

Financial Monitor:

An analysis of main reforms in the financial sector of Moldova

Monitoring report nr. 2

Monitoring period: April-July, 2016

Author: Dumitru Pîntea

Contents

Introduction.....	3
Drafting the Bank Recovery and Resolution Law	4
General provisions	4
General findings and recommendations.....	6
Drafting the Central Securities Depository Law	9
General provisions	9
General findings and recommendations.....	10
Implementation progress of the Roadmap for the priority reforms agenda	11
General provisions	11
General findings and recommendations.....	13
Continuing negotiations on signing a new Cooperation agreement with the International Monetary Fund.....	14
General provisions	14
General findings and recommendations.....	15
Carrying out the selection contest for independent members in the NBM Supervisory Board.....	16
General provisions	16
General findings and recommendations.....	17
Final conclusions and recommendations	18

Introduction

After the major banking crisis from 2014-2015 the situation of the financial and banking sector shows signs of incipient stabilization. However, in order to make sure that the process is a sustainable and irreversible one, a series of systemic reforms is necessary to fully consolidate the sector, but also to resume financial cooperation with the main development partners. Also, besides ensuring a stable and efficient legal framework for the development of the sector, the signing of a new Memorandum on economic and financial policies between the Moldovan Government and the International Monetary Fund depends on the qualitative implementation of the reforms as well. The last visit of the IMF experts group (July 5-15, 2016) confirms this, the mission mainly focusing on the last developments in the financial and banking sector. In this context, the Government and the entire political class is challenged to show will, determination and the potential to ensure quality reforms that will exclude interference by different circles of interest in the process of bank supervision and regulation, shareholder's transparency and establishing certain crisis situations management mechanisms.

Together with the publication of the *Rehabilitation of the Moldovan Banking Sector Action Plan* proposed for 2016-2017, Expert-Group has committed to constantly monitor the activity of line authorities in the financial and banking sector reform process. After the first issue of the monitoring report focused on the most urgent actions the authorities implemented to stabilize and initiate certain quality reforms of the financial and banking sector (January-March 2016), the second issue continues the analysis of the actions implemented or in process of implementation during April-July 2016. Thus, the current monitoring report comes to summarize and present the main actions implemented by the authorities to strengthen the financial regulatory framework and ensure the operational independence of line institutions to the public, to provide analytical assessments of the undertaken measures, as well as to propose recommendations to streamline reform efforts for this sector.

Summary of main actions and events in the monitored period

The monitoring exercise covered five major actions identified during the reference period:

1. The draft law on bank recovery and resolution – legal, institutional and regulatory framework for financial stability (bridge bank legislation);
2. The draft law on the Central Securities Depository;
3. Implementation progress of the Roadmap for the priority reforms agenda, especially components relevant to the financial and banking sector (section 7, 8 and 9);
4. Continuing negotiations on signing a new Cooperation agreement with the International Monetary Fund;
5. Carrying out the selection contest for independent members in the NBM Supervisory Board.

Besides these, a series of amendments were operated in the NBM law and the law on financial institutions in order to harmonize them with the aforementioned draft laws. Each action will be analysed further, and the last section of the document will present the main conclusions and recommendations to stimulate the financial and banking sector reform.

Drafting the bank recovery and resolution law

General provisions

Currently, in the national legislative framework, provisions regarding the measures that NBM can take in relation to the recovery and resolution of a commercial bank in difficulty can be found especially in the content of the Law on financial institutions¹. The special procedures foreseen in this law include a series of measures, namely: special supervision, special administration, recovery or forced liquidation measures. However, the banking crisis from the last period that resulted in granting emergency credits of over MDL 15 billion under government guarantee and the liquidation of three banks has proved the inefficiency and the gaps of the current regulatory framework. Also, the financial crisis showed a significant lack of adequate tools for quick and efficient management of banks in difficulty at the level of the central bank, a situation proving to have a significant impact on the destabilization of the entire financial and banking sector. Under these circumstances, the need for a strong legal framework that would be able to prevent future crisis situations becomes essential, and it should especially include a sufficient range of tools that could be used. Accordingly, drafting the legal, institutional and regulatory framework on financial stability is one of the main activities aiming to strengthen and reform the financial and banking sector of Moldova. Moreover, the resuming of cooperation with the development partners, especially IMF, greatly depends on the qualitative implementation of this action. The EU member-states experience and the provisions of the Directive 2014/59/EU² on establishing a framework for the recovery and resolution of credit institutions and investment companies were taken into account in its drafting.

*At EU level, as a result of the severe financial crisis that flared in 2008, a reflection process was launched in order to build a unified regime that would include detailed norms for the reorganization and resolution of credit institutions. The objectives pursued by the Union, published as early as October 2009³, include the main elements of the new harmonized framework for banking sector cross-border crises management. These are based on the consideration that, unlike the general insolvency regime the main objectives of which are a fair and predictable treatment of creditors and maximizing the value of assets in order to satisfy their claims, a specific framework for the resolution of banks in crisis has to give priority to the “public policy” objectives, such as **financial stability, continuity of services, integrity of payment systems**. After these unprecedented measures taken since the fall of 2008 for bank recapitalization and guarantee from public funds, the Directive 2014/59/EU represents the result of efforts made to create an effective crisis management framework for cross-border financial institutions. This is also a fundamental reform in regulating and supervising financial markets, which lays the ground for a regime ensuring that the authorities coordinate their actions effectively and have adequate rapid intervention tools to manage difficulties that the credit and other financial institutions face.*

Under these circumstances, the bank recovery and resolution draft law seems to be a new tool of state intervention which is harmonized with the Directive 2014/59/EU and is considered necessary especially in preventing an institution to go bankrupt. Also, if bankruptcy is inevitable, the draft law strives to reduce negative consequences to

¹ Law on financial institutions Nr. 550 as of July 21, 1995

² Directive 2014/59/EU of the European Parliament and the Council of May 15, 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms.

³ A EU Framework for Cross-border Crisis Management in Banking Sector (COM (2009)0561 final), http://ec.europa.eu/finance/bank/crisis_management/archive_en.htm

minimum, in order to maintain the systemic importance bank functions by making it more viable if possible, or, case by case, by transferring these functions to another entity. Also, the commitments taken by our country in the context of the EU Association Agreement were taken into consideration in implementing the project, respectively, the bank recovery and resolution regime is harmonized with the one in place at EU level, which gives the authorities of the member states a credible set of tools for sufficient, rapid and timely intervention in case of critical situations banks can reach.

In the context of the draft law the term of “**bank resolution**” describes the process of restructuring a banking institution by a resolution authority, using the resolution tools and competencies in order to ensure the continuity of essential functions (e.g. deposits, payments), fully or partly restoring its viability, and liquidating its residual part. The financial and banking sector crises management framework as it was conceived by the project authors is accordingly structured on three pillars: (i) preparation, (ii) early intervention and (iii) bank resolution, and triggering conditions, involved authorities and tools that can be used and how they can be implemented were established for each pillar. At the same time, the draft law describes ways to finance the resolution, derogations from applying other regulatory documents, safety mechanisms, and ways of appeal available to persons considering themselves injured.

1. Preparation – the first stage, when the need to redress the situation of a bank or apply a resolution tool arises, is accomplished by the bank developing a recovery plan on one hand, and the NBM drafting a resolution plan on the other. In cases of banks with systemic impact over the banking sector, these plans will include the fundamental elements foreseen in the draft law, and for banks with a lower complexity of structure and impact the plans can include simplified requirements. In drafting these plans, the commercial bank as well as the central bank will focus on a close collaboration with the main objective to have as low an impact as possible on the financial system of the country and the public budget resources.

2. Early intervention – at this stage NBM is authorized to take certain measures regarding a bank when it violates (or is likely to violate) the bank activity regulatory requirements. These measures refer to a series of actions that can be imposed upon the commercial bank, among which the following: replacing the management bodies, implementing a recovery plan, modifying the business strategy, modifying the legal or operational structure (NBM appointed administrators).

3. Resolution – this implies the intervention of state authorities in a bank in order to restructure it so that the objectives of the resolution are achieved. The main objectives described in the draft are related to avoiding negative effects on financial stability, especially through preventing contagion on other banks, protecting public funds, protecting the deponents falling under the Deposits guarantee law⁴, protecting the clients’ funds and assets. However, in order to not generate an abuse, a resolution can be ordered only when the following conditions are cumulatively met:

- NBM considers that the commercial bank is entering or is likely to be entering a state of major difficulty;
- there is no reasonable perspective to prevent this state of major difficulty;
- resolution is necessary from the perspective of public interest.

⁴ Law Nr.575 of 26.12.2003 on individual deposits guarantee in the banking system

When a commercial bank meets all the resolution conditions, NBM can apply a series of **resolution tools**, individually or in any combination, except for the assets separation tool, which is applicable only together with another resolution tool in order to avoid any potential moral hazard. The law does not expressly specify the circumstances for using one or another tool, yet in a situation when resolution tools are applicable, NBM will take the objectives of the resolution into account and will select those that allow achieving the objectives it deems relevant for each particular situation at the highest level.

The applicable resolution tools are:

- **Selling the business** – implies that NBM transfers the assets or other property tools issued to a viable potential buyer, as well as the transfer of assets, rights or liabilities;
- **The bridge bank** – implies operating similar transfers to a bank specifically created to receive and hold some or all shares, assets, rights and bonds of one or several banks under resolution. This is done to maintain the critical functions and for subsequent sale of the bank. The social capital of the bridge-bank is fully owned by the Ministry of Finance;
- **The assets separation tool** – implies the transfer of assets, rights and liabilities of a bank or bridge-bank to an assets administration entity. Such an entity is a legal entity with fully or partially state owned social capital, and it is created to receive and hold the assets of the bank under resolution;
- **The bail-in** – under this tool BNM has more powers in terms of the amount payable for the remaining eligible debts of a bank under resolution. These will be redirected towards the recapitalization of the bank under resolution on the account of certain classes of its creditors⁵. At the same time, the use of resolution tools does not require the bank shareholders' or creditors' agreement. Essentially, unlike the *bail-out* mechanism, the bank losses will not be covered by the state budget (taxpayers) anymore, but by the shareholders.

The resolution measures in dealings with the banks will be funded from the bank resolution fund, thus avoiding having to use public budget resources. The Fund will consist of contributions collected from the commercial banks and by December 31, 2024, the amount should be 1% of the volume of the banks' guaranteed deposits. The Banks Resolution Fund will be managed by the Deposits Guarantee Fund in the Banking System, and the resources will be used only based on the NBM decision.

On July 29, 2016, the draft law was voted in the first reading and will be reviewed for approval in the final reading in the Parliament's autumn session. At the same time, in the parliamentary discussions it was agreed that for the second reading the authors would work on finalizing a much clearer language for the text of the law, as well as on excluding all technical incoherencies.

⁵ The creditors of a bank under resolution incur losses after the shareholders according to the order of their receivables' priority within the forced liquidation procedure. Considering that the deponents are also creditors of the bank, the legal provision covers them as well, except for the deposits falling under the deposits guarantee law.

General findings and recommendations

- Moldova needed a major banking crisis to finally have a legislation on bank recovery and resolution. From a formal perspective it is fully aligned to the best international practices and European mechanisms. In terms of substance, it comes to respond to the challenges raised by the defrauding of several local banks, but also by the risks posed by the most recent international financial crisis. The table below summarizes the results of the new intervention measures in the detriment of bank failure, the third column, accordingly, showcases the hypothetical results of the draft law. At the same time, the table presents the impact of external recapitalization as well (solution admitted initially in the case of the three liquidated banks that were not granted emergency credits under Government guarantee) in comparison with the new solution proposed – internal recapitalization. Thus, through the bail-in process, the taxpayers will be exempted from incurring more costs as a result of frauds committed with the involvement of bank shareholders and management, as it seems will happen in the immediate future with the approximately MDL 15,8 billion granted to the liquidated banks (currently, the draft law on issuing state bonds is being discussed in the parliamentary committees⁶)

Table 1. Internal recapitalization vs. using public money or bankruptcy

Consequences of actions taken	Methods to redress the situation of a bank		
	Bankruptcy	External recapitalization (using public money)	Internal recapitalization (the creditors incur the loss)
Vital bank functions are continued	NO	YES	YES
Financial stability is maintained	No, in case of a systemic bank	YES	YES
The taxpayer is exempted from having to incur costs	YES	NO	YES
Guaranteed deposits are safe	YES	YES	YES
Non-guaranteed deposits are safe	NO	YES	NO
Guaranteed bonds are recovered within the limit of the guarantee	YES	YES	YES
Non-guaranteed bonds are recovered	NO	YES	NO

Source: Internal recapitalization – preferable alternative to bankruptcy or using public money, Bogdan Olteanu, National Bank of Romania 2016, compiled by Expert-Grup.

Each bank recovery solution chosen involves certain consequences, namely:

⁶ The draft law on issuing state bonds in order for the Ministry of Finance to execute the payment obligations deriving from state guarantees nr.807 of 17.11.2014 and nr.101 of 01.04.2015, which is in examination in the parliamentary committees under nr. 257. <http://parlament.md/ProcesulLegislativ/Proiectedeactelegislative/tabid/61/LegislativId/3278/language/ro-RO/Default.aspx>

1. In the hypothesis that a bank goes bankrupt, all clients and partners of the bank are affected – debtors, creditors and users of payment services. The only categories that suffer less are the holders of deposits and bonds guaranteed by certain types of contracts with adequate protection. We have to underline that there will be no direct costs for the taxpayer, and the financial stability will be affected if the bank going bankrupt is a systemic one.

2. In case of external recapitalization – internationally known as a bail-out, this procedure will ensure the continuity of vital bank functions (cards, current accounts, etc.) and the stability of current funding of the companies. Guaranteed deposits will remain safe, through the guarantee mechanism, and the guaranteed bonds will be legally covered within the guarantee limit. The decision regarding non-guaranteed deposits and receivables (shares, bonds, etc.) belongs to the stakeholder that covers the costs from public resources, thus the Government. This system was applied most recently in case of the three banks plundered that were not granted resources from NBM reserves under Government guarantee, and all non-guaranteed bonds payables have kept their quality. Conversely, the cost is to be incurred by taxpayers, by covering the recapitalization cost.

3. Internal recapitalization – the bail-in process, will ensure the continuation of critical bank functions (payment systems, cards, current accounts, etc.) and the stability of current funding of companies. The guaranteed deposits will remain safe, covered by the guarantee mechanism, and the guaranteed bonds will be legally covered within the limit of the guarantee. The non-guaranteed deposits and the other non-guaranteed payables (bonds, etc.) will be managed by the resolution authority in order to recover the recapitalization money. Conversely, there will be no more costs incurred by the taxpayers.

- If an institution does not present an adequate recovery plan, the supervisory authority should have the competence to request that it takes necessary measures to remedy the major deficiencies of the plan. In the process of transposing the Directive 2014/59/EU into the national legislation, many states were faced with the fact that this requirement may affect the freedom to conduct business, guaranteed by article 16 of the *EU Fundamental Rights Chart*. Yet, limiting this fundamental right is necessary in order to achieve the financial stability objectives. More precisely, this limitation is necessary in order to strengthen the activity of institutions and to avoid an excessive increase in their activities or risks taken by them without having the capacity to overcome difficulties, take over losses and restore their capital base;
- An important element of the draft law is the legal guarantee provided to the creditors that in the bank resolution and recovery process they will not lose more than from the bankruptcy alternative. However, the maximum amount guaranteed by the Deposits Guarantee Fund is of just MDL 6 thousand, which is extremely small compared with the limit imposed to the EU member states (EUR 100 thousand). At the same time, the deposits guarantee scheme does not cover legal entities. Thus, from the perspective of maintaining the deponents' trust in the banking system but also of current economic realities an increase of this ceiling is necessary at least up to the equivalent of 12 average wages per economy;
- Considering the temporary limits imposed by the *Roadmap for the priority reforms agenda*, the draft law was developed in an extremely short term which did not allow for full adjustment of other legislative/regulatory documents that double or contravene with this law (the Law on financial institutions, the Law on joined stock companies, etc.) Thus, together with the adoption of the Banks recovery and resolution law, the financial legislative framework strengthening process should continue with the elimination of all remaining incoherencies and gaps.

- Following the EU member states experience, the recovery and resolution provisions should be extended to other financial institutions as well, such as insurance or micro-finance companies. Even though these do not have a systemic impact on the financial chain of the country, they remain pretty well integrated with the banking sector, this fact being proven by some of the recent developments in the non-banking sector.

Drafting the Central Securities Depository Law

General provisions

Drafting the special legislation on the Central Securities Depository derived from the modification operated to the NBM law together with the approval on April 8 of the financial package⁷, Law nr.62 of 08.04.2016. Thus, the Government committed that within 3 months from its publication, it will submit a draft law on establishing a Central Securities Depository to the Parliament. A central depository makes for an important pillar of any financial system because it channels all financial tools of the capital market, and, most importantly – the accounts of holders of public interest securities. Also, as consisting part of the capital market, it mainly deals with the clearing and settlement of financial tools, their depositing and maintaining the securities holders registry. The importance of such a tool for Moldova is crucial, considering the fairly fragmented financial tools depositing infrastructure system, which often proved to be inefficient in protecting property rights. Not lastly, the country's investments attractiveness also depends on the securities holding system, this characteristic suffering from the repeated "raider attacks" on some Moldovan financial institutions, resulting in violating investors' property rights.

Considering the fact that the right to create, own and supervise the Central Depository fell under the NBM competencies, it also received the task to develop this draft law. After coordinating with the IMF experts, on July 15 this year, a draft law regarding the Central Securities Depository was remitted to the Parliament for debates and approval. The drafting process was a rather difficult one, considering the limited timeframe but also the political disagreements regarding the institutions that are to manage and supervise the Depository. The limited timeframe for this draft was dictated by the fact that this action was included in the *Roadmap on priority reforms agenda* with a deadline for May, 2016. However, the deadline for implementing this action was extended taking the final timeframe of the Roadmap into account - July 31, 2016.

Generally, the draft law submitted to the Parliament establishes the terms regulating the establishment, operation, regulation and supervision of the Central Securities Depository. It proposes the creation of the Depository as a joined stock company and the single entity empowered to carry out operations on financial tools depositing, maintaining the registry of public interest securities holders, operations of clearing and settlement of financial tools admitted for transactions on the regulated market and/or the multilateral trading facility (MTF), as well as other operations inherent to the activity. At the same time, the draft law provides that the Central securities depository is to be owned, managed, regulated and operated by the NBM for an intermediary period. The length of this period will be decided by the NBM, in consultations with the NCFM and the Ministry of Finance, taking into account the need to have a return on the investments made for creating the Depository. During the "intermediary period" NBM should hold at least 2/3 of the shares, and each of the other shareholders should not hold more than 5% of the remaining shares. In order to

⁷ Law nr. 62 of 08.04.2016 (The Official Journal Nr. 123-127 of 06.05.2016) for the amendment and supplementation of the certain legislation, also called the financial package, brings several amendments to the NBM Law and the NCFM Law, especially with regard to strengthening institutional and legal independence of the two institutions.

ensure the continuity of the Central Depository activity, the capital will consist of at least the equivalent amount of 1 million Euro, and in order to ensure a healthy and prudent administration, only NBM, any stock exchange corresponding to the criteria established by NBM, other central securities depositories, accordingly licensed in their country of origin, credit institutions and financial intermediaries corresponding to criteria established by NBM can be among the shareholders. Another novelty brought by the project foresees that it is only possible to hold dematerialized and immobilized securities as a book entry, so they do not have a serial number, are fungible by nature and can under no condition be seized by anyone except the Central depository. In case of immobilization, the Central depository can return equivalent bearer or nominative securities to the participants, disregarding their serial numbers.

On July 29, 2016, the Parliament voted the draft law in the first reading, and will return to it in its autumn session for approval in the final reading.

General findings and recommendations

- By creating the Central Securities Depository the long-lasting differences regarding the right to hold the securities registry are ending. Currently, this is done by the registration companies – authorized private entities supervised by the NCFM, Moldova being the only country in Europe where the securities holders record keeping is not done by a central depository;
- Creating a Single Central Depository is justified by the many raider attacks from the past years which undermined the attractiveness of the local financial and banking sector, especially the interest of foreign institutional investors that have avoided Moldova in their development projects in Eastern Europe. Under the influence of a faulty justice system, the registration companies have been the main weak link of the capital market infrastructure, thus it is certain that in order to ensure the overall development of the financial sector, a solid security system based on advanced technologies is necessary;
- However, the principles of Depository supervision raise certain bewilderment. Hence, in addition to the primary responsibilities of creating, operating and regulating the Central securities depository, NBM will act as its primary supervision authority. At the same time, in exercising these functions NBM will cooperate with the NCFM through an inter-institutional committee (a mixed supervision committee), consisting of 3 members appointed by NBM, 2 members appointed by NCFM, and 1 international expert appointed by the Ministry of Finance from a list of 3 candidates prepared by NBM in consultations with the NCFM⁸;
- The shared supervision of the depository, just like of any other financial entity, shared between several institutions, contradicts the international principles of financial market infrastructure, undermines the responsibility of institutions involved and complicates the regulation and decision making process. In this regard we have the example of the National Committee for Financial Stability, which in a moment of crisis showed its inefficiency because of clearly lacking separated responsibilities and decision

⁸ When this period ends, modifications will be operated in the management bodies of the Depository and namely: The Supervisory Council will consist of maximum 7 members, appointed by the general shareholders assembly, with at least 1 member appointed from a list of 3 individuals proposed by the Ministry of Finance, 1 member appointed from a list proposed by the Moldovan Stock Exchange, 1 independent member with recognized international expertise in the field from a list of 3 identified individuals; The Executive Board of the Depository will consist of 3 members appointed by the Supervisory Council and selected from among the members of the Supervisory Council;

making. Thus, we consider the inter-institutional committee for Depository supervision a major vulnerability of the law, and this does not correspond 100% with the international practices;

- The draft law does not provide what will happen with the National Securities Depository (NSD) which through the amendments operated to the law on financial market currently holds the function of central depository. At the same time, it has over 20 shareholders and a social capital of almost MDL 2,5 million.

Implementation progress of the Roadmap for the priority reforms agenda provisions

General provisions

The Roadmap for the priority reforms agenda compiles all the actions that the Government has committed to implement (the Government, the Parliament, and a series of other public institutions) in order to overcome the social, economic and political crisis from Moldova. The Document⁹ adopted by the Government and Parliament in the beginning of March is the Moldovan authorities' response to the Conclusions of the European Council for External Affairs¹⁰ of February 15, 2016. It covers 13 fields, 3 of which refer to the financial and banking sector, and namely: (i) Resuming negotiations for the sign of the Cooperation Agreement with the International Monetary Fund; (ii) Strengthening the independence and supervisory powers of the NBM and the NCFM; and (iii) Ensuring a thorough and impartial investigation of fraud cases identified in the banking system in 2014. At the same time, many of the measures planned correlate with the urgent reform needs of the financial and banking sector, some of them are also found in the IMF recommendations in the framework of the financial sector assessment program (FSAP), recommendations formulated as early as 2014. More of the actions are also found in the "Rehabilitation of the Moldovan Banking Sector Action Plan for 2016-2017"¹¹ proposed by Expert-Grup in the context of the banking crisis, which pursues the strengthening of the banking sector and prevention of similar crises in the future.

The latest target date for the implementation of all actions was set for July 31, 2016, which created additional pressure on the political factor to find a rapid consensus in order to implement all actions within the established timeframe. At the same time, in order to ensure correct information regarding the Roadmap provisions implementation methods, quality and pace, the cooperation of public institutions with civil society organizations was established through the constant monitoring of each action. This cooperation is meant to create a new framework of relationships which allows non-governmental organizations to participate in developing performance indicators for the assessment of immediate, short and medium term impact of the implementation of Government actions. The actions assessment methodology was focused on specifying performance indicators for planned actions, a quality evaluation of actions implementation and compliance

⁹ Roadmap on the priority reforms agenda, http://gov.md/sites/default/files/foaie_de_parcur_privind_agenda_de_reforme_prioritare_.pdf

¹⁰ Council's Conclusions on Moldova, <http://www.consilium.europa.eu/ro/press/press-releases/2016/02/15-fac-moldova-conclusions/>

¹¹ "How to reinstate confidence in banks?", Expert-Grup, 2016

with the implementation deadlines, which makes the main overdues to be caused by unrealistically tight timeframes established.

On July 31, 2016, the deadline for the implementation of all provisions of the Roadmap has expired. The implementation level of the actions in the financial and banking sector (point 7, 8 and 9), from the quality perspective is over 90%. Mostly, the overdues are registered for the NBM reform process aiming at increasing its independence and competencies, and the two persons for the deputy-governor position are to be identified. For the points in each chapter, the level of implementation is as follows:

1. *Resuming negotiations for signing the Cooperation agreement with the International Monetary Fund.* Out of 6 actions included in this section, 4 were implemented without deficiencies and 2 were implemented with deficiencies. The actions regarding conducting the audit in banks under special supervision were finalized, the Action Plan on recovering these banks being in development (only the plan for one more bank is yet to be developed). At the same time, within the IMF mission from 5-15 July, this year, the consultations regarding the signing of a new financial program with Moldova continued discussing the financial system reform measures foreseen in chapter 8 of the Roadmap, as well as aspects related to the fiscal reforms and ensuring sustainability of the energy system. Also the decision to sign an understanding at expert's level in the immediate future was made, which in theory could unblock the other external financing funds until the actual signing of the Agreement.

2. *Strengthening the independence and supervisory powers of the National Bank and the National Committee for Financial Market.* Out of the 8 monitored actions, 2 have not been implemented within the agreed period, 5 were implemented without deficiencies and 1 was implemented with deficiencies. Basically, this point tackles the local financial and banking sector reform – a crucial reform invoked by all development partners in order to renew cooperation with Moldovan authorities. Several actions were implemented within the established timeframe, among which the most important being related to selecting a new governor, adjusting the legal framework in order to strengthen the NBM and NCFM independence, as well as transferring the Central Depository under NBM management. However, several actions were not fully implemented. We can mention the cumbersome process of appointing the other members of the NBM management bodies (there are yet two individuals to be identified for the vacant positions of deputy-governor), but also the approval of the legislation on systemic banking crises management among them. Also, in relation to contracting an independent international evaluation for the NBM supervision process, it was decided to initiate it in August, this year. With enough delays, the banks recovery and resolution and the Single Central Depository draft laws were submitted to the parliament for debates and approval, being voted only in the first reading.

3. *Ensuring thorough, impartial investigation of the cases of fraud that affected the banking system in 2014, also with a view to recovering the diverted funds and to bringing those responsible to justice.* The measures planned within this action aim at providing all necessary support from the Moldovan authorities to the Kroll investigation (external investigation) and initiating domestic investigations under the General Prosecutor's Office. Generally, we can say that the investigation of the banks frauds is progressing slowly and so far, without any financial important results. The investigation launched by the General Prosecutor's Office is conducted in a non-transparent manner, and it is not clear how many case-files were sent to court and who the

persons concerned exactly are. Still, the NBM support to the Kroll investigations is worth appreciating. This implies a more detailed investigation, as well as the implementation of a strategy on recovering assets missing from the three banks.

General findings and recommendations

- The results of the most recent visit of the IMF mission show that it would not be possible to sign a new Cooperation agreement with the IMF within the timeframe established by the Roadmap. A part of the legislation yet to be approved is falling behind the indicated deadlines, these being fairly complex draft laws which require coordination with the international partners but also a solid political consensus for them to be approved. According to the latest statements of stakeholders involved in the negotiation process, actually, a new Agreement could be signed in October 2016 at the earliest, after the IMF Council meeting in Washington. By then, an agreement is planned at the level of expert groups, which could allow the unblocking of some external funds, such as the credit provided by the Romanian Government. Still, it is necessary that at least both the NBM and the Government show firm commitment regarding the full and quality implementation of the reforms assumed, as well as their irreversible character;
- We consider a rapid advancement of actions for the quality finalization of all provisions in section 8 of the Roadmap necessary, especially identifying the two individuals for the two deputy-governor vacancies. Besides that, it is also important to approve the two draft laws sent to the Parliament for debates within an optimal timeframe (the Central Securities Depository Law and the Banks Resolution and Recovery Law);
- We also recommend that the bank frauds investigations launched by the prosecutors and the dialogue with the partners from the states the funds were channelled to is brought up to speed. At the same time, it is important to increase transparency, within the legal limits, of the criminal investigation of said bank frauds. The correct information of the public will increase the general public's trust in the fairness of the measures taken;
- Essentially, the measures planned in the analysed roadmap are not entirely sufficient to stabilize and reform the financial and banking sector. Moldova needs an extensive action plan exclusively dedicated to the financial sector (banking and non-banking) that would cover a 1-2 years horizon and which, besides the actions already implemented or proposed for implementation, would include a comprehensive financial sector and the financial stability system regulatory mechanism reform (see "Rehabilitation of the Moldovan Banking Sector Action Plan for 2016-2017¹²").

Continuing negotiations on signing a new Cooperation agreement with the International Monetary Fund

General provisions

¹² "How to reinstate confidence in banks?" The Moldovan banking sector clean-up action plan, Expert-Grup, 2016, <http://www.expert-grup.org/ro/biblioteca/item/1212-plan-consolidare-sistem-bancar-moldova&category=7>

After over three years without a Financing Program with the International Monetary Fund, Moldova seems to have finally reached a preliminary understanding regarding the signing of a new Cooperation Memorandum. Maybe not coincidentally, but exactly during the period lacking the monitoring implied by an Agreement, the country's economy was shaken by extensive negative developments, resulting in the plundering and liquidation of three banks, a two-figure inflation, a contracting economic activity and the discontinuation of financial assistance from the development partners (especially the European Union and the World Bank). Currently, the signing of a new Agreement with the IMF seems to be the only solution for Moldova to overcome the economic crisis, which makes all the Government's efforts to be channelled towards meeting all requirements cited by the IMF experts in their working visits from the recent period. Among these, the most important ones are with regard to the financial and banking sector stabilization and strengthening, and some of them can also be found in the *Roadmap for the priority reforms agenda* which for the moment is the most important document describing the actions to be implemented by Moldovan authorities in order to overcome the social and economic crisis in the country. More exactly, in the consultation process, the requirements of the IMF experts have focused on the following general actions¹³:

- Conducting thorough assessments at the three banks under special supervision in order to establish the real financial situation;
- Drafting an action plan based on the recommendations/findings of audit reports for the three banks;
- Ensuring full functionality of the National Bank, its independence and supervisory competencies;
- Increasing transparency of the commercial banks shareholders structures and identifying their real beneficiaries;
- Improving corporate governance in financial institutions;
- Strengthening the supervisory and regulatory framework of the financial sector;
- Rational use of budget resources;
- Sustainability of the national energy system.

The last visit of the IMF experts (July 5-15, 2016) basically meant the launch of actual negotiations. The discussions with the Government and NBM representatives focused on perspectives of economic growth, policies impacting the financial sector, public finances sustainability and structural reforms necessary in order to improve the business environment and attract investments. At the same time, the experts' mission recognized the reforms undertaken and the progress made in order to sign the new Agreement, which is proved by the announcement at the end of July regarding the agreement reached at personal level on a program of economic reforms supported by a financial arrangement for 3 years. According to it, the access to financing is proposed to be of 75% of Moldova's share at IMF (DST 129 million, or about USD 179 million). However, this agreement at personal level will have to be approved by the IMF management represented by the Executive Board, which is planned for October, this year. According to the IMF clarifications, the new program is meant to become a catalyst for unblocking the donor support and the support of economic development and it will be based on two pillars:

I. Policies to ensure macroeconomic and financial stability. These mainly target eliminating the vulnerabilities generated by non-transparent bank shareholder structures and the weak supervisory and regulatory

¹³ According to the press-releases of the IMF representative office in Moldova

framework of the financial sector. Also, the monetary policy will continue to focus on maintaining the stability of prices in the context of a flexible exchange rate regime, and the fiscal policy will focus on the rational use of available financing limits in order to consolidate public investments and support social and development objectives.

II. Structural reforms to facilitate economic growth. The authorities' program supported by the Cooperation agreement with the IMF is part of a wider development framework aiming at bringing Moldova onto a track of sustainable and inclusive growth with the support of the other international partners. The structural reforms are directed at improving the business environment, attracting investments and increasing the economic growth potential.

General findings and recommendations

The poor situation that the financial and banking sector reached shows once again that besides financial support, Moldova needs a continuous financial policies monitoring which implies an Agreement with the IMF. The experience of the last three years shows that a situation without a functional Agreement with the IMF and correlated with a continuous political crisis is a dangerous combination for Moldova's economy and security. Moreover, often the state investments seem helpless when facing the shady interest groups or even the imperfect judicial system, which is negatively transposed over the investment activity of the country.

So, Moldova needs an Agreement with IMF not only from the perspective of financial support, but also from the one of technical assistance and even the pressure that the Fund can put on the Government in order to implement unpopular reforms, the structural reforms necessary to increase the country's competitiveness, and that will not be possible to implement without this external anchor.

Even if many institutions have the summer vacation, the coming months are expected to be just as complicated as the previous ones, both economically and politically. We recommend that the Government leaves no room to relax once the IMF announcement is made, and that it takes all imposed measures in order to live up to the confidence shown by external partners. Broadly speaking, we can note the following:

- Although actually the Cooperation Agreement with the IMF will not be signed within the timeframe established by the *Roadmap for the priority reforms* agenda (July 31, 2016) the understanding reached at the level of experts could allow the unblocking of other external funds in the immediate future, such as the USD 160 million offered by the Romanian Government;
- To resume the European Union's financial assistance before the actual signing of the IMF Agreement, at least the Government should show the full and quality completion of all provisions of the Roadmap within the established timeframe. Only this way the Government could have a solid advantage at the eventual negotiations with the EU representatives;
- In this regard, several draft laws continue to be on the agenda for the parliamentary committees meetings, the overall process of debating and approval not being finished. Thus, although the spring-summer parliamentary session ends on July 31, we recommend that the MPs do not accept vacations before the approval according to the procedure of all draft laws included in the Roadmap.

Carrying out the selection contest for independent members in the NBM Supervisory Board

General provisions

The process of strengthening the central bank management started together with the selection in March of a new Governor, which started activity on April 11, 2016. However, in order to ensure the NBM functioning, the two collegial management bodies are yet to be filled – The Executive Board and the Supervisory Council. One more stage in this process was finished once the other members of the Supervisory Council were identified (4 vacancies). According to the NBM law amendments from 2015, the Supervisory Council is a collegial body responsible for the organization of an efficient independent public supervision of NBM activity. It consists of 7 members, 3 of which are NBM employees (Governor, prime-deputy-governor and one deputy-governor) and 4 members that are not on the NBM payroll. The importance of this management body of the NBM is derived from its main functions, among which:

- approving annual NBM financial reports;
- establishing the NBM labour remuneration fund and the salary level for the Executive Board members;
- establishing the conditions for credits to the NBM employees;
- launching proposals on increasing the NBM capital;
- approving and verifying the execution of expenses estimate and allocations for capital investments.

Also, the Supervisory Council has the right to request any information it deems necessary from the Executive Board and can conduct any kind of control.

Thus, during June-July 2016, the Parliamentary committee for economy, budget and finance drafted, approved and initiated the procedure to select the NBM Supervisory Board members. This procedure was drafted according to the standing legislation¹⁴, the emphasis being on the candidates' professional quality in finance, judiciary or audit, irreproachable independence and integrity. At the same time, the contest was organized and carried out based on the principle of an open competition by ensuring free access to the public contest to any individual meeting the requirements, with the major purpose of selecting those of greatest integrity, professionalism and competence.

The main conditions for participation in the contest were basically the same as to the Governor's position, so to hold Moldovan citizenship, complete higher education, good reputation, at least 10 years of experience in finance, judiciary or audit, or in a scientific or academic function. The specific participation conditions sum up to being in full capacity of exercise, having not reached the age threshold for age-based retirement, being apt for public office in terms of health status, having a Bachelor's degree or equivalent in finance and banking, judicial studies or audit. Also, the candidates are prohibited to carry out any activity that could generate conflicts of interest in exercising their function as NBM Supervisory Board member.

Unlike the Governor's selection procedure for which the Committee consisted of MPs, representatives of academia, line civil society organizations and other experts, this time the chosen procedure was according to the

¹⁴ Art. 23, law nr. 548 of July 21, 1995 regarding the National Bank of Moldova, Law nr.199 of July 16, 2010 regarding the status of individuals in public office, The Moldovan Labour Code nr.154 of March 28, 2000.

NBM law. Thus, the Contest Committee consisted only of members from the Parliamentary committee for economy, budget and finance, and after hearing the accepted candidates in a closed meeting it evaluated and approved the list of selected candidates which is to be submitted to the Parliament for voting. As a result of the contest, the Committee examined 11 files, interviewing and evaluating the candidates' performance. Finally, the Committee proposed the 4 highest ranking individuals in descending order to the Parliament for validation. On July 29, 2016, the 4 candidates were approved by Government Decision for a 7 year mandate. The individuals selected for the function of NBM Supervisory Council member are Dumitru Ursu, Pelin Alexandru, Iasan Valeriu and Enicov Vadim. Specifically on the selection procedure we can positively note the following:

- The candidates selection procedure, selection criteria, the candidates profiles and the results of the contest were transparent and available to the general public shortly;
- There was a clear evaluation scale which in a certain way disciplined the process of evaluation by the Committee members;
- The evaluation criteria were basically similar to those for the Governor position.
- Overall, the selection criteria correspond to the profile wanted for e Supervisory Council member;
- The list of candidates evaluation criteria was consulted and approved before all the files were collected from the candidates, which did not allow, at least in theory, for the criteria to be adapted to the profile of a specific candidate (in the Governor's selection this order was reversed).

General findings and recommendations

- Besides the 4 members that are not on the NBM payroll, the NBM Supervisory Council consists of 3 NBM employees as well (Governor, prime-deputy-governor and a deputy-governor) which creates a certain conflict of interests. The NBM employees should not be members of an executive body at the same time, and the Law regarding the conflict of interests¹⁵ expressly provides the incompatibility of administration and control functions exercised by the same individual;
- Although the selected candidates seem to have a professional profile which is relevant to this function, their selection process did not include representatives of the civil society, which raises doubts regarding the fairness of the process carried out by the contest committee;
- Basically, after the elimination of the Administration Council, the Supervisory Council will start its activity for the first time, so a continuous monitoring of its activity is necessary, especially since this body is expected to bring more credibility to the central bank, and to increase the employees activity transparency and to implement the best international activity practices and standards of central banks;
- We also consider regrettable the decision not to include representatives of the line civil society, academia and NGOs with expertise in integrity verification and anti-corruption policies in the Selection committee. Considering that the candidates evaluation and interviews were organized behind closed doors, certain questions are raised regarding the public character of the selection contest, the candidates professionalism and integrity evaluation method;

¹⁵ Law nr. 16 of 15.02.2008 regarding the conflict of interests

- Under these circumstances, how the other members of the Executive board which are also deputy-governors of the National Bank will be appointed needs to be monitored. All members of management bodies should have relevant professional experience, should not have any political affiliation and should be integral. In this regard, the Governor should focus independently on selecting the candidates for the remaining NBM deputy-governors vacancies and should not admit any influence from the Parliament or other individuals.

Final recommendations and conclusions

The April-July period was a relatively active one from the perspective of the financial and banking sector reforms pace. Still, a great part of this activation is due to the inclusion of several actions in the *Roadmap for the priority reforms agenda* with the general implementation timeframe established for July 31, 2016. Thus, considering that for the moment the financial and banking sector reform is a crucial one in order to resume the external financial assistance, all efforts of involved institutions have focused on completing the key provisions included in the Roadmap. The two draft laws serve as proof (the Central Securities Depository Law and Bank recovery and resolution Law), although they seem to be fairly complex and with major implications for the financial sector, they have been drafted in a very short timeframe, approximately within the limits established by the Roadmap. Once these two laws are drafted, the turn of the political factor comes, specifically of the Parliament has to show will, unity and maturity in order to approve the drafts as soon as possible.

With regard to resuming the external financial assistance, a positive factor is brought by the IMF announcement of the experts level understanding on a new Agreement on economic and financial policies between the Moldovan Government and the IMF. It comes to give a dose of confidence for all external partners in the country's economic and politic environment.

However, the measures taken so far are not fully sufficient to ensure an efficient financial system, and neither to prevent similar crises in the future. More question marks remain around the quality of assets in the entire banking sector, but also around the situation at the three large banks which continue to be under special supervision. Also, one of the main recommendations of the IMF was not fully implemented, namely the quality and transparency of bank shareholders, and there are doubts concerning the actual real beneficiaries of several packages of shares.

Even if the development process of the legal, institutional and regulatory framework on systemic banking crises was completed, it does not fully solve the situation of ensuring financial stability. The National Committee for Financial Stability (NCFS), the body tasked with coordinating the institutions responsible for the stability of the financial sector, is currently facing great governance problems caused by strong political affiliation and unclear mandate, thus becoming part of the problem in solving the banking crisis. At the end of March, the German Economic Team in Moldova and the "Expert-Grup" Independent Think-Tank, submitted to the Government the causes and ways to reform this body¹⁶ based on the international best practices. However, in spite of the fact that idea of reforming the NCFS is agreed and supported, there were no clear taken actions in this regard so far.

¹⁶ "The National Committee for Financial Stability. Why and how it should be reformed", The German Economic Team in Moldova and the "Expert-Grup" Independent Think-Tank, 2016 <http://www.expert-grup.org/ro/biblioteca/item/1249-reformare-cnsm>

In order to continue the acceleration of the financial and banking sector reforms pace, for the following period we encourage the institutions involved in this process to correlate their actions and consolidate their efforts in order to implement the following measures:

- Finalize the process of appointing all members of NBM management bodies based on relevant professional experience, political non-affiliation and professional integrity criteria;
- Full and quality implementation of provisions regarding the financial and banking sector in the Roadmap on priority reforms agenda;
- Ensure a thorough banking system frauds investigation in order to bring the responsables to justice and recover the misappropriated funds;
- Increase transparency, within legal limits, of the criminal investigation process on the bank frauds. Informing the general public will increase the public opinion's confidence in the correctness of measures taken;
- Finalize the approval of the regulatory framework on systemic banking crises and the special legislation on the Single Central Depository;
- Eliminate any form of exposure and interaction between "offshore companies" and commercial banks, since this was an essential element in concealing the funds misappropriated from the liquidated commercial banks;
- Update the list of jurisdictions that do not implement the international standards of transparency¹⁷ and observe the requirements regarding money laundry by including all states and territories that do not adopt such rules in the national legislation. Following some recent disclosures we notice that certain banks continue to provide services to companies residing in jurisdictions included in that list, without any response from the NBA and NAC.
- Reform the bank deposits guarantee framework by strengthening the capacity of the Deposits Guarantee Fund so that it plays a bigger role in the process of solving bank crises, including bank liquidation. The ceiling of deposits guarantee should be increased in the following years up to 12 average wages per economy;
- Increase the prudential requirements in order to eliminate toxic assets from the entire banking sector;
- Restructure the National Council for Financial Stability so that its responsibilities do not overlap with those of NBM and NCFM, and its role is limited to facilitating communication between institutions in order to prevent financial crises;
- Accelerate the implementation of the EU – Moldova Association Agreement, including the financial services chapter. In this regard is important to adopt a schedule for overdue and remaining actions according to the Ukraine and Georgia model.

¹⁷ The BNM Decision Nr. 91 of 02.05.2013 on establishing the list of jurisdictions which do not implement the international transparency standards