Consideration needs to be given to the funding arrangements for crisis resolution.** Currently, the only resolution funding available is via the DGF. However, this is (appropriately) constrained in amount by the provision that it must not contribute funding to a greater level than it would have applied in paying out depositors of the failing bank. It is insufficiently funded for any large bank failure or a systemic banking crisis.

**42. The Government, in liaison with the NCFS, needs to assess the funding options available to facilitate effective crisis resolution.** This should be undertaken with a view to seeking to minimize taxpayer risk, ensure that any government funding is commercially priced and structured, that all private sector funding options have first been exhausted and that any government-provided funding outlays can be recovered from those who benefit from the resolution—i.e., the users of the banking system.



**43. A number of resolution funding options can be considered.** These include:

- Providing the DGF with a funding line from the MOF which is pre-appropriated (up to a defined limit), such that the MOF does not need to seek budget approval at the time the funding is drawn down.
- Providing the DGF with a back-up funding line via the NBM, indemnified by the Government, again, up to a defined limit.
- Providing the Government with a pre-appropriated source of resolution funding for capital support, guarantees and indemnities, without the need for budget approval, subject to a defined funding cap.
- Establishing a statutory authority for the Government to levy banks and other financial institutions (as appropriate) to recover funding outlays by the government which cannot be recovered through the sale of the failed bank's assets.
- Establishing a pre-funded financial stability fund, contributed to by all banks and other financial institutions (as appropriate), potentially on a risk-based fee basis.

**44. It is suggested that consideration be given to the costs and benefits of each option, and combinations of options, with a view to establishing robust resolution funding arrangements.**

## F. Domestic Coordination Arrangements

**45. The NCFS provides a sound basis for cross-agency coordination of crisis resolution.**

However, it does not appear that it is being used as effectively as it could, either at the level of the NCFS itself or at the Technical Sub-Committee. There has been relatively little detailed resolution coordination and planning via the NCFS to date.

**46. It is suggested that the domestic coordination arrangements for crisis resolution be strengthened, both multilaterally via the NCFS and bilaterally between relevant agencies.** In this regard, a number of initiatives could be considered, including:

- ensuring that the NCFS meets on a regular basis (e.g., quarterly or six monthly), with a well-defined agenda, to oversee and coordinate all elements of financial crisis preparedness;
- ensuring that the Technical Sub-Committee meets on a regular basis (e.g., monthly or quarterly), and is tasked with coordinating the development of a comprehensive contingency plan for crisis resolution;

- requiring the Technical Sub-Committee to report progress (on a comprehensive basis) to the NCFS at each NCFS meeting;
- establishing NCFS working groups to progress different elements of crisis resolution (each working group would appropriately be required to report regularly to the Technical Sub-Committee), such as working groups on:
  - bank resolution strategies (chaired by the NBM);
  - resolution funding (chaired by the MOF);
  - FMI resolution (co-chaired by the NBM and NCFM); and
  - insurance/other financial institution resolution (chaired by the NCFM);
- establishing bilateral MOUs between the NBM and MOF, NBM and DGF, MOF and NCFM, and NBM and NCFM to clearly set out the responsibilities of the respective agencies and a basis for bilateral coordination and cooperation;
- hold regular workshops on resolution strategies between the member agencies; and
- hold a crisis simulation exercise across all NCFS agencies at least every two years.

**47. Crisis exercises are especially helpful.** They provide a framework for testing and refining guidance on different resolution options and for building capacity within each agency and across agencies. They also help to build closer cooperation and coordination between agencies—both in the planning of the exercise and in the exercise itself.

**48. It is therefore suggested that the NCFS give priority to holding a crisis exercise as soon as practicable.** The World Bank has agreed to assist in this regard, with a view to a crisis exercise being held in April 2014.<sup>4</sup> As part of that exercise, it is suggested that there be a de-brief for all participants held either immediately after the exercise or on the following day. This provides a good opportunity to draw out key lessons from the exercise.

**49. Once an initial crisis exercise has been held, it is suggested that the NCFS and each agency undertake regular crisis simulation exercises**—some within each agency and some across the NCFS as a whole. In each case, it is important that the CEOs of all NCFS member agencies participate in the exercises, given that this adds to the realism and value of the exercises.

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<sup>4</sup> This Crisis Exercise was held, as planned, in April 2014.

## G. Cross-Border Crisis Resolution

**50. Although there are currently only a small number of foreign banks in Moldova, there is a need for the development of cross-border crisis resolution arrangements.** This will be especially important if the foreign banks grow in market share and systemic importance. It will equally be important if Moldovan-domiciled banks establish subsidiaries or branches in other countries.

**51. Currently, there are no resolution-specific MOUs between the NBM and its foreign counterparts, or the MOF and its foreign counterparts, in respect of the foreign banks operating in Moldova.** This creates a vulnerability in crisis resolution. It is suggested that MOUs be developed, at least in the case of the foreign banks with substantial operations in Moldova. The aim should be to develop close working relationships between the NBM and its counterparts, and the MOF and its counterparts, with a view to firming up expectations of each agency's responsibilities in a cross-border resolution. Consideration could then be given to developing resolution frameworks which cover the respective responsibilities and actions of the agencies in respect of early warning systems, solvency assessment, systemic impact assessment, recovery plans, resolvability assessments, resolution plans, and communications arrangements.

**52. Once these arrangements have been developed, it is suggested that consideration be given to holding occasional cross-border crisis simulation exercises.** This is particularly important in the case of the foreign banks with a substantial market presence in Moldova.