Financial Monitor:
Analysis of the Key Reforms in Moldova's Financial Sector

Monitoring Report No 3
Monitored period: August - December 2016

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This document is published by the Independent Think-Tank EXPERT-GRUP with the financial support of the Netherlands Embassy in Bucharest. Opinions expressed in this document belong to the authors and are not necessarily the opinions of the donors.
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## Introduction

In the second half of 2016 the economic discussions on the public arena were mainly focused on the negotiation and subsequent signing of the Memorandum with the International Monetary Fund. As expected, after the 2014-2015 banking crisis that led to the liquidation of three banks, the financial and banking sector was in the spotlight of the discussions with the International Monetary Fund. Thus, the default risk of the national budget made the authorities aware of the constant pressure coming from Moldova’s main development partners, but also from the civil society aimed at recovering the situation in the financial sector. These factors forced the decision makers from Chisinau to take important measures for the reform of the financial sector.

After the 2016-2017 Action Plan on the Rehabilitation of the Banking Sector was made public, Expert-Grup made the commitment to monitor continuously the activity of the empowered public authorities as part of the financial sector reform. In this context, the third issue of the monitoring report synthesizes and introduces the main actions taken by the authorities in order to strengthen the financial regulatory framework during August - December 2016. The report also analyses the measures taken, highlights the potential risks that could undermine the stability of this sector and makes recommendations on how to enhance the efforts of reforming this sector.

## Summary of the Key Actions and Events, Occurred during the Monitored Period

The monitoring focused on the following actions identified during the reference period:

1. Signing of the Memorandum with the International Monetary Fund
2. Changes in the shareholding and management of some banks
3. Conversion of Government guarantee into public debt
4. Development of a draft new law on preventing and combating money laundering and terrorism financing
5. Approval and enforcement of the new framework for financial stability and passing of the Law on Central Depository

Each of the aforementioned actions will be analysed hereinafter through the lens of their meaning and implications on the sector, as well as by looking at the aspects that are worth encouraging and that can be improved.

An important accomplishment that took place in the monitored period, relates to the publishing of the Law regarding banking activity and investment companies, on 30 December 2016. The draft law was developed within the Twinning project, financed by the EU in partnership with the National Bank of Romania and the Dutch Bank.

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2. [http://bnm.org/ro/content/despre-garantite-guvernului-convertite-datorie-publica](http://bnm.org/ro/content/despre-garantite-guvernului-convertite-datorie-publica)
The draft law, will come to substitute the Law on financial institutions no. 550-XIII from 21 July 1995, laying the foundation of a new legislative framework that will transpose the provisions of Basel III, and will establish new fundamental rules for the activity and supervision of the banking system. At the same time, the draft law seeks to implement the highest standards and international practices relating to the licensing, regulating and supervising processes of the National Bank of Moldova (NBM). Due to the fact that the draft law is undergoing the consultation procedure with the relevant authorities, the final version of the document will be analysed in depth in the following edition of the Financial Monitor.

The last part of the report contains conclusions and recommendations on the continuation/advancing of the financial sector reform.
Signing of the Memorandum with the International Monetary Fund

On 7 November 2016 the International Monetary Fund (IMF) Executive Board approved a three-year agreement with the Republic of Moldova funded by two credit facilities - the Extended Fund Facility and the Extended Credit Facility, with the purpose to support the economic and financial reform agenda of the country. In this way Moldova got access to a total amount of about USD 178.7 million.

An amount of about USD 35.9 million was supposed to be made available to the authorities immediately following the approval of the agreement. The remaining amount will be disbursed over the duration of the program in five tranches, subject to five semi-annual program reviews.

The signing of the Memorandum and the beginning of program implementation were subject to the precondition of implementing a number of actions meant to prove the commitment of the authorities to improve the situation in the sector. One of the major preconditions was to pass a set of legal acts meant to ensure the rehabilitation and stability of the financial and banking system, namely: Law on the Recovery and Resolution of Banks, Law amending and supplementing some legislative acts (including the Law on the National Bank of Moldova, Law on Financial Institutions, Criminal Code, and other laws), and the Law on Central Securities Depository. These laws were adopted in the first reading during the Parliamentary meeting on 29 July 2016. Expert-Grup analysed broadly the provisions of these laws in the previous issue of the Financial Monitor, published on 4 August 2016. Considering the urgency of the matter and the importance of approving the set of legal acts in a proper format, they were approved, with certain adjustments from the initial versions, by Government’s assumption of responsibility during the special meeting of 26 September 2016. The major purpose of these laws was to strengthen the legal framework needed to safeguard the financial stability in the Republic of Moldova and to protect the public interest in ensuring a sound and prudent management of institutions in the financial sector. Last but not least, it was aimed to strengthen the national legal framework regarding the transparency and quality of bank shareholding, corporate governance of banks and risk management.

In such a way, significant progress has been made in enhancing the resilience of the banking sector and address weaknesses that triggered the 2014 crisis. Authorities should focus further efforts on appropriate implementation of new provisions to end forbearance in the face of shareholder or manager misconduct. Strengthening the independence of the National Bank and building an effective and fair court system are critical factors that will determine whether the amendments to the legal framework achieve the expected results.

Objectives of the Program in the Financial and Banking Area

An imminent priority for the financial and banking sector is to recover the entire sector from the long-lasting crisis, so that banks could resume their main activity. The key objective of the program is to

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tackle upfront the urgent governance and stability issues in the banking sector. Therefore, among other aspects pertaining to the monetary policy, taxation and other structural reforms, the Program centred on a successful rehabilitation of systemically important banks and radical improvements to the regulatory, supervisory, and contingency frameworks for banks, including through a demonstrated fundamental shift in the enforcement and sanctioning regime.

The policy framework set by the program for the strengthening of the financial sector aims at ensuring long-term stability by building sound institutions that would work under a well-defined regulatory and oversight framework. These policies will be directed at the following intervention areas:

1. **Enforcement actions**: The NBM has implemented strong actions to address the irregularities identified in the problematic banks. The NBM blocked and cancelled some of the shares of the two largest banks: Moldova-Agroindbank and Moldindconbank; owned by unfit shareholders that were found to have acted in concert. All potential new shareholders (those who would like to purchase bank shares greater than 1 percent) will be subject to fit-and-proper testing, in line with NBM regulations. It is worth mentioning that the early intervention regime was introduced in one bank following the blocking of over 60 percent of shares. Another achievement was restoring, after a long time, a functional board in Victoriabank.

2. **Identification of beneficial owners and related parties**: The authorities amended some legal acts to clarify the definitions of related parties, thus granting to the NBM clear tools to determine affiliates on the basis of objective criteria. These new provisions, if appropriately implemented, should significantly shorten the process of beneficial owners’ identification and provide economic incentives to the banks to submit information about related parties on their own initiative. With respect to identification of banks' beneficial owners, the NBM has prepared a plan for full identification of beneficial owners of bank shares by end-December 2016 for the three largest banks and by end-June for the remaining part of the sector. In case of related-party lending, the banks will be required to submit a plan to unwind large exposures to related parties that are above the limits set by law.

3. **Revamping the framework on resolution and contingency planning**: Though the Law on Recovery and Resolution of Banks provides for broad intervention powers for NBM, some aspects have been postponed, notably the creation of a resolution fund (1 January 2020) and introduction of an 8% bail-in (1 January 2024). Until that date, according to the provisions of the law, the Government has the right to decide upon financing by the Ministry of Finance of resolution measures, actions or instruments, through issuing government bonds, state guarantees or any other actions that have an impact on the budget, including measures that exceed the limits established in the state budget in any given year.
At the same time, every bank that has an important share of the financial system is obliged to develop and maintain a recovery plan, envisaging measures that the bank should be taking in order to restore its financial position in case of significant damage to it. Furthermore, NBM - as a resolution authority - develops a resolution plan for each important bank in the financial system and NBM can implement such a plan when a bank meets the conditions for triggering the resolution procedure.

It is worth mentioning that in order to revamp the resolution framework the composition of the National Financial Stability Committee was changed, excluding political decision-makers and limiting the composition to 5 persons only. As well, the NBM will be responsible for the NFSC secretariat. These changes should help the NFSC to perform its tasks more effectively without undue political influence.

4. **Upgrading the regulatory and supervisory framework**: Once the key financial stability risks are taken off the table, the program will focus on certain issues of the supervisory and regulatory framework. A key priority will be to improve the supervision of risk and risk management processes. Another issue is the reform of the bank deposit guarantee framework by strengthening the capacities of the Deposit Guarantee Fund so as for it to play a greater role in the settlement of banking crises, including in bank liquidation. Last but not least, it is important for the Ministry of Finance to define a clear procedure for procurement rules in contracting bank services for public funds management, and refrain from giving some banks privileged access to these resources.

5. **Enhancing NBM Governance**: The strengthening of NBM’s full functionality was achieved by having filled all vacant positions in the two management bodies (Executive Board and Supervisory Council). Despite this, the National Bank still struggles with the retention of qualified staff. The amendment of the NBM Law gives it independence in establishing the remuneration system, which will strengthen NBM’s capacity to motivate its staff.

**General Findings and Recommendations**

Signing the Agreement with IMF and obtaining a commitment of about USD 178.7 million, disbursement of the first tranche of about USD 35 million, and the unblocking of other funding sources from international partners such as the Romanian Government, the World Bank and the European Commission do not imply that relaxing the implementation of reforms is an option for authorities. The following 5 semi-annual reviews of the program (the first in February 2017) with the strict fulfilment of the undertaken commitments will be crucial to continue and complete successfully the program with IMF. Under the last program with IMF the Republic of Moldova missed the last tranche of over USD 75 million, on the background of several actions undertaken by the decision makers from Chisinau, among which: give in to the pressure of interest groups regarding the
introduction of some fiscal changes favoring these groups, the inaction regarding the need to rehabilitate “Banca de Economii” by enhancing the bank management with its further transparent privatization.

Thus, in order to avoid a similar situation with the new program with IMF, the authorities must show a strong commitment to fully rehabilitate the functionality of the banking sector and to fulfil the other aspects set out in the Agreement. With this regard, the adoption of legal initiatives that seem to be promoted by certain interest groups, such as the Law on Capital Liberalization and Tax Amnesty can lead to the deterioration of relationships with the development partners of the Republic of Moldova, and finally destabilize the situation in the country, which could result in a new freezing of the external financial support.

As mentioned in the previous issue of the Financial Monitor: the Republic of Moldova needs an Agreement with IMF not only from the financial perspective, but also because of the Fund’s pressure on the Government to implement the unpopular reforms that are necessary in order to increase the competitiveness of the country and which cannot be implemented without this external anchor.

The commitments identified in the program with IMF in the financial sector imply the following responsibilities for the authorities:

- The strict fulfilment of the calendar and plan agreed with IMF in order to identify the banks’ beneficial owners, as well as observing all commitments deriving from the five areas of intervention related to strengthening of the banking sector.
- Give up on the promotion of some legislative drafts that would favour certain interest groups, such as the Law on Capital Liberalization. IMF provided a formal response on that draft: “The Draft Law in its current form would seriously affect the anti-corruption measures and the fight against fraud and money laundering. We will continue the dialogue with the authorities to identify the possibilities to align the legal initiatives to the program objectives.”
- The unsuccessful completion of the last program with IMF was caused by the failure of authorities to supervise the banking sector and by the promotion of some initiatives favoring certain interest groups. Due to the presence of the same two problems, we risk to interrupt the good development of the program long before its completion.

**Changes in the Shareholding and Management of Biggest Banks**

Generally, the situation in the banking sector is satisfactory. The licensed banks from the Republic of Moldova have high liquidities: the current liquidity indicator by sector on 30 November 2016 was 48.09%. The risk weighted capital adequacy for the sector was 29.39% (the standard is 16%). The Tier I Capital by sector registered a value of MDL 9,672.1 million and the banks have enough capital.
BC “Moldova-Agroindbank” S.A.

Based on the analysis and assessment of the Moldova-Agroindbank’s shareholders, the largest bank of the system, NBM identified two groups of people that were acting in concert in relation to this bank and have purchased in the past a substantial quota of the authorized capital without the prior written consent of the National Bank. As a result, the Executive Committee decided to suspend some rights of these shareholders, who owned jointly 43% of the bank shares. In March 2016, the NBM withdrew the confirmation for 3 members of the Management Board representing around 40% of shareholders. Following the enforcement of legal proceedings and of the Decision of National Commission for Financial Markets of 25 March 2016, these shares were cancelled, and new shares of BC “Moldova-Agroindbank” S.A. were issued. In September 2016, the newly issued shares were put for sale on the Moldova Stock Exchange with the shares procurement deadline set on 26 December 2016. Subsequently, an additional decision of NCFM extended this term by 6 more months because no qualified investors were identified until the initially set deadline. The lack of interest of potential buyers should not be interpreted as a negative sign for the Moldovan banking sector. Due to the fact that new investors have to obtain the prior consent of the NBM and meet the transparency and fit-and-proper requirements set by the Law on Financial Institutions, limits the pool of unqualified investors. Many times, the capital invested in the banks of the Republic of Moldova was suspicious, which repeatedly exposed the banking system to the Eastern obscure interests. Once the standards for the new significant shareholders of the banks were tightened, and taking into account the significant reform in the sector, the interest of this type of investors decreased considerably, favouring the entire system.

However, there are some objective circumstances that might diminish the appetite of foreign investors to enter the local banking sector, among which:

- Though the Moldovan banking sector showed a high profitability even during the crisis, the small market and the unstable political situation in the country, and in the region, reduces considerably the appetite of foreign bona fide investors to invest in Moldovan banking projects.

- The decision of companies registered in Russian Federation – Evrobalt and Kompozit, which were shareholders of Moldova-Agroindbank, to appeal in the Court of Arbitration the NBM Decision and the NCFM Decision imposing the alienation of shares of shareholders that acted in concert and their cancellation, generates additional risks regarding the integrity of future investors’ property.
Evrobalt LLC vs Moldova

Evrobalt LLC – a company registered in the Russian Federation, stakeholder of 46,717 shares that were purchased in two stages for a total of USD 3,853,232. Evrobalt states that the transactions were concluded according to legislation of the Republic of Moldova with notification of the competent authorities, and during 2013-2014 the NBM requested various documents and information to analyse the situation of Moldova-Agroindbank shareholders.

The NBM Decision No 43 of 2 March 2016\(^5\) found that Evrobalt, together with other 19 shareholders acted in concert and obtained a substantial quota in the bank capital, without the prior consent of the NBM. This violates the Law on Financial Institutions, stating that there is no method for a potential purchaser to acquire a substantial quota in the bank’s authorized capital or to increase it, so that the proportion of voting power or of the participation in the authorized capital to exceed the level of 5%, 10%, 20%, 33% or 50% or to transform the bank into their branch, without the prior consent of the NBM.

Thus, the investors were requested to alienate the shares related to the substantial quota procured without the prior consent of the NBM in the authorized capital of Moldova-Agroindbank, within 3 days from 2 March 2016. Given that the shares were not alienated within the term set by the law, according to the Decision of NCFM No 15/2 of 7 April 2016, the bank had to cancel those shares and to issue new shares that were put for sale on the Moldova Stock Exchange. The deadline was set on 26 December 2016, and in case of no new investors, the shares will be purchased by the bank at their nominal price, transferring the money generated by the reduction of the authorized capital to the former stakeholders.

Evrobalt LLC claims that the NBM and NCFM acts are arbitrary, violate its rights and create unfavourable conditions for the activity of foreign investors. In addition, the investor invokes the violation of Articles 3(1) and 3(2) of the Agreement between the Government of the Russian Federation and Government of the Republic of Moldova on encouragement and mutual protection of capital investments stipulating that each party commits to ensure the foreign investors with a proper and fair treatment. Moreover, Evrobalt LLC believes that the obligation to alienate the shares resulted into an illicit expropriation and points to the violation of Article 6(1) of the Agreement that forbids the parties to authorize measures equal to the expropriation against investors.

Based on the preliminary findings of the emergency arbitrator – Georgios Petrochilos, the damage claimed by the plaintiff to be caused by the NBM Decision and by the NCFM Decision, is purely economic (both with respect to suspension of voting power and to the obligation to alienate the

\(^5\)https://www.bnm.md/ro/content/bnm-blocat-un-grup-de-actionari-ai-bc-moldova-agroindbank-sa-care-activeaza-concertat-si
shares). As a result, the arbitrator mentioned that any damage caused to the plaintiff, legally bounds the Republic of Moldova to compensate the damage according to the Agreement mentioned above in the form of a pecuniary compensation. If any shares listed on the Moldova Stock Exchange are not sold and are purchased by Moldova-Agroindbank at the nominal price, transferring the money to Evrobalt LLC, the investor will be able to claim a considerable economic damage and the Republic of Moldova will risk to pay the difference between the value of investment and value of compensation.

Such an outcome could generate additional problems because Evrobalt LLC is not the only investor affected by the cancellation of the shares. The other 19 affiliated shareholders are in the same situation. At the same time, it is worth mentioning that a similar situation is noticed in case of another bank and of other three insurance companies, two of them being top companies on the insurance market. In case of impossibility to alienate the shares by the shareholders within three months and in case of impossibility to further sell the newly issued shares, the companies will be obliged to purchase the shares at nominal prices that will result inevitably in economic damages for the initial investors.

**BC “Moldindconbank” S.A.**

Based on the analysis and assessment of the Moldova-Agroindbank’s shareholders, the second largest bank of the system, NBM identified one group of people that were acting in concert in relation to this bank and have purchased in the past a substantial quota of the authorized capital without the prior written consent of the National Bank. As a result, beginning with 20 October 2016, the Executive Committee suspended some rights of these shareholders accounting for 63.89% of shares.

Taking into account that at least 50% of the bank’s capital is owned by persons that do not have the consent of the National Bank of Moldova according to the Law on Recovery and Resolution of Banks, the NBM established, beginning with 20 October 2016, an early intervention regime in order to ensure a sound and prudent management of the bank activity during the removal of the deficiencies identified in its ownership structure.

On 17 November 2016, the National Bank appointed new members to the Management Committee and the Board of Moldindconbank filling all the positions. Giedrius Steponkus was named chairman of the board. He has extensive experience in the financial sector, having been in the past member of the Supervisory council and deputy chairman of the Stock Exchange in Vilnius. Despite the changes in the leadership of the bank, and the early intervention regime applied to the bank, the institutions is operating normally providing all the services, including ones relating to deposits and credits.

The dangers related to the possible need to compensate the Moldova-Agroindbank shareholders have the same impact in the case of Moldindconbank.
Following the NBM requests to rehabilitate the functionality of the Victoriabank Board, by ensuring the quorum, the General Meeting appointed on 8 July 2016, two new Board members. After the candidates were evaluated, the NBM confirmed the appointment of two new managers, thus the quorum and the functionality of the Board was re-established. The first Board meeting took place on 14 October 2016, after being blocked for almost two years.

At the same time, according to the agreement with the IMF, the beneficial owners of Victoriabank were to be identified by the end of the year. In other violations are found to be committed by owner of substantial quota (over 1% of shares according to the Law on Financial Institutions) of Victoriabank, or if it is proved that the owner does not fulfil the requirements set by the law and by the regulatory acts of NBM regarding the quality of shareholding or that he performs an influence aiming to damage the sound and prudent management of the bank, as well as if the direct or indirect owner or the beneficial owner did not submit to NBM the information revealing the identity of the beneficial owner, the shareholder might be obliged to sell the shares like in cases of other banks, or other sanctions will be applied according to the legislation in force.

General Findings and Recommendations

The processes taking place at the shareholding level of a bank, and at the level of insurance companies, show positive signals regarding the change of financial sector. Although no qualified investor has shown interest in the equity stake for sale, the initiation of the reforms in the banking and non-banking systems must continue at the same pace in order to ensure the finality of the process.

We draw the attention to the provisions that require the share issuer to purchase the equity stake for which no investors were identified within the time limits set out by the regulators. Although the law in force does not stipulate expressly the procurement price of those shares, according to the regulators’ decision, these transactions are to be made at nominal price, which is usually much lower than the market price (or procurement price) of those shares. In the event of such an outcome, the initial shareholders that were identified to be acting in concert will suffer an economic damage, which may be recovered from the public funds (Evrobalt vs Moldova case). In order to avoid new costs for the population, it is important to set the following priorities:

- Identify in a reasonable time the qualified investors that may take over the equity stake in the institutions subject to regulatory measures.
- Review the law in force in order to extend the deadline for the alienation of suspended/cancelled shares by the supervising body. The procurement of significant equity stake is quite slow due to the multiple implications, like the objective assessment of the stocks value, the analysis of the market and of the economic perspectives or trends, etc. As a
result, three months is a rather short term for the qualified investors to make such complex decisions.

- Assess the beneficial owners that own shares in all the financial institutions, first of all in banks and afterwards in insurance companies. In practice, the problems in the banking sector, with a small delay, can impact the companies in the insurance sector.

**Conversion of Government Guarantee into Public Debt**

During the same specific meeting of 26 September 2016, where the legislative package reforming the banking sector was adopted, the Draft Law on Issuing Government Bonds in order for the Ministry of Finance to Enforce the Government Guarantees granted to those three banks was adopted, being another precondition for the signing of the IMF Memorandum. By converting the Government guarantees into public debt, bonds amounting to MDL 13.6 billion were issued for a period of 25 years with an effective interest rate of 5%.

The recent conversion of Government guarantees into Government debt, was, from the legal point of view, a result of the fulfillment of commitments undertaken by the Government by issuing guarantees from 2014 and 2015, and this was the inevitable resolution for the created situation. Otherwise, the country could default, with all macroeconomic and social consequences (e.g. MDL depreciation, inflation, no foreign funding, skyrocketing poverty rate, etc.). At the same time, it is important to outline that the decision to convert the Government guarantee into public debt was not taken in the best manner – it was adopted without the organisation of prior consultations and/or public debates by the Parliament, the Government, the NBM and by other relevant institutions with respect to the existent alternatives to solve the banking crisis.

The aspect that brought increased attention of the experts community is related to the effective interest rate of 5% on bonds issued for a period of 25 years. According to the estimates this will add around MDL 11.2 billion to the total debt. In order to mitigate the tax risks and/or of the lost social and economic investments, priority must be given to certain types of non-tax budget revenues when settling the debt. In this regard, the authorities rightly provided in the Law No 235 two special revenue sources to serve and settle the debt:

1. **NBM profit transferred to the state budget.** The legal relationship between NBM and the Government compel the Central Bank to transfer to the State Budget a part of the profit obtained from its activity. A part of the profit is retained to strengthen the statutory capital of the NBM. When the statutory capital reaches 10% of its total liabilities, the profit must be transferred to the State Budget. Currently, the deficit of statutory capital of the Central Bank in relation to its liability is almost MDL 2.1 billion. Once this deficit is

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6According to the balance sheet (unaudited) of NBM, as of 30 June 2016, the total of monetary liabilities amounted to MDL 48.2 billion. On the other hand, the statutory capital amounted to MDL 2.7 billion. In order to respect the provisions
covered, the profit of NBM will be transferred to the State Budget and will be used to redeem early the bonds with the highest maturity\(^7\). To be realistic, for the next 25 years, only in the interest of MDL 11.2 billion that the Ministry of Finance will pay to NBM, according to the current situation, about MDL 9.1 billion\(^8\) will represent the NBM profit transferred to the State Budget. It is worth mentioning that NBM must give priority to the strengthening of the independence and of the capacity to meet its core objectives and not to the profit generation aimed at settling the debt.

2. **Selling the assets of the three bankrupt banks.** The claims of the Ministry of Finance towards “Banca de Economii”, “Banca Sociala” and “Unibank” will be paid according to the Law on Financial Institutions\(^9\). Given that the liquidation of a bank is a very slow process, the Ministry of Finance will continue to collect additional revenue by selling the assets of those three banks in the following years, until the liquidation is finalized. According to the statements of certain officials, at best, after the liquidation of banks, about MDL 2 billion will be recovered. The data published on the official website of the Ministry of Finance, as of 1 October 2016, almost MDL 835 million were reimbursed from the proceedings accumulated by selling the assets of those three banks. Therefore, some more MDL 1.17 billion can be obtained from this source.

The stipulation of these revenue sources in Law No 235\(^10\) is welcome, as they can cover up to 40% of the whole debt burden. In the hope that another portion of the debt will be covered with the funds from Kroll investigation, the debt coverage rate may increase even more. According to the third investigation report\(^11\), the Kroll company identified the embezzlement of about USD 600 million and their tracking until the final destination is in progress. The report states that considerable shares of fraudulent income were transferred to parties from all over the world, but their majority were transferred to bank accounts from Russia (USD 200 million), the Republic of Moldova (USD 95 million), Estonia (USD 58 million), and Cyprus (USD 41 million). The next stage of the investigation will include the commencing of legal action to obtain information from various jurisdictions to support the

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\(^7\)Article 2(11) of Law No 235 of 03.10.2016 on Issuing Government Bonds in order for the Ministry of Finance to Enforce the Government Guarantees

\(^8\)Thanks to the fact that the NBM profit transferred to the state budget will be used to recover the bonds prior to the term, the total burden on the taxpayers will decrease in time. In order to avoid speculations, we will calculate the interest rate from the entire amount for which the bonds were issued.

\(^9\)Article 3 of Law No 235 of 3 October 2016

\(^10\)Law No 235 of 03.10.2016 on Issuing Government Bonds in order for the Ministry of Finance to Enforce the Government Guarantees

\(^11\)http://bnm.org/ro/content/bnm-primit-cel-de-al-treilea-raport-despre-investigatia-companiei-kroll
detection of funds in order to initiate in 2017 the recovery proceedings against the identified individuals and organisations that benefited from the fraud or facilitated it.

**General Findings and Recommendations**

- Taking into account the complexity of the process and involvement of multiple authorities and entities from various jurisdictions, it is important to further ensure independent investigation. In this context, we emphasize the risk of legislative initiative on capital liberalisation, which can jeopardise the investigation results, since according to the draft Law approved in the first reading\(^\text{12}\), the State, represented by public authorities, guarantees not to prosecute the liberalisation subjects who liberalised their capital in compliance with the respective Law. This provision in its present form could protect the beneficiaries of the bank theft, endangering the entire international investigation.

- At the same time, to avoid the issue of guarantees without any coverage or a clear plan for using the resources in the future, we recommend to amend the Law on Public Debt, State Guarantees and State On-lending, tightening the conditions under which the Government can issue state guarantees for loans granted by the NBM to distressed banks, in order to eliminate leverages that allow turning bank frauds or errors into Government debt. We believe that the discretionary practice allowing the Government to use budgetary sources to offer state guarantees shall be ended as soon as possible.

**Development of a New Draft Law on Preventing and Combating Money Laundering and Terrorist Financing**

In light of last years’ scandals related to involvement of the Moldovan banking system in money laundering, particular attention has been paid to the national legislation on preventing and combating money laundering and terrorist financing. According to the National Action Plan for RM-EU Association Agreement, the transposition in the national legislation of Directive 2005/60/EC of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing and the Commission Directive 2006/70/EC laying down implementing measures for Directive 2005/60/EC of the European Parliament and of the Council as regards the definition of politically exposed person and the technical criteria for simplified customer due diligence procedures and for exemption on grounds of a financial activity conducted on an occasional or very limited basis, should have been carried out until 31 December 2016\(^\text{13}\). Since the Office for Prevention and Fight against Money Laundering under the National Anti-Corruption Centre preferred to develop a new law instead of adjusting the legal framework existing since 2007, the

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\(^{12}\)Article 10 of the draft Law No 452 on Capital Liberalisation and Fiscal Stimuli [http://www.parlament.md/ProcesulLegislativ/ProiecteDeActeleLegislativ/Tabid/61/LegislativId/3503/language/ro-RO/Default.aspx](http://www.parlament.md/ProcesulLegislativ/ProiecteDeActeleLegislativ/Tabid/61/LegislativId/3503/language/ro-RO/Default.aspx)

process of the national framework adjustment was delayed. It is also worth mentioning that on 20 May 2015 a new directive on the prevention of the use of the financial system for the purpose of money laundering or terrorist financing\textsuperscript{14} was adopted, also called Directive IV.

The draft Law on Preventing and Combating Money Laundering and Terrorist Financing\textsuperscript{15}, includes a series of innovations that will impact business entities, including: traders in goods and services, currency exchange offices, reporting entities, as defined by the existing legal framework, etc.

Directive IV provides a new approach to identification and discovering of the beneficial owners (who are individuals that own or control an individual or legal entity in the last resort, or that directly or indirectly possess the right of ownership or control over at least 25% of shares or of the right to vote of a legal entity). Thus, it includes the obligation to create national registers for keeping the information on beneficial owners of all legal entities registered in a certain jurisdiction. The competent authorities and entities covered by Directive IV will also have access to this register in case they demonstrate their “legitimate interest” in the need to access the information. However, Directive IV doesn’t define the term “legitimate interest”, leaving it to the discretion of authorities.

The proposed draft Law doesn’t provide for creation of a national register, which could strengthen the authorities’ efforts in combating hidden beneficiaries and off-shore companies. According to the draft, although the state registration authority verifies, records, keeps and updates the information on beneficial owners at state registration of legal entities and individual entrepreneurs, at the registration of changes in constitutive documents of the legal persons, at the state registration of the persons under reorganization or their removal from the State Registry, it does not have the responsibility to hold a central register as is provided by article 30 of the Directive 2015/859. The aspect related to maintaining information on beneficial owners is imposed on the reporting entities, such as: financial institutions, currency exchange offices, investment companies, real estate agents, postal services providers etc., that keep records of measures taken to identify beneficial owners for each client individually, and submit them, upon request, to the Office for Prevention and Fight Against Money Laundering and supervisory authorities of the reporting entities.

At the same time, according to the draft’s information note, to optimise the efficiency and identify transactions and activities that present real indices of suspicion, it was decided to give up on the reporting system that automatically generates suspicious transactions and activities in favour of reporting within 24 hours after identification of a suspicious act or circumstance. This will allow initiating the reporting procedure after preliminary analysis by conformity officers and at the same time will significantly reduce the number of reported transactions without real indices of suspicion. To


\textsuperscript{15}Draft Law on Preventing and Combating Money Laundering and Terrorist Financing \url{http://particip.gov.md/public/documente/131/ro_3749_proiect1612.pdf}
this end, but during another period, the transactions exceeding MDL 100,000 in cash and MDL 500,000 by transfer will also have to be reported.

And last but not least, considering the specifics of activities carried out and risks related to decisions that have to be adopted by the Office for Prevention and Fight Against Money Laundering, on the grounds that involve considerable applicability risks, the draft law introduces a guarantee regime for the employees of the Office for Prevention and Fight Against Money Laundering, equivalent to the employees of NBM and prosecution bodies. In a previous issue of the Financial Monitor, when talking about introduction of guarantee regime for the NBM employees, we noted that although the authors substantiated the respective provision the need to adhere to the Basel principles, the adopted wording of the amendment distorts the respective principles. According to the Basel principles for effective banking supervision, the staff of the regulator must enjoy legal protection if sued for action or inaction, resulting from good faith. Thus, in the current wording of the draft law being discussed, as well as in case of guarantees introduced for other authorities’ employees, the focus is on full protection, except for the action or inaction, resulting from bad faith. This generates the risk of avoiding the punishment, considering that the action or inaction resulting from bad faith are hard to prove in the court, the accountability principle being, thus, undermined.

**General Findings and Recommendations**

The Moldovan financial system became known for money laundering, which could jeopardise the State security. Thus, the development of the new draft Law on Preventing and Combating Money Laundering and Terrorist Financing is welcome, in spite of the considerable delay. Nonetheless, to ensure that the new law includes the best practices, we believe it crucial to completely transpose the provisions of the Directive IV, especially the ones related to:

- Establishment of a national register of beneficial owners. This could strengthen the authorities’ efforts in fighting the hidden beneficiaries and off-shore companies.
- Hold accountable the employees of the Office for Prevention and Fight Against Money Laundering, emphasizing the performance of the employment duties in good faith. The current wording of the draft undermines the accountability principle, since the action or inaction resulting from bad faith are hard to prove in the court.

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16 Article 35 of Law No 548-XIII of 21.07.1995 on the National Bank of Moldova and Article 34 of Law No 3 of 25.02.2016 on the Prosecutor’s Office
Enforcement of the New Framework for Financial Stability and Passing of the Law on Central Depository

In the previous issue of the Financial Monitor we examined two draft laws important for strengthening the independence of the financial system, and namely: the Law on the Recovery and Resolution of Banks and the Law on Central Securities Depository, approved through Government’s assumption of responsibility, on 26 September\(^2\).

The Law on the Recovery and Resolution of Banks aims at remodelling the crisis management framework in the financial and banking system, which will actually be based on three pillars: (i) preparation, (ii) early intervention and (iii) bank resolution. Triggering conditions, involved authorities, competences and instruments that can be applied, as well as the means of their implementation were established for each pillar. The draft Law also describes resolution financing method, derogations from application of other regulatory acts, security mechanisms, remedies accessible for persons who are deemed affected.

The situation with the draft Law on Central Securities Depository is specific, since there existed two separate draft laws: one was registered by a group of Members of Parliament\(^3\) and the second one was adopted by Government’s assumption of responsibility\(^4\). While the essence of the concept remained the same as in the initially discussed draft, the adopted draft Law comprised a series of amendments, among which:

<table>
<thead>
<tr>
<th>Draft Law registered by a group of MPs and later withdrawn</th>
<th>Draft Law adopted by Government’s assumption of responsibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>At least 2/3 of shares issued by the Central Depository were to be owned by NBM</td>
<td>At least 76% of shares issued by the Central Depository are owned by the NBM</td>
</tr>
<tr>
<td>Only the Depository can seize securities owned by the participants</td>
<td>The Depository, court, a law enforcement agent or other authorities having this prerogative can seize securities owned by the participants</td>
</tr>
<tr>
<td>The supervision was to be carried out by a joint supervision committee consisting of 3 NBM representatives, 2 NCFM representatives and 1 international expert appointed by the Ministry of Finance. NBM had to be the main supervisor</td>
<td>The NBM will be the only supervisor of the Depository, while the joint committee will only have the monitoring functions. It will have the same composition, except for the member appointed by the Ministry of Finance (who</td>
</tr>
</tbody>
</table>

\(^2\) [http://gov.md/ro/content/sedinta-guvernului-din-26-septembrie-2016-ora-1530](http://gov.md/ro/content/sedinta-guvernului-din-26-septembrie-2016-ora-1530)

\(^3\) [http://www.parlament.md/ProcesulLegislativ/ProiecteDeActeleLegislative/tabid/61/LegislativId/3367/language/ro-RO/Default.aspx](http://www.parlament.md/ProcesulLegislativ/ProiecteDeActeleLegislative/tabid/61/LegislativId/3367/language/ro-RO/Default.aspx)

\(^4\) [http://www.parlament.md/ProcesulLegislativ/ProiecteDeActeleLegislative/tabid/61/LegislativId/3429/language/ro-RO/Default.aspx](http://www.parlament.md/ProcesulLegislativ/ProiecteDeActeleLegislative/tabid/61/LegislativId/3429/language/ro-RO/Default.aspx)
| responsible for licensing and regulation of the Depository’s activity. | doesn’t need to be an international expert anymore). The committee will serve as a platform for information exchange. |

Within 18 months from the effective date of the aforementioned Law, the NBM is obliged to ensure the establishment of the Central Depository, as well as to develop regulatory acts subordinated to the law.
Final Conclusions and Recommendations

In spite of the significant progress registered in enhancing the resilience of the banking sector and eliminating the multiple drawbacks, the authorities shouldn’t feel relaxed before the constant challenges generated by the financial sector. The banking systems both in Western Europe and to the East of Moldova undergo difficult periods, and the risks of financial destabilisation in these areas can also extend over the local banking system. We think that in order to ensure sustainability of the national banking system, it is necessary to:

- Strictly observe the schedule and the plan agreed with the IMF, especially when it comes to the banking sector which received increased attention during the last discussions with the IMF. We would like to emphasize the importance of identifying the banks’ beneficial owners, as well as observing all commitments deriving from the five areas of intervention related to strengthening the banking sector.
- Continue reforms in the banking system, including for identification of qualified investors who would be ready to take over significant packages of shares from the banks where large shareholders were blocked.
- The same aspect refers to non-banking financial market, where at least 3 insurance companies undergo similar processes. Recently, pursuant to a NCFM decision, most shareholders of the three companies were obliged to sell their shares. NCFM, being the supervisory body in the insurance sector, has the necessary powers and should have intervened, placing the respective companies under special administration. This should be done mainly to protect the clients who bought insurance policies, as well as to ensure security of the insurance sector. At the same time, these companies lack corporate governance, since their general directors resigned their offices, while the situation with the Boards functioning is unclear.
- To strengthen the regulatory capacities, it is important to note that in March 2015 the NCFM Chairman was dismissed, and since then the institution has been functioning with short composition of the Board. At the same time, at least one member of the NCFM Board acts with an expired mandate. It is important for the Parliament to fill in all the functions of the NCFM management. We think that the procedure of selecting candidates for the NBM managerial positions has set the necessary standard that needs to be applied to NCFM and other regulatory agencies in the country, with little adjustments: representatives of Non-Governmental Organisations, with expert knowledge in verifying the integrity and the anti-corruption policy, must be included as members of such commissions; candidates must submit integrity statements during the application process; selection criteria grid and other rules that can influence the candidates’ assessment must be established and agreed on before starting collecting the candidates’ files.
• To include in the national legal framework, in the context of prevention and combating of money laundering and terrorist financing, provisions related to the establishment of a national register of beneficial owners. This could lead to the decrease of off-shore phenomenon in the national economy and set the basis for transparent activity of business entities.