Expert-Grup
Independent Think-Tank

How to Reinstate the Confidence in Banks?

Proposed Action Plan for the Rehabilitation of the Moldovan Banking Sector for 2016-2017

Authors:

Adrian Lupusor
Dumitru Pintea

Disclaimer

Kingdom of the Netherlands

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.

Table of contents

Introduction

This document follows 2 complementary purposes: (i) to share with the general public and relevant institutions the vision of Expert-Grup on how to settle the banking crisis and prevent similar crises in the future; (ii) to promote a proposed Action Plan for reforming the Moldovan banking sector, and hold, thus, decision-makers accountable for its implementation.

This Action Plan is based on the best international practices (particularly of the EU), Basel III criteria, as well as on the diagnosis of the situation in the banking sector and causes of the current crisis. The authors, thus, anchored this Plan on the main issues of the system, particularly the factors that triggered the crisis.

This Action Plan is recommended for 2016-2017. We recommend that most of the actions be implemented as a matter of emergency in 2016-2017, considering the difficult condition of the banking sector and the profile of the internal and external risks. Last but not least, the importance of certain decisive actions in this field is also determined by the need to strengthen the people's and development partners' faith in public institutions, who expect immediate actions and results.

Expert-Grup commits to monitor the actions taken by authorities in order to stabilize the banking sector and prevent similar crises in the future. Besides the promotion of this Plan, Expert-Grup will monitor to what extent the authorities acted on the recommendations, and the actions implemented in this regard. It is obvious that a plan proposed by the civil society cannot be implemented fully by authorities. Nevertheless, we will welcome the authorities' actions that will at least go in line with the proposed objectives, as the final goal is to rehabilitate the banking sector and prevent similar crises in the future.

Key Messages

- The banking crisis that disturbed the entire Moldovan economy in 2015 needs to be mitigated by a comprehensive set of emergency measures, implemented both at the level of the regulatory authority and other relevant institutions, and at the level of commercial banks. To consolidate the trust in the banking system, it is necessary to adopt as soon as possible a complex plan of measures for the upcoming 2 years (2016-2017) that would: (i) mitigate the consequences of the crisis, and (ii) prevent similar crises in the future.

- A potential banking sector rehabilitation plan must take into consideration 7 systemic gaps that were the main causes that triggered the banking crisis. Thus, the following need to be addressed urgently:

    1. *Low level of independence of the National Bank of Moldova*
    2. *Insufficient bank monitoring and oversight tools*
    3. *Low transparency of the actual beneficiaries of bank shares*
    4. *Poor corporate governance in most of the banks*
    5. *Poor mechanisms to hold shareholders and bank managers accountable*
    6. *The "offshoring" of the banking sector*
    7. *Banks' limited capacity to absorb losses.*

- To make sure that the action plan will be implemented efficiently, it is necessary for the key institution in charge of this – the National Bank of Moldova (NBM) – to be independent. Accordingly, the reform of the banking sector must begin by strengthening the independence of NBM. The actions must focus on getting rid of the levers by which certain political or private groups could put pressure on the central bank. Besides enhancing the efficiency of the regulatory activities, it will also increase the accountability of the central bank in terms of financial and banking stability.

- Alongside the strengthening of NBM's independence, it is also necessary to reinforce and come up with more tools by which it could fulfil more efficiently its banking system monitoring and oversight duties, as well as prevent future banking crises. In essence, the actions must focus on decreasing the human involvement in the monitoring and regulation process by implementing IT solutions, increasing the capacity of NBM to identify and curb concerted activities, harshen criminal sanctions for market abuse and other violations committed by commercial banks, streamline communication and coordination between institutions directly and indirectly in charge of the financial stability.

- Considering the systemic importance of commercial banks and their public nature (they work mainly on the basis of the resources drawn from the population and companies), the banks' customers, the regulator and the entire society have the right to know who the actual owners of the banks are. To this end, the actions must focus on the implementation and institutionalisation of the fit-and-proper test (minimum integrity and transparency standards), facilitation of information exchange with the states of legal residence of the banks' final shareholders, strengthening of the institutional capacities of the NBM

in the field of shareholders' transparency, as well as developing and publishing the scoring and reports on the transparency of the shareholders of every bank.

- The long-term development of any entity depends on the quality of corporate governance. Corporate governance is even more important in banks because they work with attracted resources and are, therefore, of systemic importance. To this end, motivational measures (development and promotion of a general Corporate Governance Code, drafting and publishing annual reports on transparent risk management and promoting ethical and professional standards among employees of banks) and coercive measures (harshening sanctions for inappropriate governance) are needed. Furthermore, it is necessary to prohibit the participation in the Boards of several banks in order to avoid a potential conflict of interests, considering the precedent involving 3 banks undergoing liquidation (BEM, BS and UB).

- A key condition to prevent any kind of crises is to hold those who can cause such crises materially and criminally liable. In our case, the accountability of shareholders and bank managers can be enhanced by developing the four-eye approach, implementing the bail-in mechanism, increasing the independence of Board members that check the activity of bank managers, harshening the sanctions for inappropriate bank management. Actually, it is necessary to develop a system, where the bankers' mistakes are paid for by bankers themselves, rather than by the population.

- Considering the unfortunate precedents in the recent years, but also the imperative of ensuring full transparency of the banking activity, it is necessary to prohibit any interaction between banks and companies from jurisdictions that do not comply with the transparency standards (they are often referred to as "offshore companies"), as well as to completely harmonize the local legislation with the EU provisions on money laundry.

- To improve the quality of the bank capital and decrease any budgetary implication of the eventual banking crisis – the capacity of banks to cover potential losses must be enhanced. For that it is necessary to review the prudential indicators against the Basel III provisions, to delimit certain even harsher requirements for systemic banks in relation to small banks and to increase the coverage of deposit insurance.

Defining the Issue

Over the recent years, the Moldovan banking system had to overcome a number of challenges and even go through hard times because of corporate raids, fraudulent transactions and the increase in the share of non-performing credits. These peaked in 2015 when 3 banks[1] that held about a third of the system's assets entered the liquidation procedure, the volume of decapitalisation accounting for about 12% of GDP, while 3 other banks[2] (about 40% of the system assets in early 2015) were put by NBM under special oversight. The effects didn't take long to appear. Thus, in 2015, the national currency depreciated on average by about 25%, inflation reached a 2-digit level, dollarization of bank deposits exceeded 50%, the amount of new credits decreased by more than 50%, whereas the economy contracted by about 1% (roughly[3]). What is more, to repay the deposits in the bankrupt banks, the State used public resources, which will put a major long-term pressure on the State Budget (for about 10 years)[4]. As a result, in 2015 the budget deficit increased from 1.7% of GDP in 2014 up to about 3.4% of GDP. If we take into account the loans provided to bankrupt banks against state guarantees, the deficit is estimated to reach 15.1% of GDP[5]. The issue is worsened by the fact that on the background of an increasing deficit, the possibilities to fill the gap under advantageous conditions decreased (the support of the development partners decreased significantly, whereas the average rate of state securities reached the level of 24-25%). Last but not least, people's trust in banks dropped essentially (according to the Public Opinion Barometer from November 2015 – only 16% of the population trust banks to a certain extent or completely, compared to 34% in November 2014).

Ultimately, these disturbances triggered a series of systemic deficiencies that were not addressed and continue to pose imminent threats to the banking sector. The combination of the constraints mentioned hereunder formed the main components of the banking crisis in the Republic of Moldova:

- *Low level of independence of the National Bank of Moldova* Although NBM was suspecting as far as in 2013 that a number of suspicious transactions were taking place in the banking system, it did not use its entire toolkit to prevent frauds. For that matter, the central bank did not do more than warn the shareholders of the banks concerned and the National Financial Stability Committee. It was only by the end of 2014 that it established a special administration regime over the 3 banks on the brink of bankruptcy (BEM, BS and UB)[6]. However, it did not block (or it couldn't block) the decisions of the shareholders in relation with whom the bank had evidence that they acted in a concerted manner[7], it did not impose fines on the banks concerned, nor did it establish special oversight regime (which is different from the special administration regime, and which would have granted NBM full access to information about the bank concerned) on the banks that gave rise to concerns for good reasons[8] (Table 1). Such a passive behaviour of the central bank could be explained by its low independence, which makes it vulnerable to obscure political and private interests. According to the assessment carried out by Expert-Grup in December 2013[9], NBM can be

[1] B.C. "Banca de Economii" S.A. (BEM), B.C. "Banca Sociala" S.A. (BS), B.C. "Unibank" S.A. (UB)
[2] B.C. "Moldova Agroindbank" S.A., B.C. "Victoriabank" S.A., B.C. "Moldindconbank" S.A.
[3] Moldova Economic Growth Analysis (MEGA), 13th issue, Expert-Grup, 2015
[4] Moldova Economic Growth Analysis (MEGA), 12th issue, Expert-Grup, 2015
[5] IMF, Press Release 16/16, 20 January 2016
[6] Banca de Economii of Moldova, Banca Sociala and Unibank
[7] Kroll Report, 2014
[8] Decoding the Kroll Report, Expert-Grup, 2014
[9] Is the Independence of the National Bank of Moldova in Danger? Expert-Grup, 2013

qualified as a bank with moderate independence (scoring 0.64 of the maximum 1.0), with the main drawback consisting in the possibility of any court of law to block its decisions. Essential drawbacks concerning the independence of the central bank were also identified during the assessment carried out by the World Bank, published in December 2014[10].

Table 1. Measures that could have been taken by law and actual measure taken by NBM in the context of the suspicious transactions carried out in BEM, BS and UB

What NBM could do?	What did NBM do?
Issue a warning[11]	Accomplished
Apply and undeniably levy fines on banks and/or shareholders[12]	Unaccomplished
Withdraw the confirmation issued to the administrator of the bank [13]	Unaccomplished
Limit or suspend the activity of the bank[14]	Unaccomplished
Withdraw the license or authorization[15]	Unaccomplished
Compel the bank to take remediation measures[16]	Unaccomplished
Block the activity of the shareholders acting in a concerted manner[17]	Unaccomplished
Establish special oversight[18]	Accomplished too late

Source: "Decoding the Kroll Report", Expert-Grup, 2014

- *Insufficient bank monitoring and oversight tools.* The crisis proved that NBM must strengthen and extend the tools used for bank monitoring and oversight, particularly by implementing IT solutions at a larger scale. It was also noticed that there was insufficient/inefficient communication and cooperation for financial stability between NBM and other public institutions (National Commission for Financial Markets, National Financial Stability Committee, Parliamentary Committee for Economy, Budget and Finance, Prosecutor's Office, Intelligence and Security Service). The regulatory loopholes allowed some banks to accumulate excessive exposures to large groups of affiliated companies, and to manipulate the indicators on the quality of bank portfolios by surrendering the portfolios with suspicious loans to offshore companies, and the liquidity indicators by accumulating liquid assets (mainly on paper rather than in fact) abroad.

- *Low transparency of actual beneficiaries of bank shares* was a key factor that made the extremely large bank frauds possible. It did not allow for the full verification of the identity and quality of the persons (fit-and-proper test) who were the ultimate shareholders of the commercial banks, which, in its turn, did not allow to hold them accountable for the bank frauds. Practically, most of the banks where the actual shareholders were disguised as "shell-companies" or "offshore companies", were taken over hostilely and

[10] Financial Sector Assessment – Moldova, Banca Mondială, 2014
[11] According to Article 38, Law on Financial Institutions No 550-XIII of 21 July 1995
[12] Idem
[13] Idem
[14] Idem
[15] Idem
[16] Idem
[17] According to Article 15, Law on Financial Institutions No 550-XIII of 21 July 1995
[18] According to Article 37[1], Law on Financial Institutions No 550-XIII of 21 July 1995

served as war-fields between shareholders, which later resulted in suspicious transactions that undermined the stability of the banks concerned.

- *Poor corporate governance in most of the banks* is a direct result of low transparency of the activity carried out by bank shareholders. The three banks under liquidation, as well as other banks, were affected by the enmity between shareholders and by the corporate raids. In most of the cases the obscure changes of shareholders preceded obscure changes in the management, which allowed banks to carry out risky transactions and even large bank frauds. It became later complicated to bring anyone to account because of the vague split of responsibilities among bank shareholders, boards and management.

- The fact that there *are not enough mechanisms to hold shareholders and bank managers accountable* is a serious corporate governance issue that must be analysed in a particular manner. The law is currently quite mild when it comes to penalizing bank frauds, as the applied fines are incommensurable with the scale of embezzlements, whereas the Criminal Code contains vague and, thus, interpretable provisions in relation to deprivation of liberty in case of bank frauds. What is more, the Boards of many banks promote the obscure interests of certain groups of shareholders to the detriment of sustainable development and do not exert the due control over management, the checks-and-balances principle being thus undermined. Actually, in most cases the banks' majority shareholders, boards and management act in a concerted manner by carrying out risky and even questionable transactions. These issues worsen because in most of the banks the internal audit departments are not enough independent from the management, which undermines the efficiency of audits (these severe issues were also highlighted in the report developed by the American company Kroll, as well as in the assessment carried out by the World Bank[19], both published in 2014). On the background of the inefficient mechanisms for holding bank managers accountable, the legislation does not foresee the bail-in mechanism that obliges shareholders, and not taxpayers, to cover the damages caused by frauds or mistakes in the management of banks.

- *The "offshoring" of the banking sector.* An essential circumstance that made suspicious bank transactions possible in the banking sector was the fact that Moldovan banks could interact with different types of "offshore companies". It became, thus, possible to surrender credit portfolios to such companies, certain shareholders or "offshore companies" could buy bank shares on the basis of loans from "offshore companies", and they could even extend loans to certain "offshore companies".

- *Banks' limited capacity to absorb losses.* This is a universal cause of most bank crises in the world, including in the Republic of Moldova. The fact that Moldovan banks are capitalized enough and abound in liquidities was stated plenty of times. In reality, however, if we pay attention to the quality (not only quantity) of the bank capital – we can see that the bank capitalization was overrated. As a result, even if the risk weighted capital adequacy in the three bankrupt banks was higher than the minimum admissible level before the crisis (16%), they could still not cover the capital losses, the State having to intervene in order to reimburse the deposits in the banks concerned. This was also due to the high level of the risks that the banks were exposed to and to the poor quality of the credit portfolios with underlying poor quality of liquid assets.

[19] Financial Sector Assessment – Moldova, December 2014, World Bank

Furthermore, most of the commercial banks implement Basel I principles (dated 1988), which foresee unstrained conditions for the classification of non-performing loans and assets at risk.

The Republic of Moldova needs to implement as soon as possible a comprehensive action plan that would eliminate the aforementioned systemic constraints. They are still in place, which exposes the banking system and the entire country to similar shocks in the future. The proposed action plan is based on the best international practices and Basel III principles that must guide the comprehensive reform of the Moldovan banking system. The National Bank of Moldova is the main institution in charge of implementing these actions in order to ensure the principle of accountability. However, NBM needs to become more independent, as this is the key element of the reform.

Proposed Action Plan for the Rehabilitation of the Moldovan Banking Sector for 2016-2017

We believe that the Moldovan banking sector can be rehabilitated only by eliminating all the systemic gaps that caused the current crisis. We recommend the authorities to develop and implement as soon as possible an action plan that will address the 7 major systemic deficiencies of the Moldovan banking system, which were identified in the previous chapter:

1. *Low level of independence of the National Bank of Moldova*
2. *Insufficient bank monitoring and oversight tools*
3. *Low transparency of the actual beneficiaries of bank shares*
4. *Poor corporate governance in most of the banks*
5. *Not enough mechanisms to hold shareholders and bank managers accountable*
6. *The "offshoring" of the banking sector*
7. *Banks' limited capacity to absorb losses.*

Objective 1. Strengthen the independence of the National Bank of Moldova

To make sure that the action plan will be implemented efficiently, it is necessary for the key institution in charge to be independent. Accordingly, the reform of the banking sector must begin by strengthening the independence of NBM. The actions must focus on getting rid of the levers by which certain political or private groups could put pressure on the central bank. Besides enhancing the efficiency of the regulatory activities, it will also increase the accountability of the central bank in terms of financial and banking stability.

a) Eliminate the right of courts of law of any level to suspend the NBM decisions. In order to comply with the checks-and-balances principle, certain NBM documents could be suspended but only in some strict conditions that could be established by the Supreme Court of Justice.
b) Regulate stricter the conditions for extending NBM loans under the guarantee of the Government, and thus eliminate the authorities' discretion on such matters.
c) Introduce clearer provisions for the situations when NBM can support the economic policies of the State so as not to affect the inflation-targeting strategy and the objective to stabilize prices.
d) Dismiss members of NBM management only with the vote of at least 2/3 of Members of Parliament (like in the case of the Governor).
e) Prohibit expressly the Governor and other Board members from holding positions of accountability in public institutions and banks for at least 2 years before taking over the mandate and at least 2 years after leaving the position.
f) All NBM documents, if needed, should enter into force immediately after their approval and the obligation to have a legal expert review and to be registered with the Ministry of Justice needs to be cancelled. The main condition is to post immediately the acts on the website of the institution and, further, to publish them in the Official Gazette. Currently the procedure of enactment of NBM regulatory acts can take too much time (several months), which can undermine the promptness with which the institution should respond in order to maintain the stability of the banking sector.

Objective 2. Strengthen the tools for bank monitoring and supervision, and for the prevention of crises in the banking sector

Alongside the strengthening of NBM's independence, it is also necessary to reinforce and come up with more tools by which it could fulfil more efficiently its banking system monitoring and oversight duties, as well as prevent future banking crises. In essence, the actions must focus on decreasing the involvement of the human factor in the monitoring and regulatory process by implementing IT solutions, increasing the capacity of NBM to identify and stop concerted activities, harshen criminal sanctions for market abuse and other violations committed by commercial banks, streamline the communication and coordination with institutions in charge directly and indirectly of the financial stability.

a) For the NBM to allocate a budget line that is enough to implement the ICT solutions for all monitoring and regulatory tools in order to increase the efficiency and decrease the impact of the human factor (discretionary).
b) Define clearer and extend the set of criteria that would be used to identify the concerted activities in the banking system. This could also imply a memorandum between the public institutions that are involved directly (Prosecutor's Office, National Anti-corruption Center, Intelligence and Security Service, National Financial Market Commission, Competition Council) with regards to information exchange so as for NBM to single out the groups of persons acting in a concerted manner. It is also appropriately to develop and implement a test that would assess the degree to which the activities of a particular bank are concerted.
c) Transpose Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (market abuse directive). This would prevent making deals on the banking market as it would also strengthen people's trust in NBM and the commercial banks.
d) Without decreasing the leadership and responsibilities of the NBM, it is necessary to identify all the institutions that can be involved directly (NBM) or indirectly (Prosecutor's Office, NAC, NCFM Ministry of Finance, Intelligence and Security Service etc.) as part of the bank monitoring and supervision process, to improve dialogue between these institutions, facilitate quick data exchange, establish contact points in each institution and convene meetings regularly (according to a scheduled prepared beforehand) between the institutions concerned.
e) Establish the methodological framework for the coordination of financial crisis management activities. It would include arrangements on the basis of which the coordinating authorities will be identified by types of activities, as well as the way of systematic communication with the market participants and the authorities from abroad. Every authority will invest efforts in order to assess the situation and coordinate the actions in accordance with the methodological framework established together with the other authorities.
f) Determine the capacities of regulatory institutions to handle shocks by periodically carrying out stress-tests on them in order to assess their response capacity and quality of interventions.

Objective 3. Increase the transparency on the actual beneficiaries of bank shares

Considering the systemic importance of commercial banks and their public nature (they work mainly on the basis of the resources drawn from the population and companies), the banks' customers, the regulator and the entire

society have the right to know who the actual owners of the banks are. To this end, the interventions must focus on the implementation and institutionalisation of the fit-and-proper test (minimum integrity and transparency standards), facilitation of information exchange with the states of legal residence of the banks' final shareholders, strengthening of the institutional capacities of the NBM in the field of shareholders' transparency, as well as developing and publishing the scoring and reports on the transparency of the shareholders of every bank.

a) Apply and institutionalise the fit-and-proper test (minimum integrity and transparency standards) for the shareholders from the entire banking system of the Republic of Moldova, regardless of their share of participation into the capital of banks. Thus, every person who wants to buy shares in a commercial bank/banks must pass the test successfully. The current shareholders should also pass the test. Thus, every institution must report to the regulatory body and publish on their websites which shareholders were awarded the fit-and-proper certificate. Ultimately, those who do not have such a certificate will not be able to hold shares.
b) The main elements of the fit-and-proper test are listed hereunder and will be adapted to the specificity of the local banking system (many shareholders are natural persons) and the implementation manner, with the main objective being to protect the bank customers from shareholders and managers who are not "fit-and-proper":
    a. Honesty, integrity, reputation
    b. Competence, managerial skills
    c. Position and financial condition
c) Sign international agreements with shareholders' states of legal residence on information disclosure and establish operational partnerships with UE institutions.
d) Build the skills of the recently created NBM Division that will be in charge of monitoring the transparency of bank shareholders.
e) Develop and publish a scoring function (e.g. Σ share of stock * rating) which would assign a certain rank to every bank as regards the shareholders.
f) Develop, by the Board of each commercial bank, reports on transparency that would include every shareholder's CV, number of attended meetings, voted decisions etc., and place the annual transparency reports on their websites. Draft a similar report for the management team of every bank.

Objective 4. Improve the corporate governance in most of the banks

The long-term development of any entity depends on the quality of corporate governance. Corporate governance is even more important in banks because they work with attracted resources and are, therefore, of systemic importance. To this end, motivational measures (development and promotion of a general Corporate Governance Code, drafting and publishing annual reports on transparent risk management and promoting ethical and professional standards among employees of banks) and coercive measures (harshening sanctions for inappropriate governance) are needed. Furthermore, it is necessary to prohibit the participation in the Boards of several banks in order to avoid a potential conflict of interests, considering the precedent involving 3 banks undergoing liquidation (BEM, BS and UB).

a) Develop and promote a general Corporate Governance Code. This Code must contain a set of clear corporate governance principles, as well as the measures that should be implemented if they are not complied with.
b) Delimit clearly the duties and establish the maximum extent to which shareholders, the Board and the management of commercial banks can be involved, stipulated in the standards issued by NBM.
c) Develop and publish annually the report on risk management transparency (prudence of bank management, effective and prudent administration of every bank, clear division of responsibilities within the Board and between the supervisory authority and top management, and prevention of conflicts of interest).
d) Implement and promote certain ethical and professional standards for the shareholders and managers of commercial banks, with the basic elements being stipulated by the NBM.
e) Harshen the requirements and sanctions for improper and inappropriate management of financial institutions, violation of the prudential and banking risk management rules.
f) Prohibit explicitly by law the possibility to be simultaneously member of the Boards of several banks.

Objective 5. Develop mechanisms that will increase the accountability of bank managers

A key condition to prevent any kind of crises is to hold those who can cause such crises materially and criminally liable. In our case, the accountability of shareholders and bank managers can be enhanced by developing the four eye approach, implementing the bail-in mechanism, increasing the independence of Board members that check the activity of bank managers, harshening the sanctions for inappropriate bank management. Actually, it is necessary to develop a system, where the bankers' mistakes are paid for by bankers themselves, rather than by the population.

a) Develop the four-eye approach in every bank – the internal audit departments in every bank must check whether the corporate governance, risk management and financial management criteria are observed. It is important that they are directly subordinated to the Boards of commercial banks and report exclusively to their members, without the management of banks participating or getting involved in any way. Besides the periodical audit reports, these departments have to work as internal police forces and be obliged by law to report to the Board and NBM on severe corporate governance and prudential management violations. At the same time, the specialists working in the internal audit departments must bear individual and collective responsibility for failing to report on time and in detail on eventual deviations.
b) Develop the independence of commercial banks' Boards by NBM promoting integrity standards and professional skills for Board members. Furthermore, it is important to impose a maximum limit of 2 mandates, 4 years each, for Board members in order to avoid the situation of permanent Board members, who would promote particular obscure interests of certain groups of shareholders or bank managers (given the precedent of the three banks undergoing liquidation – BEM, BS and UB).

c) Develop the bail-in mechanism (instead of the current bail-out mechanism). It is necessary to align the local regulatory framework to the 2014/59/EU Directive[20]establishing a framework for the recovery and resolution of credit institutions and investment firms which foresees that the shareholders are obliged to cover from own resources the losses and any other consequences of defective management. To this end, the banks could form a common fund to ensure accountability.
d) Harshen the penalties, both financial and by deprivation of liberty for deficient and fraudulent administration of commercial banks, by amending accordingly the Criminal Code.

Objective 6. "De-offshor" the banking sector

Considering the unfortunate precedents in the recent years, as well as the need to ensure full transparency of the banking activity, it is necessary to prohibit any interaction between banks and companies from jurisdictions that do not observe the transparency standards (they are often referred to as "offshore companies"), as well as to harmonize fully the local legislation with the EU provisions against money laundry.

a) Eliminate any possibilities by which offshore companies can interact with commercial banks: prohibit the companies concerned from owning bank shares, the procurement of bank shares with loans taken from offshore companies, pledging bank shares to offshore companies, and the crediting or transferring the bank's credit portfolios to such companies.
b) Transpose as soon as possible and fully comply with Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.

Objective 7. Increase the banks' capacity to absorb losses

To improve the quality of the bank capital and decrease any budgetary implication of the eventual banking crisis – the capacity of banks to cover potential losses must be enhanced. For that it is necessary to review the prudential indicators against the Basel III provisions, to delimit certain even harsher requirements for systemic banks in relation to small banks and to increase the coverage of deposit insurance.

a) Take on the Basel III requirements on the main prudential indicators:
    - determine the impact of Basel III requirements on banks (recapitalization, prudential and profitability indicators, particularly ROE).
    - review the risk weighted capital adequacy indicator - it shall take into account large exposures, exposure to the currency risk, as well as the assets placed abroad (the experience of BEM, BS and UB proved that such assets can be regarded as liquid only de jure).
    - harshen the criteria on the basis of which banks recognise non-performing loans.

[20] Directive 2014/59/EU (on the recovery and resolution of banks) of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms. According to these Directives, the losses as a result of bankruptcy or the recovery of a bank that does not satisfy minimum capital conditions shall be covered in the following sequence: (a) shareholders; (b) subordinate creditors; (c) senior owners of bonds and certain groups of depositors that are not covered by the Deposit Guarantee Fund; (d) other depositors that are not covered by the Deposit Guarantee Funds.

b) The prudential requirements on the liquidation and risk weighted capital adequacy should be more conservative for the systemic banks in comparison with the other banks. It is necessary to define to this end clear criteria for the grouping banks into systemic and non-systemic.

c) Regulate stricter the large exposures of banks (in case of large loans extended to interconnected or affiliated companies).

d) Harmonize the law guaranteeing deposits of natural persons in the banking system (Law No 575-XV of 26 December 2003) with Directive 94/19/EC[21] of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes. This is also a requirement laid down in the Association Agreement. The provided term is 5 years since the Agreement entered into force, except for the provision with regards to the minimum level of compensation for every depositor foreseen by Article 7 of this Directive, a provision that can be implemented within 10 years since this Agreement entered into force. Nevertheless, to build confidence in the banking system, we recommend increasing the coverage level up to MDL 100,000 by 2020. It is also necessary to extend the protection of legal entities' deposits. It is important that, in tandem with the increase of the coverage level, NBM gradually loosens up the monetary policy so as to allow for the "thawing" of bank resources in order to supply the Deposit Guarantee Fund in the Banking System.

[21] Directive 94/19/EC of the European Parliament and of the Council was amended substantially by Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit-guarantee schemes.