

**IMMEDIATE
ATTENTION**

SM/08/270

August 19, 2008

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Republic of Moldova—Publication of Financial Sector Assessment Program—Detailed Assessment of Compliance with Standards and Codes**

Attached for the **information** of Executive Directors is the detailed assessment of compliance with the standards and codes for the Republic of Moldova in connection with the Financial Sector Assessment Program. The detailed assessment provides more detail and background to the Financial System Stability Assessment for the Republic of Moldova, which was circulated as SM/08/61 (2/26/08).

It is intended that this detailed assessment be published on the Fund's external website as requested by the authorities of the Republic of Moldova and approved by management.

Questions may be referred to Mr. Habermeier, MCM (ext. 38857).

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (1)

Other Distribution:
Department Heads

FINANCIAL SECTOR ASSESSMENT PROGRAM

REPUBLIC OF MOLDOVA

DETAILED ASSESSMENT OF COMPLIANCE WITH STANDARDS AND CODES

APRIL 2008

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS
DEPARTMENT

WORLD BANK
FINANCIAL SECTOR VICE PRESIDENCY
EUROPE & CENTRAL ASIA VICE PRESIDENCY

Contents	Page
Glossary	3
Executive Summary	4
I. Observance of the Basel Core Principles for Effective Banking Supervision	4
A. Introduction	4
B. Information and Methodology Used for the Assessment	5
C. Description of Regulatory Structure and Practices	5
D. Institutional Setting	6
E. Main Findings	6
F. Authorities' response to the assessment	53
II. Core Principles for Systemically Important Payment Systems and of Payment System Oversight	54
A. The Committee on Payment and Settlement Systems Core Principles	54
B. Payment System Infrastructure—Overview	55
C. Principle-by-Principle Assessment	58
D. Authorities' response to the assessment	71
Tables	
1. Detailed Assessment of Implementation of the Basel Core Principles for Effective Banking Supervision	9
2. Recommended Action Plan to Improve Implementation of the International Organization of Securities Commission Principles	51
3. Detailed assessment of observance of CPSS Core Principles for SIPS and	59
4. RTGS System Observance of Core Principles for Systemically Important	66
5. Supervisory Responsibilities of the Central Bank in Applying the Core	67
6. Informal assessment of observance of CPSS Core Principles for SIPS for	67

GLOSSARY

AC	Audit Committee
AIPS	Automated Interbank Payment System
AML	Anti Money Laundering
ATM	Automated Teller Machine
BCP	Basel Core Principles
BCPBS	Basel Core Principles for Effective Banking Supervision
BOSS	Bank OffSite Supervision
BRL	Bank Regulation and Licensing Division
BRSD	Bank Regulation and Supervision Department
BSC	Bank Supervision and Control Division
CA	Council of Administration
CAMELS	Capital, Assets, Management, Earnings, Liquidity, and Sensitivity to interest rates
CAR	Capital Adequacy Ratio
CCECC	Center for Combating Economic Crime and Corruption
CPSIPS	Core Principles for Systemically Important Payment Systems
CPSS	Committee on Payment and Settlement Systems
DNS	Designated-time Net Settlement
EU	European Union
FBB	Foreign Bank Branches
FIFO	First-in-first-out
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
LFI	Law on Financial Institutions
LNBM	Law on the National Bank of Moldova
MOU	Memorandum Of Understanding
MOF	Ministry Of Finance
MDL	Moldovan Leu
MSE	Moldova Stock Exchange
NBM	National Bank of Moldova
NCFM	National Commission on Financial Markets
RTGS	Real Time Gross Settlement

EXECUTIVE SUMMARY

This volume contains summary assessments of Moldova's adherence to the Basel Core Principles for Effective Banking Supervision (BCPBS) and the Basel Core Principles for Systemically Important Payment Systems and Payment System Oversight (CPSIPS). The detailed assessments have been undertaken in October 2007 as part of the Joint World Bank/IMF FSAP Update and have served as a basis for the summary assessments. The assessment reflect policies and measures in effect as of end-October 2007.

The assessments have been used to gauge the risks and vulnerabilities as well as the developmental needs of the financial sector. In the areas not yet fully aligned with these international codes, the FSAP team made recommendations to the authorities, who expressed their willingness to implement these suggestions as soon as feasible.

While appreciating the progress achieved in banking supervision, the assessors noted the need for continuing action to obtain transparency on the suitability of banks' significant beneficial shareholders, the ownership structure, and the source of initial capital. The assessors recommended that the Law on the National Bank of Moldova (LNBM) include legal protection for supervisors and that the National Bank of Moldova (NBM) set up agreement for cooperation with the National Commission on Financial Markets (NCFM). New regulations or the revision of existing ones are still needed in the areas of a capital charge on market risks and Anti-Money Laundering (AML) legislation. Supervisory practices should be developed further in the direction of risk-oriented supervision, by requiring that banks undertake effective analysis of risk and by developing a tool to extract and combine details on large credits. Finally, the NBM should formalize contacts with supervisors of those Western European countries whose banks have a presence in Moldova.

Regarding the payment systems, the assessor focused on the Automated Interbank Payment System (AIPS) operated by the NBM that consists of the Real Time Gross Settlement System (RTGS—the systemically important payment system element) and the Designated-time Net Settlement (DNS). The assessor found that the RTGS and the DNS systems largely comply with the Core Principles, but there is much less compliance with the additional Supervisory Responsibilities of the Central Bank in Applying the Core Principles. Hence, most of the recommendations aim at ensuring that the NBM formulate proper oversight objectives, separate this function from the operational parts, and extend its oversight as a minimum to the Securities Settlement System.

I. OBSERVANCE OF THE BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

A. Introduction

1. **This detailed assessment of Observance of the BCPBS follows the comprehensive assessment of the system of banking supervision in Moldova done during the 2004 FSAP.** The assessment was conducted in October 2007 by Keith Bell, World Bank expert

and Walter Zunic, IMF expert. The NBM cooperated fully with the assessment team and provided extensive clarification in the form of documents and oral explanations. Their assistance is gratefully acknowledged.

B. Information and Methodology Used for the Assessment

2. **The NBM was requested to complete a self-assessment and a questionnaire in advance of the mission.** The questionnaire and self-assessments were made available to the IMF and the World Bank in advance of the mission. During the mission, the two assessors reviewed documents made available in advance of the mission, spent several days interviewing representatives of the NBM, as well as commercial bankers, accountants, and other market participants, in order to clarify and/or verify the facts contained in the questionnaire responses.

3. **The assessment of observance of each of the core principles adopts a qualitative approach and is based on the BCPs, as revised in October 2006.** The assessment method consisted of examining the degree of observance of each of a principle's essential criteria and, where the assessors judged necessary, of the additional criteria, too. In addition to the responses to the IMF questionnaire by the NBM, detailed information available on the NBM's internet website facilitated the drafting of this report. The BCP assessors were able to focus their discussions and verify information provided in the LNBM which entered into force on July 21, 1995, and the Law on Financial Institutions (LFI), which entered into force on the same date (amended November 9, 2001), regulations and recommendations for enforcing provisions of the above-mentioned laws. Follow-up questions were raised with NBM staff and supplemental information was provided to the assessors as necessary.

C. Description of Regulatory Structure and Practices

4. **The LNBM specifies that the NBM, through its Bank Regulation and Supervision Department (BRSD), is responsible for banking supervision in Moldova.** The NBM's powers vest in its Council of Administration (CA) composed of 5 persons, namely the Governor (acting as Chairman), the First Vice-Governor (acting as Vice-Chairman) and 3 vice-governors (one of the latter is responsible for the operations of the BRSD). The objective of the NBM is to maintain the financial stability of the banking system with a view to protecting the interests of depositors. It is the sole authority for carrying out banking supervision for banking institutions licensed under this law. Under the LNBM, the NBM may enact secondary legislation and does so by issue of "decisions, regulations, instructions and directives" in order to implement its authority. Taken together, the primary and secondary legislation incorporate a framework of prudential standards that banks must meet.

5. **Supervisory functions are performed by the BRSD, headed by a Director, assisted by an authorized staff of 42 persons.** Staff is deployed in two divisions: (i) Bank Regulation and Licensing Division (BRL Div.) (17 persons authorized) and (ii) Bank

Supervision and Control Division (BSC Division) (25 persons authorized). The BRL Div. comprises three Units: (a) Bank Licensing; (b) Reporting (“Off-Site”); and (iii) Methodology and Rating. The BSC division functions through two units: (a) Bank Supervision and Control (“Onsite”) and (b) Economic Analysis. The current actual strength of BRSD is 36 persons (including 3 persons involved in bank liquidations). Given the 15 licensees subject to the LFI, the NBM’s supervisory human resources appear sufficient. Managements at supervised institutions indicate that relationships with the NBM are business-like and that its staff members are competent in the conduct of their duties, albeit with a noticeable attention to matters of detail.

D. Institutional Setting

6. **While being overwhelmingly dominant in the financial sector, the banking sector is still relatively small.** The assets of the sector amount to 54 percent of the GDP, while lending represents only 33 percent of GDP (in 2004 these figures amounted to 42 percent and 23 percent, respectively). The relatively low level of financial intermediation is partially due to the early stage of market development and the widespread use of cash in the economy. Despite the continuous growth of deposits in banks indicating the increase of confidence in the banking sector, cash holdings are still prevalent and are supported also by the inflow of remittances through official and non-official channels.

7. **The concentration of the banking sector has slightly decreased and its less than in the peer countries.** All 15 banks are universal and have licenses that allow them to compete in almost all areas of operation. Despite recent foreign acquisitions, majority residents-owned banks control two-third of the banking sector’s assets. While foreign participation in the banking sector’s assets has increased to 64 percent in 2006 from 49 percent in 2004, a large part of nonresidents own only minority shares in banks. Majority foreign owned banks represent only 23 percent of the sector’s total assets. In addition to small stakes in other banks, one of the largest banks, with 15 percent of the banking sector assets, is in majority state ownership. In line with regional trends, banking sector assets and liabilities are dollarized, albeit dollarization is about the average of that in the peers.

E. Main Findings

8. **Objectives, independence, powers, transparency, and cooperation (CP 1):** The LNBM and the LFI, supplemented by regulations, recommendations, and internal manuals and guidelines, provide a sound basis for banking supervision. Supervisory independence exists in practice. A reference to legal protection for supervisors, however, is still absent from the LNBM and the LFI. An information-sharing mechanism has been established by the exchange of letters between the NBM and the newly created NCFM. However, no formal Memorandum of Understanding (MOU) has been put in place and the issue of effective cooperation remains unaddressed. A deficiency noted in the 2004 FSAP—the participation of the Ministers of Economy and Finance at meetings of NBM’s Council, where decisions of

the BRSD are discussed—has not been addressed in the recent amendments of the LNBM, but it is unclear how frequently this occurs. A Collaboration Agreement between the NBM and the Center for Combating Economic Crime and Corruption (CCECC) was signed in June 2005 and remains in effect.

9. **Licensing and Structure (CPs 2-5):** The infrastructure and the process of licensing are adequate, and previously reported deficiencies in identifying bank shareholders below the significant interest threshold have been largely eliminated. In 2005, the threshold definition of “significant interest” (i.e., beneficial interest) was reduced, as recommended in the 2004 FSAP, to 5 percent from 10 percent of a bank’s equity or voting rights and the NBM has strived to obtain all necessary information on the shareholders of all active banks with reasonable success. “Fit and proper” provisions of the legislation now approximate the European Union (EU) standard. However, in one case the NBM has still not been able to extract information on holders of 27 percent of the shares of a licensed bank, and in some other cases only incomplete information was obtained.

10. **Prudential regulation and requirements (CPs 6-18):** The essential elements for effective ongoing prudential regulation and supervision are in place, albeit with deficiencies in the areas of large exposure limits and connected lending (see comments on incomplete information on owners). An important remedial supervisory power of the NBM, however, is in jeopardy. The Law on The Core Principles of Regulating Entrepreneurial Activities (the so-called “Guillotine Law”) will limit the NBM’s current powers. While the NBM will still be able to restrict a bank’s operations, its action will almost immediately be made subject to court review. The rules and regulations regarding capital adequacy generally conform to the Basel Capital Accord of 1988, but do not include a capital charge for market risk, except for foreign exchange risk. Although banks’ trading portfolios are relatively small and their capital adequacy ratios (CARs) are well in excess of the 12 percent required minimum, a capital charge on market risk should be considered. In case of credit risk, the lack of information on some shareholders’ identities obstructs the analysis to determine the extent of banks’ exposures to closely related borrowers. The current assessment recognizes that the NBM has undertaken significant efforts to address weaknesses highlighted in the 2004 BCPs assessment in the area of country risk, market risk, liquidity risk, operational risk, and interest rate management.

11. **Methods of ongoing supervision (CPs 19-21):** Supervision is carried out through a combination of offsite surveillance and full and limited-scope onsite monitoring. The NBM conducts comprehensive annual onsite inspections of all banks and, when warranted, performs limited-scope onsite inspections to detect and analyze specific problems. In addition, the offsite unit reviews periodic financial information submitted by banks and performs financial analyses of individual banks and of the banking system. The NBM should develop an efficient and effective means to extract useful supervisory information, particularly regarding large loans and loans to banks’ related parties, from its loan database already compiled from on- and offsite supervision. In the context of consolidated

supervision, while banks currently have a very limited number of subsidiaries, more explicit powers are needed to allow the NBM to extend supervision to bank holding companies or banks' sister companies. Further, with the enactment of the 2007 Accounting Law, all public interest companies (including banks) will be required to maintain their financial statements in accordance with International Financial Reporting Standards (IFRS) from January 1, 2009. This will require promptly reworking NBM reporting formats.

12. **Accounting and disclosure (CP 22):** The 2007 Accounting Law represents a major change for financial reporting and auditing practices in Moldova, particularly for the banks and will, upon implementation, largely align practice with that currently in effect in the countries of the EU. As part of the implementation process, it would be useful for the NBM to undertake formal discussions with both external auditors and with the banks themselves, in order that implementation proceeds smoothly. As a start, the NBM should consider revision of its own reporting formats to accommodate reporting under IFRS.

13. **Remedial measures (CP 23):** The LFI provides the NBM a broad range of remedial powers to which it can have recourse at its discretion and there is evidence that such powers are used. Nevertheless, as mentioned earlier, if the "Guillotine Law" comes into effect unchanged, certain of these powers of the supervisor will be curtailed.

14. **Consolidated cross-border supervision (CPs 24-25):** The NBM now has full authority to supervise domestic banks' foreign subsidiaries. There are currently no foreign subsidiaries of Moldovan banks. However, considering the expansion of trade with the EU, this could change. In order to provide a basis for consolidated supervision, should Moldovan banks establish subsidiaries elsewhere, the NBM has exchanged letters enabling exchange of supervisory information with regulators in Belarus, Kazakhstan, Romania, and Russia. Foreign banking institutions are subject to similar regulatory requirements applicable to all other banks operating in Moldova. In this regard, the NBM should consider setting up communication mechanisms with the respective "home" supervisors of the four western European banks that have established subsidiaries in Moldova since the 2004 FSAP.

Table 1. Detailed Assessment of Implementation of the Basel Core Principles for Effective Banking Supervision

Principle 1.	<p>Objectives, independence, powers, transparency, and cooperation</p> <p>An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks. Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the discharge of its duties. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision; powers to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.</p>
Principle 1(1)	<p>Responsibilities and objectives</p> <p>An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks.</p>
Description	<p>1. The NBM is responsible for supervision of banks and foreign bank branches (FBBs) in the Republic of Moldova. Its supervisory role for banks and FBBs (licensees) is primarily found in the LNBM, where its exclusive responsibility “for the licensing, supervision and regulation of financial institutions’ activity” is set out, together with its powers in these regards: “(a) to issue necessary regulations and to take actions in order to execute its powers and duties...; (b) to cause an inspection to be made...of any financial institution...; (c) to require ...the financial institution to furnish ...information as requested...; (d) to cause any financial institution to take remedial actions...”(art. 44). Elaboration of the NBM’s broad, functional responsibilities to license, supervise and regulate the activity of financial institutions (art. 5d) is set out in the LFI which, <i>inter alia</i>, sets out provisions governing:</p> <ul style="list-style-type: none"> • Scope of the LFI (art.1); • Banks’ Licensing (arts. 4 through 12); • Banks’ Organization and Administration (arts. 13 through 24); • Operations, including prudential requirements and prohibitions (arts. 25 through 32); • Accounting, Auditing, Reporting and Inspection (arts. 33 through 37); and • Infractions, Penalties and Remedial Measures (art. 38). <p><u>“financial institution” is defined in the LFI (art. 3) as a “legal entity engaged in the business of accepting deposits or their equivalent, <u>non-transferable by any payment instrument</u> and using such funds either in whole or in part to make loans or investments for its own account and risk”, while “bank” is defined as a “financial institution accepting deposits or their equivalents of individuals or their entities, <u>transferable by different payment instruments</u> and utilizing these funds in whole or in part for lending and investing on its own account and risk”).</u></p> <p>2. Under the LNBM (arts. 11 and 44), the NBM may enact secondary legislation and does so by issue of “decisions, regulations, instructions and directives” in order to implement its authority. Taken together, the primary and secondary legislation incorporate a framework of prudential standards that banks must meet, and are noted below:</p> <ul style="list-style-type: none"> • LNBM, No. 548-XIII of July 21, 1995 (Official Monitor of Republic of Moldova No. 56-57 of October 12, 1995)

	<ul style="list-style-type: none"> • LFI, No. 550-XIII of July 21, 1995 (Official Monitor of Republic of Moldova No. 1/ 2 of January 1, 1996) • Law on Preventing and Combating Money Laundering, No. 633-XV of November 15, 2001 (Official Monitor of Republic of Moldova No. 139-140 of November 15, 2001) • Law on Auditing, No. 729-XIII of February 15, 1996 (Official Monitor of Republic of Moldova No. 20-21/214 of April 4, 1996) • Law on the National Commission for Securities, Stocks and Bonds, No. 192-XIV of November 12, 1998 (Official Monitor of Republic of Moldova No. 22-23 of March 4, 1999) • Law on Accounting, No. 426-XIII of April 4, 1995 (Official Monitor of Republic of Moldova No. 28/321 of May 25, 1995) • Law on the Securities, Stock and Bond Market, No. 199-XIV of November 18, 1998 (Official Monitor of Republic of Moldova No. 27-28/123 of March 23, 1999) • Law on State Registration of Companies and Organizations, No. 1265-XIV of October 5, 2000 (Official Monitor of Republic of Moldova No. 31-34 of March 22, 2001) • Law on Corporations, No. 1134-XIII of April 2, 1997 (Official Monitor of Republic of Moldova No. 38-39 of June 12, 1997) • Law on Licensing Certain Types of Activities, No. 451-XV of July 30, 2001 (Official Monitor of Republic of Moldova No. 108-109/836 of September 6, 2001) • National Standard for Accounting, No. 27 "Consolidated Financial Statements and Accounting for Investments in Subsidiaries," Department of Finance Order No. 16 of January 29, 1999 (Official Monitor of Republic of Moldova No. 35-38/70 of April 15, 1999) • National Standard for Accounting No. 28 "Accounting for Investments in Associates," Department of Finance Order No. 174 of December 25, 1997 (Official Monitor of Republic of Moldova No. 88-91/182 of December 12, 1997) • National Standard for Accounting No. 30 "Disclosures in the Financial Statements of Banks and Other Financial Institutions," Department of Finance Order No. 174 of December 25, 1997 (Official Monitor of Republic of Moldova No. 88-91/182 of December 12, 1997) • Regulation No. 1/09 on Transactions with Banks' Affiliated Persons (Minutes No. 31 of November 10, 1995) (Official Monitor No. 67 of November 30, 1995) • Regulation No. 3/09 on Large Exposures (Minutes No. 37 of December 1, 1995) (Official Monitor No. 70 of December 14, 1995) • Regulation No. 23/09 01 on Bank Licensing (Report No. 37 of August 15, 1996) (Official Monitor No. 59-60 of September 12, 1996) • Regulation No. 33/09 01 on Extension of Credit to Bank Employees (Report No. 43 of September 18, 1996) (Official Monitor No. 64 of October 3, 1996) • Regulation No. 34/09 01 on the Issuance of Competence Certificates for Bank Auditors (Report No. 46 of October 11, 1996) (Official Monitor of Republic of Moldova No. 69 of October 24, 1996) • Regulation No. 37/09/01 on the Opening of Branch Offices by Banks (Minutes No. 51 of November 15, 1996) (Official Monitor No. 75-76 of November 21, 1996) • Regulation No. 42/09 01 on Holding Significant Interest in a Bank (Report No. 53 of November 29, 1996) (Official Monitor No. 80 of December 12, 1996)
--	--

	<ul style="list-style-type: none"> • Regulation No. 53/09 01 on Requirements to Banks' Administrators (Minutes No. 15 of March 26, 1997) (Official Monitor No. 24 of April 17, 1997) • Regulation on the Preparation and Submission of Audit Reports (Report No. 28 of August 7, 1997) (Official Monitor No. 64-65 of October 2, 1997) • Regulation on Bank Liquidity, Decision No. 32 (report No. 28 of August 8, 1997) (Official Monitor of Republic of Moldova No. 64-65 of October 2, 1997) • Regulation on Banks' Open Foreign Exchange Position, Decision 126 of November 28, 1997 (Official Monitor of Republic of Moldova No. 112-114 of October 14, 1997) • Regulation on Equity Investments of Banks in Legal Entities, Decision No. 81 of April 9, 1998 (Official Monitor of Republic of Moldova No. 49 of May 28, 1998) • Regulation on Past-Due Credits, Decision No. 130 of May 15, 1998 (Official Monitor of Republic of Moldova No. 87-88 of September 24, 1998) • Regulation on Credit Classification and Establishment of Reductions for Credit Losses (Reserve Funds), Decision No. 164 of June 22, 1998, Report No. 24 (Official Monitor of Republic of Moldova No. 87-89 of September 24, 1998) • Regulation on Managing Interest Rate Risk, Decision No. 249 of the Board of Directors of the NBM of September 22, 1999 (Official Monitor of Republic of Moldova No. 109-111 of October 7, 1999) • Regulation on Long-Term Investment of Banks in Tangible Assets, Decision No. 384 of the Board of Directors of the NBM of December 23, 1999 (Official Monitor of Republic of Moldova No. 1-4 of January 6, 2000) • Regulation on Mergers and Absorptions of Banks or Partnerships in the Republic of Moldova, Decision No. 143 of the Board of Directors of the NBM of June 2, 2000 (Official Monitor of Republic of Moldova No. 65-67 of June 8, 1999) • Regulation on the Disclosure of Information on Financial Activities by Banks of the Republic of Moldova, Decision No. 392 of the Board of Directors of the NBM of December 21, 2000 (Official Monitor of Republic of Moldova No. 163-165 of December 29, 2000) • Regulation on Risk-Weighted Capital Adequacy, Decision No. 269 of October 17, 2001 (Official Monitor No. 130 of October 26, 2001) • Regulation on Bank Credit in the Republic of Moldova, Decision No. 153 of December 25, 1997 (Official Monitor of Republic of Moldova No. 8/24 of January 30, 1998) • Regulation on the Accounting Organization in the Banks of the Republic of Moldova, Decision No. 238 of October 10, 2002 (Official Monitor of Republic of Moldova No. 144-145 of October 24, 2002) • The Chart of Accounts in Accounting of Banks and Other Financial Institutions in the Republic of Moldova No. 55/11-01, Decision No. 15 of March 26, 1997 (Official Monitor of Republic of Moldova No. 63 of June 14, 2001) • Instructions on Preparation and Submission of Financial Statements by Banks, Decision No. 36 (Report No. 28 of August 8, 1997), (Official Monitor of Republic of Moldova No. 64-65 of October 2, 1997) • Recommendations of the NBM on Internal Control Systems within the Commercial Banks of the Republic of Moldova, Decision No. 330 of the Board of Directors of November 9, 1998 (Official Monitor of Republic of Moldova No. 14-15 of February 12, 1999) • Recommendations on the Establishment of Programs for Preventing and
--	--

	<p>Combating Money Laundering by Banks of the Republic of Moldova, Decision No. 94 of April 25, 2002 (Official Monitor of Republic of Moldova No. 59-61 of May 2, 2002)</p> <ul style="list-style-type: none"> • Recommendations on Managing Country and Transfer Risk by banks of the Republic of Moldova, Decision No. 188 of July 13, 2006 (Official Monitor of Republic of Moldova No. 116-118 of July 28, 2006) • Decision of the NBM CA on notification to the NBM of the opening by foreign banks of representative offices in the Republic of Moldova (Official Monitor of the Republic of Moldova No. 98-100 of July 22, 2005) • Regulation on Procedures for Establishment and Implementation of Remedial Measures and Sanctions, Decision No. 92 of October 27, 1997 (internal recommendations) • Policy on the Discussion of Information in Control Reports with Bank Management, Decision No. 92 of October 27, 1997 (internal recommendations) • Manual on On-site Inspections (internal recommendations) (approved by the vice-governor of the NBM on February 12, 1999) • Manual on Bank Authorization (internal recommendations) (approved by the Vice-Governor of the NBM on February 26, 1999) • Manual on the Analysis of Financial Institutions (internal recommendations) (approved by the vice-governor of the NBM on March 22, 1999) • Internal Procedures on Monitoring Reports and Letters to Management from External Auditors (internal recommendations) (approved by the vice-governor of the NBM on June 29, 2000) <p>3. Banking laws and regulations are periodically updated, a major impetus being the necessity to ready the legal and regulatory framework in anticipation of the eventual accession to the EU.</p> <p>4. The LNBM (art. 13) requires the NBM to publish an annual report, which contains a brief section on its supervision and regulation of banks' operations, including financial indicators of the banking system. Further, pursuant to the LNBM (art. 69):</p> <ul style="list-style-type: none"> • monthly, information related to assets, liabilities and capital, as well as financial indicators of the banking system is published on the NBM website (www.NBM.org); • monthly, information about the basic data of commercial banks operations is published in the media; and • information about the development of the banking system for the previous quarter is published by the NBM in quarterly bulletins and on its website. <p>The LFI stipulates that "a financial institution shall regularly publish truthful information about its financial activity, and terms and conditions associated with the deposits made and credits extended, including the rate of interest, in accordance with regulations issued by the National Bank" (art. 30), and sets out requirements (including deadlines and public availability) for publication of the bank's balance sheet, auditor's opinion and annual report (art. 35).</p>
Assessment	Compliant
Comments	
Principle 1(2)	<p>Independence, accountability and transparency</p> <p>Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the discharge of its duties.</p>

Description	<p>1. The LNBM (art. 1(2)) declares that “the NBM is an autonomous public legal entity and is responsible to the Parliament” and that “(it) shall be independent in exercising the attributions vested by this Law and shall not request, nor shall be instructed by public authorities or any other authority (art. 6(4))”.</p> <p>The NBM’s powers vest in its CA composed of 5 persons, namely the Governor (acting as Chairman), the First Vice-Governor (acting as Vice-Chairman) and 3 vice-governors (one of the latter is responsible for the operations of the BRSD). The Governor is appointed by parliament on the recommendation of the Chairman of the parliament. The First Vice-Governor and the three vice-governors are appointed by parliament on the recommendation of the Governor. The LNBM (art. 27(2)) deals with “Disqualification and Removal of Council Members”. The Governor may be dismissed only by a vote of two thirds of the members of Parliament. Other CA members may be dismissed (only for cause as set out in art. 27(2)) on the proposal of the Governor, confirmed by a simple majority of the members of parliament.</p> <p>Appointments/dismissals of the governor, the first vice governor and three vice-governors are announced in the Official Monitor. (The Director of BRSD is appointed (and dismissed) pursuant to NBM’s internal terms and conditions of employment established by the CA, such appointment being for an indefinite period.) CA members serve a renewable seven-year term and must be “citizens of the Republic of Moldova (and) persons of recognized integrity and professional experience (ten years of) in monetary and financial matters (art. 23(5))”.</p> <p>The LNBM (arts. 25 and 26) set out the functions and powers of the CA. Inter alia, the CA shall “establish the operation of the NBM” and “examine statements...on the soundness of the financial system, including the banking system”. In this latter regard, the NBM has powers to “adopt all regulations of general application that are to be issued by the NBM;...decide on the issuance procedures of licenses, permissions, approvals provided in the LFI;...examine, when required, the results of relevant controls at banks (and) to approve decisions thereon”.</p> <p>It is understood that, to date since the previous FSAP, neither government nor industry has interfered in any policy or operational decision of NBM as banking supervisor, or in its ability to obtain and deploy the resources for execution of its mandate.</p> <p>2. The NBM has, as a general function (LNBM art. 5(d)) “to license, supervise and regulate the activity of financial institutions”. Pursuant to the LNBM (Art. 13(1)(a)), “annually, no later than February 1st, the NBM shall deliver to the parliament and to the government and shall publish a statement”, such statement being entitled “The Monetary and Exchange Policy of the NBM for 20XX”. This statement includes a section entitled “Banking Supervision” which sets out the NBM’s activities envisaged thereunder. There is no requirement for the NBM to render account of its performance in regard to those envisaged activities and review of the statement for the years 2003 through 2007 indicates that it does not do so.</p> <p>3. Supervisory functions are performed by the BRSD, headed by a director assisted by an authorized staff of 42 persons deployed in two divisions, namely; (i) BRL Div. (17 persons authorized) and (ii) BSC (25 persons authorized). The BRL division comprises three Units: (a) Bank Licensing; (b) Reporting (“Offsite”); and (iii) Methodology and Rating. The BSC division functions through two Units: (a) Bank Supervision and Control (“Onsite”) and (b) Economic Analysis. The current actual strength of BRSD is 36 persons (including three persons involved in bank liquidations). Given the 15 licensees subject to the LFI, the NBM’s supervisory human resources appear sufficient. Managements at supervised institutions indicate that relationships with the NBM are business-like and that its staff members are competent in the</p>
-------------	--

	<p>conduct of their duties, albeit with a noticeable attention to matters of detail.</p> <p>4. Funding is provided from the NBM's general budget—as determined by the CA (LNBM art.26 s). Management indicates that, in general, current salary scales are sufficient to attract and retain suitable staff for BRSD. External experts may be engaged on an as-required basis, but this is rare. Software has been obtained for Bank OffSite Supervision (“BOSS”) (BRSD's prudential report analysis system). Each employee assigned to supervision has a PC allowing access to all databases of use for analyzing the financial situation of banks. To raise its staff's professional standards, the NBM regularly conducts training sessions and enrolls staff members on courses sponsored by international financial institutions. While the NBM publishes analysis of activities of the supervised licensees in the market, there does not appear to be a publication setting out the NBM's plans for a forward period (e.g., for two years) showing how it will achieve its mandate and the related costs (and funding thereof). The BRSD prepares under direction of its vice-governor, a Strategic Plan setting out goals and objectives for the forthcoming year (e.g., update of Supervisory Manual to maintain currency with “best practice”; preparation of “Regulations”/ “Recommendations” to meet regulatory issues recently encountered). There is a review of performance against objectives by BRSD's top management following year end. Both the Strategic Plan and the review of performance are internal to BRSD.</p> <p>Criteria for dismissal of CA members are specified (LNBM art. 27). There is no requirement that the reason(s) for the director of BRSD's removal from office be publicly disclosed. (However, in the case of the dismissal of the governor, first vice-governor or a vice-governor, approval of the parliament is required, which would mean that the matter be reported in the Parliamentary Record.)</p>
Assessment	Largely Compliant
Comments	<p>While the NBM publishes analysis of activities of the supervised licensees in the market, there does not appear to be a publication setting out the NBM's plans for a forward period (e.g., for two years) showing how it will achieve its mandate and the related costs (and funding thereof). Such a publication would serve to increase the NBM's transparency. It is recognized that the statement entitled “The Monetary and Exchange Policy of the NBM for 20XX” (which appears on the NBM's website) includes a section entitled “Banking Supervision” setting out the NBM's activities envisaged thereunder. However, the Policy statement does not address performance in regard to those envisaged activities in its first section (which addresses Macroeconomic Trends, Banking System and the Monetary Policy Assessment of the previous year). Transparency would be improved (and with relatively minor use of additional resources) by doing so. It would be advisable to administratively separate the budget of the BRSD from the overall budget of the NBM.</p>
Principle 1(3)	<p>Legal framework</p> <p>A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision.</p>
Description	<p>1. Chapter II of the LFI (arts. 4 through 12) addresses “Banking License.” The NBM has the exclusive right to issue banking licenses (LFI art. 4).</p> <p>2. As noted in the discussion of CP 1(1) above, under the LNBM (arts. 11 and 44), the NBM may enact secondary legislation and does so by issue of “decisions, regulations, instructions and directives” in order to implement its authority. (The discussion of CP 1(1) contains an extensive list of the NBM's use of its powers in this regard.) Secondary legislation proposed by the NBM (such as the prudential Regulations and Recommendations) follows the NBM's internal legislation development procedures, which require full public consultation.</p> <p>3. The LNBM (arts. 44 and 47) and the LFI (arts. 22 and 40) obliges banks and FBBs</p>

	to submit periodic returns to NBM, in the manner and within the time limits it establishes.
Assessment	Compliant
Comments	
Principle 1(4)	Legal powers A suitable legal framework for banking supervision is also necessary, including powers to address compliance with laws as well as safety and soundness concerns.
Description	<p>1. 3. Chapter VI of the LFI sets out “Infractions, penalties and remedial measures”. The text (art. 38) indicates the NBM’s application of qualitative judgment in addressing compliance with laws as well as broad “safety and soundness” concerns (the NBM has capacity to “determine that the bank or any of its owners or administrators are guilty of an infraction consisting of... (<i>inter alia</i>) unsafe or unsound operations;...”). Thus, the NBM may—depending on the seriousness, scope, duration, consequences and nature of the perceived infraction—take one or more of a broad selection of measures ranging from issue of a warning to the licensee, through suspension of some of its activities to, finally, license withdrawal (art. 38(1)). In the event that a bank becomes undercapitalized, the NBM may require dismissal of one or more of its administrators (art. 38(2)(f)). Indeed, should a bank’s regulatory capital be determined to be less than two-thirds of the required minimum regulatory capital and, in the NBM’s opinion, the bank be likely to face insolvency, the NBM “shall withdraw the license and contact the law authorities to initiate the insolvency process” (art. 38(3)). However, the concept of “early remedial action” —involving immediate action as regulatory capital falls below defined thresholds—has not been introduced in the NBM supervisory regime.)</p> <p>2. The LNBM (art.44) and the LFI (art.37) provide the NBM unfettered access to banks’ files to assess compliance with internal rules and limits as well as NBM’s “decisions, regulations, instructions and directives”.</p>
Assessment	Compliant
Comments	While an assessment of “Compliant” is given, it is noted that the Law 235 – XVI of 20 July 2007 (art. 17) the Law on The Core Principles of Regulating Entrepreneurial Activities (referred to as the “Guillotine Law”), which was scheduled to be proclaimed in force on January 1, 2008, would provide for limitation of the NBM’s capacity to suspend activities of a licensee as a prudential and remedial measure. While imposition of a suspension of activities would still be available to BRSD, its suspension order would immediately be subject to review by the court. Legal counsel has already brought to the attention of the Government the reduction in the NBM’s capacity to take timely corrective that Law 235 – XVI would entail. At the writing of this assessment, it is unclear whether the provisions of this law are applicable to banks, as the President required that financial institutions become exempt. However, if the law is enacted in its present form, the assessment of this CP would necessarily change. ¹
Principle 1(5)	Legal protection A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.
Description	The NBM’s employees are not explicitly protected against the possibility of lawsuits against them (and not implicitly protected against legal costs) for actions taken while discharging their duties in good faith.
Assessment	Non-Compliant
Comments	The NBM’s position is that the protection envisaged by CP 1(5) is not necessary as its staff members do not act on their own behalf in the performance of their duties, but rather as representatives of the NBM. The LFI (art. 38) contemplates the possibility of

¹ According to information given by the authorities, in February 2008 the financial sector was exempted from the provisions of this Law.

	the actions of the NBM being contested before the courts and it is NBM's management's view that this is the course that would be followed by any aggrieved party. The mission team repeats the view—expressed at the conclusion of the 2004 FSAP—that legislation supporting legal protection for NBM officials who act in good faith in the performance of their duties needs to be adopted.
Principle 1(6)	Cooperation Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Description	<p>1. The LNBM (art. 6(2)) provides for exchange of information and cooperation among the NBM and "Governmental Bodies". The NCFM came into being on June 7, 2007 and started its operation in August 2007, and is now responsible for the regulation and supervision of nonbank financial services such as insurance, securities, non-state pension funds, leasing companies, and savings and loan associations. Memoranda of Understanding (MOUs) with NCFM's pre-existing agencies responsible for the supervision of the insurance and securities industries have been continued informally by an exchange of "letters of agreement" between the NBM and the NCFM. The latter provides the NBM a quarterly report on the activities and operating performance of those securities and insurance companies related to banks. On a monthly basis, the NBM supplies to the NCFM summary information on the activities of banks holding broker and/or dealer licenses. As yet, there is no defined mechanism in place for coordinating actions between the NBM and the NCFM, should this become necessary.</p> <p>A "Collaboration Agreement" was signed between the NBM and the Centre for Combating Economic Crimes and Corruption in June 2005.</p> <p>2. 3. There is a "letter of agreement" system of cooperation and information sharing in place with the banking regulatory agencies of Belarus, Kazakhstan, Romania, and Russia, based upon the Basel Committee document "Essential elements of a cooperation agreement between banking supervisors." All such "letters of agreement" incorporate confidentiality provisions as well as requirements for use of information obtained there under solely for supervisory purposes. The LNBM (art.36 (2d)) allows disclosure of information "to foreign financial institution supervisory authorities" and exempts such sharing from the Commercial Secrecy Law. The NBM is not required to perform any particular due diligence to ensure that information provided to another supervisor is kept in confidence.</p> <p>4. As noted above, the LNBM defines the institutions, both domestic and international, that can be provided with confidential information. Although not specifically stated, the belief is that other authorities which may demand confidential information would be denied access (citing the lack of authorization in the LNBM and the terms of the Law on Commercial Secrecy).</p>
Assessment	Largely compliant
Comments	While there are in place means for the exchange of information, there is not—as yet—an agreed procedure for practical cooperation between the NBM and the NCFM should the need arise. It is essential that an appropriate MoU be adopted between the two authorities, providing—among others—for an agreed procedure for cooperation and coordination in the use of their regulatory powers.
Principle 2.	Permissible activities The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined and the use of the word "bank" in names should be controlled as far as possible.
Description	1. The LFI (art. 3) defines a "bank" as a "financial institution accepting deposits or their equivalents of individuals or their entities, <u>transferable by different payment instruments</u> and utilizing these funds in whole or in part for lending and investing on its own account and risk" (A " <u>financial institution</u> " is defined in the LFI as a "legal entity

	<p>engaged in the business of accepting deposits or their equivalent, <u>non-transferable by any payment instrument</u> and using such funds either in whole or in part to make loans or investments for its own account and risk”).</p> <p>2. The LFI (art. 26) lists in detail the “financial activities” permissible for banks, including those that are directly ancillary or supplemental. The authorization for performing those “financial activities” is issued in accordance with the stipulations of arts 6, 7, and 26 of the LFI and under the terms stipulated in Regulation No. 23/09-01 on Bank Licensing. Pursuant to art. 26 (3) of the LFI, a bank may not engage in financial activities that are not included in the authorization.</p> <p>3., 4. The LFI (art. 12) sets out “Prohibitions”. The word “bank” and its derivatives, may only be used in a trade name by a legal person granted a banking license, unless such usage is recognized by law or international agreement or the context clearly indicates that financial activities are not contemplated (art. 12 (3)). No person may engage in “financial activities”, including the acceptance of deposits or their equivalent, without a license issued by the NBM (art. 12(1) and (2)).</p> <p>5. The NBM maintains a list of current licensees which it displays on its website (www.NBM.org). A register of authorized banks—open to the public—is maintained by the NBM (LFI art.9).</p>
Assessment	Compliant
Comments	
Principle 3.	<p>Licensing criteria</p> <p>The licensing authority must have the power to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the ownership structure and governance of the bank and its wider group, including the fitness and propriety of Board members and senior management, its strategic and operating plan, internal controls and risk management, and its projected financial condition, including its capital base. Where the proposed owner or parent organization is a foreign bank, the prior consent of its home country supervisor should be obtained.</p>
Description	<p>1. The NBM is the sole licensing and supervisory authority (see above. CP 1(3)).</p> <p>2., 3. The LFI (arts. 6 and 7), together with the Regulation No. 23/09-01 on Bank Licensing, the Regulation No. 42/09-01 on Holding Significant Interest in a Bank and the Regulation No. 53/09-01 on Requirements for Bank Administrators, set out criteria for, and method of issuance of, a license for a financial institution by the NBM. Procedures and methods of license issuance are established through internal recommendations and formalized in the Manual on Bank Licensing, approved by the NBM's Governor on February 26, 1999. The LFI (art. 6) provides criteria for issuing licenses consistent with those applied in ongoing supervision.</p> <p>4., 5., 6., 8., 13. The NBM has the right (LFI, art. 7) to reject an application if the criteria are not fulfilled or if the information provided is inadequate. The LFI, read in conjunction with Regulation No. 23/09-01 on Bank Licensing, enables the NBM to determine that the proposed legal and managerial structures of the proposed licensee will not hinder effective supervision. The LFI (arts. 6 (1d) and 7 (2b)) and the Annexes to Regulation No. 23/09-01 on Bank Licensing help the NBM, albeit to a limited extent, to determine the suitability of administrators, all shareholders and the level of transparency of ownership structure.</p> <p>The Regulation No. 53/09-01 on Requirements for Bank Administrators, based on the LFI (art. 21), establishes the criteria for qualifications, experience, business reputation, lack of criminal record and lack of evidence of responsibility for prior financial or</p>

	<p>administrative issues, tax evasions, etc. Intending administrators must be accepted as appropriate by the NBM before commencing employment. On-site inspectors verify that all employees who conduct activities on behalf of the bank are approved by the NBM.</p> <p>The LFI (art. 7(2b)) provides that the NBM will only grant a license if, inter alia, it is assured that the qualifications, experience and integrity of the administrators and those shareholders holding a "significant interest", as defined, are appropriate for the bank's business plan and financial activities for which the bank will be licensed.</p> <p>7., 9. The capacity of the shareholders to acquire bank shares will be established in compliance with the LFI (art. 14) and the Regulation No. 23/09-01 on Bank Licensing, based on the financial documents provided. A new bank must have a paid-in capital of at least 50 million lei (the minimum requirement for a new bank with a restricted license—category A). In cases where, according to the business plan, the projected activity requires more funds, which is normally the case, and an unrestricted—category C—license, the initial capital is required to be 150 million lei. The LFI (arts. 6 and 7) and Regulation No. 23/09-01 on Bank Licensing, provide for a review of strategic and operating plans, structure and policies and procedures, internal control procedures and the system for appropriate oversight of the financial activities in the proposed licensee etc. This means that the bank to be licensed has to set up an organization that is able to meet the demands of the projected business. In this regard, its by-laws and internal regulations have to clearly define the type and geographical limits of the planned banking activity and, accordingly, the internal organization for that activity. The NBM checks if the internal regulations of the future bank are issued in accordance with the LFI (art. 17), including the organization and functions of the bank units and the competency of bank administrators and employees. The LFI and Regulation No. 23/09-01 on Bank Licensing contain detailed guidelines concerning the documents to accompany the authorization application, i.e., pro-forma financial statements and the financial information on the principal shareholders. The NBM grants authorization if, in the opinion of the BRSD, the business plan of the intending licensee is feasible and the above-noted criteria are met.</p> <p>10. A bank's business plan, established for the next three years, is reviewed during the licensing process (LFI (art. 6) and Regulation No. 23/09-01 on Bank Licensing). In addition, supervisors assess the bank's capacity to operate in accordance with the LFI, as well as the shareholders' financial capacity to support the bank in the future.</p> <p>11. The LFI (art. 6(3)) provides that a subsidiary of a foreign bank or a FBB will be subject to licensing conditions laid down by Regulation No. 23/09-01 on Bank Licensing. The licensing process for a foreign bank's subsidiary requires procedures similar to those applying to a domestic bank. Pursuant to the LFI (art. 7(6)), a foreign bank is issued a license for a branch or a subsidiary in the event that:</p> <ul style="list-style-type: none"> • in the country of origin, the foreign bank is authorized to attract deposits or other reimbursable funds; • the competent authorities of the country of origin that supervise the financial activity of the foreign bank at its head office have approved in writing the issuance of such a license; and • the NBM determines that the foreign bank is appropriately supervised on a consolidated basis by competent authorities in the country of origin. <p>12. The NBM has authority (LFI art. 10) to revoke a license if it determines that the license was obtained based on false information. Regulation No. 23/09-01 on Bank Licensing gives the NBM power to penalize the bank administrators if incorrect information has been supplied to it.</p>
--	---

	Once the license is issued, a bank is monitored on the basis of financial reports submitted to the NBM; after six months, an onsite inspection is conducted in order to ensure that the bank is complying with the requirements of the license and business plan.
Assessment	Largely Compliant
Comments	Reference is made in the description, above to the fact that; “The LFI (arts. 6 (1d) and 7 (2b)) and the Annexes to Regulation No. 23/09-01 on Bank Licensing help NBM, albeit to a limited extent, to determine the suitability of administrators, all shareholders and the level of transparency of ownership structure.” In the case of the one license that has been sought since the 2004 FSAP, the BRSD appears to have overcome previously encountered difficulties in establishing suitability of shareholders and the level of transparency of the ownership. The assessment of “Largely Compliant” reflects the continuing challenge that the BRSD confronts in establishing full ownership details of certain banks licensed in the past.
Principle 4.	Transfer of significant ownership The supervisor has the power to review and reject any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.
Description	<p>1. Under the LFI (art. 3), a “significant interest” “means a direct or indirect holding of an interest in a legal entity that represents the equivalent of 5 per cent or more of the equity or the voting rights, or that makes it possible to exercise a significant influence over the management or policies of that entity.”</p> <p>2. Prior written approval of the NBM (LFI art. 15(1)) is required for any one person or persons acting in concert to acquire (directly or indirectly) a holding of 5 percent or more and, subsequently, a holding of 25, 33, and 50 percent or more of a bank’s equity or voting rights. Pursuant to the LFI (art. 10 (1g)), the NBM may revoke a bank’s license if the owner of a “significant interest” in the bank’s shares has transferred or lost such interest without the NBM’s written approval. (During onsite inspections, NBM inspectors establish whether a bank’s internal procedures regarding the collection and analysis of information about its shareholders match the LFI’s requirements (art. 15(1)).</p> <p>3., 5. The NBM has power to reject proposals for changes in significant ownership or controlling interest in a bank as its prior approval depends upon the conditions for initial licensing being satisfied (LFI art. 7(2)). Where a transfer is made without the NBM’s written approval, the shareholder(s) involved are denied the right to vote based on the size of the shareholding exceeding the prescribed limits (LFI art. 15(1)) and, within three months, the shareholder involved must obtain from the NBM its approval to the transfer or, in the alternative, sell the shares wrongfully acquired.</p> <p>4. The LFI applies no quantitative limitation on share ownership in banks. Every month, a bank must submit a report on its shareholders who own 1 percent or more of the shares of its capital, identifying those persons or groups of persons exerting a “controlling influence” over the bank. The Recommendations of the NBM on Banks’ Internal Control Systems (as amended by DCA No. 13 of January 12, 2006) requires a bank to obtain and update—at least once a year—information on the direct or indirect owners of interests of 2 per cent or more of the bank’s shares. There is no requirement (or capacity for the NBM to ensure) that licensees provide notification of any material information which may negatively affect the suitability of a licensee’s major shareholder.</p>
Assessment	Largely Compliant
Comments	The NBM has expended considerable effort to obtain the identities of beneficial owners of shares being held by custodians in order to achieve transparency of the ownership structure of certain banks. Progress has been achieved but challenges

	<p>remain (in particular, the identity of three shareholders of a bank with an aggregate 27 per cent interest). While the prudential regulations—as revised—do require the NBM to determine the beneficial owner of these mostly off-shore corporations, the true owners of these shareholdings have not been determined with certainty. Situations of this type also affect prudential regulation on lending to connected or related parties and may also have ramifications for abuse of financial services which banks may legitimately provide.</p> <p>As recommended at the conclusion of the 2004 FSAP, the NBM has decreased the limit of “significant ownership” requiring its approval from 10 percent or more to 5 percent or more of a bank’s equity or voting rights and is now seeking disclosure of all shareholdings down to a 1 per cent limit. Aggressive efforts to achieve full transparency should be continued.</p>
Principle 5.	<p>Major acquisitions</p> <p>The supervisor has the power to review major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and confirming that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.</p>
Description	<p>1. - 5. The value of a single equity interest taken up by a bank (except an equity interest in a legal entity engaged in financial activities) should not exceed either 15 percent of the bank’s regulatory capital or represent a “significant interest” (i.e., 5 per cent or more) (LFI art. 15(3)) in the equity or voting rights of the investee company. The total net current value of a bank’s equity interests may not exceed 50 percent of the bank’s regulatory capital. If the aforementioned limits are exceeded, prior written authorization of the NBM is required. The monitoring of the risk inherent in investments and assessment of the investment policy of banks is part of the onsite examination. The Regulation on Banks’ Equity Investments in Legal Entities (Decision No. 81 of 9 April, 1998) specifies the criteria for review of applications for approval submitted by banks to the NBM.</p> <p>Applications are approved for banks that have a satisfactory financial status and are not subject to remedial measures imposed by the NBM. As a result, these banks are able to invest in corporate assets. The decision on review of an application for an increase in the number of shares already held will depend on whether the bank’s status has changed, whether the economic status of the investee corporation has worsened, and whether the acquisition may affect the bank’s financial status.</p> <p>The above mentioned limits are not valid for banks acquisitions of banks. In such a case the reporting and approval requirements of CP 4 come into effect. The Regulation on Bank Mergers or Partnerships establishes the following restrictions on a dominant position in the banking market:</p> <ul style="list-style-type: none"> • a bank’s total assets should not exceed 30 percent of the total assets of the entire banking system and • individuals’ deposits in a single bank should not exceed 30 percent of the total deposits of individuals in the entire banking system. <p>Every month, in accordance with the instructions on preparation and submission of financial reports, the banks report to the NBM on their ownership of all the shares in corporate assets, as well as investments in long-term tangible assets.</p> <p>Beyond the LFI’s general prescription for management of risks (art. 25), neither the LFI nor secondary legislation provide specific criteria by which to judge individual investment proposals other than the quantum limitations specified above and the single provision for exemption from a limitation on the NBM’s prior approval. (The</p>

	<p>Regulation on Banks' Equity Investments in Legal Entities indicates that the rationale and the bank's financial analysis of the intended investment are required.) In quantitative terms, the legislation restrains capacity for acquisitions/investments within modest limits and, as noted elsewhere, the legislation's licensing and continuing management provisions require that licensees have in place organizational resources adequate to manage the risk those acquisitions/investments represent. The NBM's on-site supervision has a focus on assessment of the caliber of risk management.</p> <p>The LFI's Remedial Measures (art.38) are sufficiently broad should the NBM determine that mitigating action be warranted.</p>
Assessment	Compliant
Comments	
Principle 6.	<p>Capital adequacy</p> <p>Supervisors must set prudent and appropriate minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. At least for internationally active banks, these requirements must not be less than those established in the applicable Basel requirement.</p>
Description	<p>1., 2., 4. The Regulation on Risk-Weighted Capital Adequacy (Decision No. 269, 17 Oct. 2001), issued pursuant to related provisions of the LFI (arts. 14, 25 and 28(1)), requires all licensees to maintain a minimum risk-weighted capital ratio of 12%, and is generally based on the provisions of the Basel Capital Accord of 1988. While both on-balance-sheet and off-balance-sheet items are incorporated, the ratio computation does not implement the 1996 amendment to the 1988 Capital Accord to incorporate a capital charge for market risk (except for foreign exchange risk). Lack of implementation of the 1996 amendment reflects the minimal exposure to market risk due to Moldovan banks' very small trading portfolios.</p> <p>The Regulation establishes requirements regarding:</p> <ul style="list-style-type: none"> • the detailed structure and components of "Total Regulatory Capital"; • the "Minimum Required Capital", i.e., Tier One capital (banks must originally have—and thereafter maintain—capital at a level that complies with the license category, i.e. Category A—50 million lei; Category B—100 million lei; Category C—150 million lei); • CAR, determined as the ratio between Total Regulatory Capital and Total Risk Weighted Assets (including both on-balance sheet assets and off-balance sheet items, the latter converted into lending at nominal value on an individual basis). The CAR reflects the risk profile of individual banks, the Regulation prescribing risk weightings for both on-balance-sheet (0%, 20%, 50%, 100%) and off-balance-sheet (0%, 50%, 100%) items. Off-balance sheet items are converted into the "other loan category" with a risk weight of 100 percent. At the present state of development of the banking sector, it has not been found appropriate to permit banks to use internal assessments of risk as inputs to the calculation of regulatory capital; • A bank must provide its detailed CAR computation to the BRL Division monthly. While the minimum CAR of 12 per cent exceeds that normally associated with the Basel requirement, the BRSD finds it appropriate to the circumstances of the Moldovan market. (Licensees currently operate with CARs well in excess of the minimum.) <p>The CAR computation is performed on a solo basis only. At present, few Moldovan banks have subsidiaries and for those which do, the subsidiaries' activities are minimal in relation to those of the bank. (The NBM requires half-yearly submission of financial</p>

	<p>statements of all legal entities in which a bank holds 25 per cent or more of the equity capital so that it may monitor whether such entities' activities and financial condition have materiality for the investing bank.)</p> <p>3., 6. By application of the LFI's "Remedial Measures" provisions (Ch. VI., art 38(1)(f)) the NBM has power to impose limits on all material risk exposures of a bank and via the interlocking of arts. 25(2) ("Prudential Requirements"), 28(1) ("Prudential Measures"), and the "Remedial Measures" powers under art. 38(1) has the authority to take measures should a bank fall below the minimum CAR. The LFI (art. 38(3)) contemplates mandatory action on the part of the supervisor: "For financial institutions in.... over-indebted situation, or whose regulatory capital is determined to be less than two-thirds of the required minimum regulatory capital and that are likely to face insolvency situation... the NBM shall withdraw the license and shall contact the law authorities to initiate the insolvency process.</p>
Assessment	Largely Compliant
Comments	<p>Currently, CARs are not computed a consolidated basis. This is understandable, given that few licensees have subsidiaries. However, growth in the industry and the imposition that "public interest entities" (including banks) prepare financial statements under the IFRS for financial years beginning January 1, 2009, will require that consolidated computations be made.</p> <p>A prior notification of dividend payment from the bank to the NBM should be considered. As currently written, the LFI contemplates an after-the-fact remedial measure (art. 28(4)) rather than preventive action: "A bank shall make no capital distribution if in the opinion of the NBM, after making the distribution, the bank would have less than the minimum regulatory capital."</p> <p>The LFI (art. 38(3)) contemplates mandatory license withdrawal once a licensee's regulatory capital is two-thirds of the required amount. The NBM should consider introduction of other elements of a "early remedial action" program for implementation prior to activation of the mandatory license withdrawal contemplated by the LFI (art. 38(3)). For example, once the CAR falls below 12 per cent, recovery measures would be required. Here, the Board and the Executive Body would have to approve and submit within a given time span to the NBM, an acceptable binding recovery program. (As indicated in the Descriptions of CP 1(4) and CP 23, the NBM has a broad selection of powers that would accommodate an early remedial action regime.)</p>
Principle 7.	<p>Risk management process</p> <p>Supervisors must be satisfied that banks and banking groups have in place a comprehensive risk management process (including Board and senior management oversight) to identify, evaluate, monitor and control or mitigate all material risks and to assess their overall capital adequacy in relation to their risk profile. These processes should be commensurate with the size and complexity of the institution.</p>
Description	<p>The Recommendations on the internal control systems issued in November 1998 and subsequent amendments, indicate that financial institutions must establish their own internal control systems, taking into account their financial activity and risks. The internal control procedures established by the financial institution should also ensure the identification, the assessment, the monitoring, and the control of the bank's significant risks.</p> <p>Article 18 of LFI and the above-mentioned recommendations also indicate that the bank's Board is responsible for the elaboration and the ensuring of the bank's internal policy application.</p> <p>The NBM has issued the appropriate standards related to credit risk, country risk, market risk, liquidity risk, interest rate risk in the banking book, and operational risk.</p>

	<p>These standards are detailed in Principles 8, 9, 12, 13, 14, 15 and 16.</p> <p>During the onsite inspections, the NBM supervisors review the decisions made by the Board and senior management with regard to all material risks taken by the bank. In the event the supervisors are not satisfied with the actions taken by management, they can specify a period of time within which the bank is obliged to improve its risk management processes. In addition, the supervisors monitor whether there is an adequate flow of information between senior management and the operational staff who is conducting risk assessments.</p> <p>The onsite supervisors of the NBM determine that banks have adequate information systems for measuring, assessing, and reporting on the size, composition and quality of exposures.</p> <p>The BSRD on-site supervisors review that the reports prepared by banks' staff are submitted on time to the Board or senior management and that such reports reflect the bank's risk profile and capital requirements.</p> <p>The Regulation on assets and contingent engagements classification, allowance for assets losses and provisions for contingent liability losses that was issued in August of this year is currently in the process of implementation at all banks.</p> <p>The NBM's BRSD supervisors verify that risk management strategies, policies, processes and limits are properly documented, reviewed and updated, communicated within the bank, and adhered to in practice at the onsite examinations. The supervisors determine that exceptions to established policies, processes and limits receive the prompt attention and authorization by the appropriate level of management and the Board where necessary.</p> <p>The Regulation on the risk-weighted capital adequacy, issued in Oct 2001, sets out the requirements to all commercial banks for the calculation of the regulatory capital. According to the Recommendations on the internal control systems issued in November 1998, banks are required to have concise documents on short-term and long-term policy and strategic objectives, and are required to establish internal procedures on regular assessment of assets, liabilities, off-balance assets and liabilities.</p> <p>The banks' policy of maintaining an adequate capital is being assessed by the onsite examiners by taking into consideration, among other, the following factors: the current and expected growth, future profits, liquidity and resources management, risk-weighted assets, assets quality, etc. The banks' policy is also evaluated in order to determine whether it is realistic and adequate taking into account the bank's current and anticipated financial situation.</p>
Assessment	Largely Compliant
Comments	At onsite inspection of the banks, the NBM supervisors determine: (a) that the bank's risk management process is adequate for the size and nature of the activities of the institution; (b) risk management policies, processes and limits are properly documented; (c) the Board understands the nature and level of risk being taken by the bank, and that the bank has an internal process for assessing the overall capital adequacy in relation to the risks taken. In addition, offsite supervisors determine that banks have policies and processes in place to ensure that the Board approves new products and major management initiatives. Also, the supervisors determine that the

	<p>banks have risk evaluation monitoring, with duties clearly segregated from the risk taking functions in the bank. The NBM examiners verify that relevant reports on risk exposures are sent directly to senior management and to the Board.</p> <p>The NBM should ensure that all banks continue the process of improving their risk management policies and processes. Generally, each bank has stylized its own way of assessing risks depending on its internal operational differences and volume of transactions.</p> <p>The Onsite Examination Manual should be amended in order to reflect the additional emphasis placed on the review of risk areas within a financial institution, due to the revised BCPs assessment methodology issued in October 2006.</p>
Principle 8.	<p>Credit risk</p> <p>Supervisors must be satisfied that banks have a credit risk management process that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control credit risk (including counterparty risk). This would include the granting of loans and making of investments, the evaluation of the quality of such loans and investments, and the ongoing management of the loan and investment portfolios.</p>
Description	<p>The Regulation on credit activity of banks, Decision 153 of Dec 1997 with later amendments covers the prudential credit requirements to be followed by the banks.</p> <p>The NBM carries out at least one onsite inspection annually of every bank. A prime focus of these visits is to review loan files to ensure that documentation is complete, that loans and other exposures have been correctly classified and that the bank's internal control function is carrying out its monitoring function properly and in accordance with the above regulation. Article 37, paragraph 3 of the LB, specifies that staff of the bank or subsidiary is required to provide to the examiners of the NBM all information requested on any matters relating to the bank's administration and operations</p> <p>The BSRD manual for onsite examination/inspection specifies that supervisors must review whether the bank has effective credit administration policies and processes that include continued analysis of a borrower's ability and willingness to pay under the terms of the debt. Approximately 50 to 65 percent of the loan portfolio of the larger banks is reviewed at the onsite yearly examination. For the small banks, the percentage of loans analyzed by the supervisors at the onsite examinations is close to 100.</p> <p>The supervisors review and analyze the policies and processes for reporting exposures on an ongoing basis and ascertain that the bank has comprehensive policies and processes for identifying problem assets. In addition, the onsite examiners analyze the lending controls and limits, including policies and processes for monitoring exposures. Also the supervisors review and determine that the bank's Board periodically reviews the credit management strategy including the various processes for assuming, identifying, controlling, and reporting credit risk. The supervisors also review that senior management follows the credit-risk strategy approved by the Board. In addition, the NBM supervisors review the decisions of credits extension to ensure they are free from conflicts of interest and comply with the stipulations of article 24 of LFI. Any deficiencies detected in the credit area during an onsite examination are reflected in the report of examination that is submitted to the bank's Board. The Board of the bank is advised that early remedial action of all</p>

	<p>regulatory and prudential violations is required.</p> <p>As a consequence of the recent embargo to the wine export industry, banks are requested to supply information on credits to viticulture, and the winemaking industry. Quarterly stress tests are conducted in this area.</p> <p>In general, the NBM's BSRD is compliant with the essential criteria of the credit risk Core Principle.</p>
Assessment	Largely Compliant
Comments	<p>The NBM's onsite inspectors should ensure that banks undertake effective analysis of risk under currently valid, alternative stress test scenarios.</p> <p>The NBM should put pressure on banks to establish a Credit Registry where all banks would report direct and indirect credit facilities exceeding the equivalent of approximately US\$1,000 and to start the operation of such a bureau without delay</p>
Principle 9.	<p>Problem assets, provisions and reserves</p> <p>Supervisors must be satisfied that banks establish and adhere to adequate policies and processes for managing problem assets and evaluating the adequacy of provisions and reserves.</p>
Description	<p>The NBM has issued a set of comprehensive guidelines relating to the review and provisioning of banks' assets. Article 28(2)(c) of the LFI stipulates that banks must observe the NBM regulations' requirements on asset classification and assessment, as well as the risk provisions that must be created, in order to cover potential losses related to credits. The NBM Regulation on Past due credits, issued in May 1998, stipulates that a bank should have in place systems of internal credit analysis and evaluation of the credit portfolio quality. Based on the NBM's credit classification system, banks are required to split their credit portfolio into five risk levels.</p> <p>Bank's management and the NBM supervisor are able to determine the risk of the bank's credit portfolio and its impact on the bank's capital, liquidity and income by assigning a risk level to all credits of the bank's portfolio.</p> <p>Banks are required to classify all credits at least once per quarter in compliance with this Regulation.</p> <p>As indicated in CP 8, the NBM supervisors have full access to all information in the credit and investment portfolios and discuss loans with the bank officers responsible for assuming, managing, controlling and reporting credit risk.</p> <p>Banks are required to maintain provisions for loan losses not lower than the required level, by establishing the following loan loss reserve allocation to credits of each classification category: –</p> <ul style="list-style-type: none"> • Standard 2 percent, • Under supervision 5 percent, • Substandard 30 percent, • Doubtful 75 percent, • Loss 100 percent. <p>The Regulation on Asset Classification and Allowance for Losses issued in June 1998, amended in August 2007 (came into force in November 2007), includes—among other—a provision where the Doubtful classification for loan loss reserve is decreased to 60 percent from 75 percent.</p> <p>It should be noted that the loan loss provisions for all classified categories are made</p>

	<p>on the whole outstanding amount of the loan and NOT after giving effect to the value of any collateral.</p> <p>The credit classification is performed taking into consideration the borrower's financial situation, credit insurance, and other favorable and/or unfavorable factors concerning the repayment of the credit. All the newly extended credits have to be classified at the moment of the extension of the loan. Based on the classification, the required amount of the loan loss provision (risk fund) is determined. This Regulation details the classification procedures for renegotiated loans and past due consumer credits.</p> <p>The Regulation on Classification of Credits and Contingent commitments and provisioning on assets losses on contingent commitments issued in August 2007, that went into effect in November 2007 provides the system for classifying and taking into account of-balance sheet exposures.</p> <p>According to Instructions issued by the NBM, the BRSD have the power to require a bank to increase its level of provisions and reserves if such provisions are deemed inadequate.</p> <p>According to the Regulation on Past due credits, issued in May 1998, for supervisory purposes a credit is considered "past due loan" when no payment has been received within a maximum of 30 days; a credit is considered "non accrual loan" when no payment has been made for more than 60 days. "Non accrual loans" are classified as doubtful or loss. Also, "impaired loans" are loans classified in the categories "substandard", "doubtful," and "loss".</p> <p>The NBM BSRD is largely compliant with the essential criteria of the Core Principle 9.</p>
Assessment	Largely Compliant
Comments	<p>1. The NBM should consider implementing greater detail by "time buckets" for delinquency reporting. This should be: 30 days, 30-60 days, 60-90 days, over 90 days, rather than the 30-60 days and 60+ now in effect.</p> <p>2. Moreover, the NBM should determine impact of banks' required implementation of IFRS and particularly use of International Accounting Standards (IAS) 36 "Impairment of Assets" for years beginning January 1, 2009.</p>
Principle 10.	<p>Large exposure limits</p> <p>Supervisors must be satisfied that banks have policies and processes that enable management to identify and manage concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties.</p>
Description	<p>1., 2., The Regulation on Large Credits No. 3/09, first issued in December 1995, and last amended in January 2003, establishes that net credit exposure of a bank to a "person" or "group of interrelated persons"—both as defined—should not exceed 25 percent of the bank's Total Regulatory Capital, and that large credits must be approved in advance by a majority of the Council of the bank. (There is no capacity given the NBM to exercise discretion in applying the definition of "group of interrelated persons".) "Exposures" includes all claims, both on and off balance sheet. The same Regulation stipulates that the sum of the net credit exposures for credit extensions to the largest ten borrowers, including groups of inter-related persons, should not exceed 50 percent of the bank's total credit portfolio, and the sum of all large credits should not exceed five times the bank's Total Regulatory Capital.</p> <p>3., 4. Pursuant to the Recommendations on Internal Control Systems Dec. No. 330 of November 9, 1998, a bank must have in place procedures that ensure provision of accurate information to management on the implementation of policies and</p>

	<p>procedures related to credit operations. Assessment of whether the bank's management information system is sufficiently robust to capture and aggregate exposures to "persons" and "groups of interrelated persons" is established by onsite inspection. Similarly, confirmation is sought by inspection staff that the bank's risk management policies and processes quantify acceptable credit concentrations and provide that major concentrations be subject to Board review.</p> <p>5. Banks are required to submit quarterly returns to the NBM showing information on large exposures, including sectoral, geographical, and currency exposures and, as well, conformity (or otherwise) to limits set by the Regulation on Large Credits.</p>
Assessment	Materially non-compliant
Comments	<p>In most respects, the NBM's systems for ensuring that banks do not have excessive large exposures and maintain prudent systems for managing their large exposures are reasonably adequate and well applied. However, it is applied to data that does not take into consideration the lack of detailed information on the financial activities of a number of shareholders below the 10 percent threshold. The 25 percent limit on exposures to single borrowers or groups of closely related borrowers and the 500 percent limit on aggregate large exposures ("large exposure" being defined as net exposure to any person or to a group of inter-related persons constituting 10 percent or more of a bank's regulatory capital) approximate EU practice. The NBM has implemented requirements for banks to disclose economic, industry and geographic concentrations that exceed 40 percent of a bank's capital.</p> <p>The NBM has reporting arrangements to monitor banks' compliance with Regulation limits and its onsite examination process provides an adequate basis for evaluating banks' systems for managing their large exposures. However, at times there is difficulty in ascertaining the nature of connections between borrowers, making it difficult to accurately determine the extent of banks' exposures to closely related borrowers.</p> <p>The NBM should increase the yield it obtains from currently available prudential reporting by developing a tool (to be used by both on- and offsite supervision) to extract and combine detail on large credits.</p>
Principle 11.	<p>Exposures to related parties</p> <p>In order to prevent abuses arising from exposures (both on-balance sheet and off-balance sheet) to related parties and to address conflict of interest, supervisors must have in place requirements that banks extend exposures to related companies and individuals on an arm's length basis; these exposures are effectively monitored; appropriate steps are taken to control or mitigate the risks; and write-offs of such exposures are made according to standard policies and processes.</p>
Description	<p>1. The LFI (art. 3) and Regulation No. 1/09 of November 30, 1995 on "Business Transactions, including Credit Extensions, with Banks' Affiliated Persons," set out detailed definitions of "affiliate of the legal entity". In essence, an "affiliate" is every person (natural and legal) that has a special relationship with the bank and the categories set out in the LFI (art. 3) and Regulation 1/09 closely track those in the footnote to the Core Principle. Beyond the comprehensive definitions, there is no capacity for the NBM to exercise discretion and deem a legal or natural person to be an "affiliate".</p> <p>2. The LFI (art.31) and Regulation No. 1/09 prohibit providing services to affiliates on preferential terms.</p> <p>3., 4. Banks are obliged to have adequate administrative and internal control procedures which allow supervision and management of the credit risk, as well as to keep under scrutiny loans granted to affiliates, to the bank's own personnel and to</p>

	<p>their families, within the regulatory limits prescribed. In addition, the bank must keep records of agreements contracted with affiliates. The records must be kept for at least five years from the date that the affiliate ceases to be so and/or discharges all obligations to the bank.</p> <p>In accordance with Regulation No. 1/09, any agreement with an affiliate must be previously approved by the majority of the members of the bank's Council (equivalent to a Board of Directors) and, where applicable, the affiliated individual must not vote directly or indirectly for the agreement in order to avoid a conflict of interest (LFI art. 24). For certain loans, up to Moldovan Leu (MDL) 250,000, there is provision for delegation of the Board's authority to the bank's Executive Body.</p> <p>The LFI (art.28) and Regulation No. 1/09 set the following maximum limits to credit outstanding to an affiliate and/or group of interrelated persons:</p> <ul style="list-style-type: none"> • the total credit outstanding to any affiliate and/or a group of his/its interrelated persons may not exceed 20 percent of the bank's Total Regulatory Capital; • the total amount of credits outstanding to all affiliates of the bank may not exceed the amount of the bank's Tier One capital. <p>When applying such limitations, credits made to the following entities are aggregated with those to the affiliate: "a) legal entities in which the affiliated person owns or controls ten percent or more of the capital, serves as an administrator, or is a subsidiary thereof; b) a legal entity that is under common control with an affiliate; and c) a legal or natural person to whom the affiliate issued a surety (warranty)" (Regulation No 1/09 Section III – Limitations)"</p> <p>The LFI (art. 24) requires bank administrators to present to the bank's Board of Directors a written notification that describes their conflicts of interest every year.</p> <p>Pursuant to the LFI (art.31) and Regulation No. 33/09-01 on Extension of Credit to Bank Employees, the following requirements regarding granting of loans by banks to their employees (except for affiliated individuals, as defined) are in force:</p> <ul style="list-style-type: none"> • for essential needs – a maximum of 10 "minimum wages" (per function) from the date that the loan is granted for up to 2 years; • for real estate investments – a maximum of 100 "tariff rates" (per function) from the date that the loan is granted, for up to 20 years; • the total debt for loans granted to bank employees should not exceed 10 percent of the Total Regulatory Capital; • the bank is required to establish an internal regulation regarding the criteria for granting loans to its employees; and • the bank must keep separate records for loans granted to employees. <p>7. Every month, in accordance with the Instructions on Preparation and Submission of Financial Reports, the banks provide the NBM information about loan granting to the bank's affiliates and to bank employees in compliance with the maximum limits prescribed. As noted in CP 10 Large Exposure Limits, pursuant to the Recommendations on Internal Control Systems Dec. No. 330 of November 9, 1998, a bank must have in place procedures that ensure provision of accurate information to management on the implementation of policies and procedures related to all credit operations, including those involving affiliates. Assessment of whether the bank's management information system is sufficiently robust to capture and aggregate exposures to "affiliates" and "groups of persons related to an affiliate" is established by</p>
--	---

	<p>on-site inspection. Similarly, confirmation is sought by inspection staff that the bank's risk management policies and processes quantify acceptable credit exposure to affiliates and provide that major exposures be subject to Board's review.</p> <p>5. The LFI (art. 1(f)) provides the NBM capacity to limit exposures to related parties and to require collateralization (art. 2(c)) of such exposures.</p>
Assessment	Materially Non-Compliant
Comments	<p>The NBM requires banks to have information systems to identify individual exposures to connected and related parties as well as the total amount of such exposures, and to monitor them through an independent exposures' administration process. Moreover, the NBM is able to require the necessary information concerning related parties. However, it does not receive all the necessary information to assess that banks' monitoring concerning lending to related parties is effective in identifying the beneficial borrower, especially in the case where foreign shareholders with less than a 10 percent shareholding are involved (see also Comments CP 10).</p>
Principle 12.	<p>Country and transfer risks</p> <p>Supervisors must be satisfied that banks have adequate policies and processes for identifying, measuring, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining adequate provisions and reserves against such risks.</p>
Description	<p>The Recommendations issued under Decision 188 of July 2006, covering the system of managing country risk and transfer risk by the banks, establish the basic principles that are considered by banks while issuing their own internal control systems that cover country and transfer risk management. In addition, the recommendations are a base for the bank's policies and procedures to eventually cover the type and scope of the banks' activities in the international field. The Recommendations also cover off-balance items related to the foreign exchange and cross-border exposures. The above Recommendation did not address the risk in the contingent accounts. In August 2007, a new Regulation was issued covering the potential risk exposure in contingent accounts. The new Regulation will be implemented in November 2007.</p> <p>NBM supervisors determine at an onsite examination whether the risk evaluation policies, practices, and procedures for country risk and transfer risk are adequate to bank management's decision-taking related to foreign currency transactions. The NBM supervisors verify that extension of credits in foreign currency for the export/import of goods, investments in foreign securities, placements with correspondent accounts at foreign banks are within bank's management established limits and verify that exposures are identified and monitored on an individual country basis. Based on the Regulation of August 2007, the NBM supervisors prior to yearend 2007 start to verify the enforcement of these policies and procedures.</p> <p>NBM supervisors, in the reports of examination indicate that banks perform scenario analysis and stress testing. In addition, the supervisors verify that the bank monitors and evaluates developments in countries in which it has activities or in which its customers are having business on the basis of established qualitative and quantitative criteria. Country analysis is conducted by the financial institution at least once a year.</p> <p>The bank is classifying countries by the risk classes pursuant to its own rating supplemented by such ratings as furnished by the international rating agencies. Reportedly, the bank's country ratings and the ratings of the international rating agencies are similar.</p> <p>The Regulation on classification of credits and conditional commitments and provisioning on asset losses and on conditional commitments losses (DCA no.224) issued on August 30, 2007, will come in force on November 30, 2007. The new</p>

	<p>Regulation complements the Regulation on Credit classification and allowance for loan losses first issued in June 1998 and last amended in June 2006 (Decision no.148). The BSRD supervisors report that the banks are finalizing the introduction of the provisions of the Regulation in their reporting systems. This Regulation will be applied by banks while classifying and provisioning off balance sheet items subject to credit risk. The Regulation specifies that: assets and/or conditional commitments of the bank that may be affected by circumstances and conditions existing in a foreign country, should be included in one of the following categories:</p> <p><u>Standard (2% reserve allocation)</u>: countries assigned by one of the international rating agencies- Standard & Poor's, Moody's and Fitch-IBCA- the rating from AAA/Aaa to A-/A3.</p> <p><u>Under supervision (5%)</u>: countries assigned by one of the rating agencies a rating ranging from BBB+/Baa1 to BBB-/Baa3.</p> <p><u>Substandard (30%)</u>: countries assigned by one of the international rating agencies the rating from BB+/Ba1 to BB-/Ba3.</p> <p><u>Doubtful (60%)</u>: countries assigned by one of the international rating agencies the rating from B+/B1 to CCC-/Caa3/C.</p> <p><u>Compromised (Loss) (100%)</u>: countries assigned by one of the international rating agencies the rating from CC/Ca/ DDD to R/C/D.</p> <p>The NBM conducted analysis and established its rating for the following countries: Germany, Romania, Russia, Ukraine, United Kingdom, and United States. Based on the external ratings, such as Moody's, S&P's and Fitch, the NBM established limits of exposure by countries. Limits were approved by the Council on February 26, 2007.</p>
Assessment	Largely Compliant
Comments	The banks are currently finalizing the implementation of the new Recommendation covering off balance sheet exposure in foreign currency that at most banks is minimal. The new regulation will also require additional training for bankers in order to ensure a thorough understanding of the concepts established in the Regulation.
Principle 13.	<p>Market risk</p> <p>Supervisors must be satisfied that banks have in place policies and processes that accurately identify, measure, monitor and control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.</p>
Description	<p>Article 26 of the LFI specifies that in order to be permitted to engage in foreign exchange transactions, provide financial and investment portfolio management services and enter in securities investments, banks must maintain a higher capital. The banks permitted to enter in this type of transactions must hold a B or C license category and are required to maintain a higher capital level, two times or three times respectively, the level of minimum required capital.</p> <p>Article 28 of the LFI and the Regulation on bank's open foreign exchange position establishes limits with regard to maintaining the bank's foreign exchange (FX) position. The FX position is calculated as the percentage ratio between the foreign exchange position (recalculated in MDL) and the bank's total regulatory capital. The NBM is monitoring the following:</p> <ul style="list-style-type: none"> the limits established for the foreign exchange position and the compliance of activities conducted by the bank with article 26 of the LFI; the analysis of the maturing margins depending on the sensibility of assets,

	<p>liabilities and contingent items to interest rates; and</p> <ul style="list-style-type: none"> Information covering off-balance sheet items that depend on certain eventual circumstances and which are not reflected in the balance sheet of the bank. <p>The recommendations covering the Internal Control Systems within the banks as amended July 2007, specify among other, that to address the Valuation risk, the financial institutions should ensure that:</p> <ul style="list-style-type: none"> assets held for dealing purposes are revalued on a regular basis at prices verified independently by dealers; the value of assets, liabilities, off-balance rights and obligations are regularly reviewed and assessed; and provisions and other adjustments are made against the mentioned assets in order to conform with current legislative provisions and normative acts of the NBM, accounting standards and the institution's accounting policies. <p>Stress testing is conducted by the BSRD supervisors on a quarterly basis for each bank, each group of banks, and the full banking system. This includes, among others, direct credit risk, indirect credit risk caused by foreign exchange risk, credit risk of credits to the energy and fuel industry, interest rate risk, liquidity risk.</p> <p>Within the framework of the Onsite Inspection manual, the BSRD supervisors determine the adequacy of the policies, practices, procedures and internal controls covering foreign exchange transactions. The supervisors verify that banks have established limits on their foreign exchange risk.</p> <p>The Recommendations on Internal control specify that the executive management of the financial institution should implement a relevant and efficient internal control system approved by the Council of the bank. The BSRD supervisors review that there are adequate systems and controls in place to ensure that all transactions in the money market area are captured on a timely basis, marked to market, and revalued on a daily basis.</p> <p>At onsite inspections the NBM supervisors ascertain that management has set market risk limits that are commensurate with the institution size and complexity and that reflect all material risks. A review of examination reports indicated that non-compliance with foreign exchange limits is detailed in the report of examination and management is requested to take corrective actions to avoid reoccurrence.</p> <p>Management of the banks and the BSRD supervisors indicate that derivatives or other sophisticated financial instruments are not yet used by the banks in Moldova.</p>
Assessment	Largely compliant
Comments	<p>Capital charge on market risk exposure should be implemented. The NBM has established suitable policies and procedures that clearly articulate roles and responsibilities related to identification, measuring, monitoring and control of market risk. The Regulations on banks' open foreign exchange positions, and on managing interest rate risk should be fully implemented, especially in the areas of scenario analysis and stress testing. The NBM should continue to promote adequate policies and practices for risk management, regarding risks that affect the banks' activity and should encourage the banks to perform stress testing covering these risks. Some banks indicated that, at the onsite examination of foreign exchange activities, the NBM supervisors emphasize the prudential review of documentation in the foreign exchange department during the onsite examination process. Furthermore, the NBM should dynamically adapt its stress testing methods and models to the changing</p>

	circumstances in the country.
Principle 14.	<p>Liquidity risk Supervisors must be satisfied that banks have a liquidity management strategy that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control liquidity risk, and to manage liquidity on a day to day basis. Supervisors require banks to have contingency plans for handling liquidity problems.</p>
Description	<p>The NBM requires banks to implement policies and practices for maintaining an adequate liquidity level. Art. 28 of the LFI and the Regulation on liquidity issued in September 1997, require banks to observe the following liquidity-related requirements: (1) the amount of the bank's assets with the reimbursement term of over 2 years should not exceed the amount of its financial resources for over 2 years (long-term liquidity) and (2) banks must maintain a short-term liquidity ratio of not less than 20% of the bank's total assets (current liquidity). The observance of these requirements is monitored on a monthly basis by the offsite supervisors and verified at least once a year by the onsite supervisors.</p> <p>The Regulation on interest rate risk management requires the bank's Board to approve the bank's own internal control systems and re-examine periodically (at least once a year) the policy on the interest rate risk management that should include the combined management of interest rate risk, liquidity risk, maturity risk, measures of the observance by the bank of the normative acts' provisions and the control of the policy achievement.</p> <p>The above requirements are monitored through monthly reports submitted by banks to the NBM and at the onsite examinations.</p> <p>At the onsite examination the NBM supervisors determine whether the bank's Board has established adequate policies, practices and procedures. In the event that the NBM supervisors consider that the policies, the practices and /or the processes of liquidity and interest rate risk management are insufficient, the BSRD supervisors indicate the matter in the report of examination and request their revision and modification.</p> <p>The Capital, Assets, Management, Earnings, Liquidity, and Sensitivity to interest rates (CAMELS) rating includes Liquidity as one of its 6 components. Banks are assigned a Liquidity rating score based on their liquidity condition as specified in the CAMELS method.</p> <p>Any significant foreign currency liquidity risk or a position in a foreign currency that is experiencing problems is criticized in the Liquidity component and management is required to take action in order to correct the problems. The analysis of the CAMELS liquidity component compels the NBM supervisors to review the bank's liquidity management strategy and policies and processes for managing liquidity risk and to determine that the bank has contingency plans in place for handling possible liquidity problems and that management has established policies and processes to monitor, control and limit liquidity risk.</p> <p>The Regulation on oversight of automated Interbank payment system set general principles on liquidity and operational risks management, and the way participants' supervision to the automated Interbank payment system is performed.</p> <p>Based on Art. 28 of the LFI and according to the Regulation on banks' open foreign exchange position, banks are obliged to observe certain limits established with regard to maintaining their daily foreign exchange positions. Based on the daily and monthly reports submitted by banks, the supervisors verify the observance of the</p>

	<p>limits established by NBM, as well as the positions to the main foreign currencies traded by the bank. (euro, U.S. dollar, Russian ruble).</p> <p>All banks are required to establish an Asset Liability Committee (Committee). The NBM supervisors assess the activity of the Committee and the process of managing assets, liabilities, and off-balance sheet items, in order to determine whether the bank is able to cover efficiently the anticipated and potential liquidity needs.</p> <p>The Regulation on Oversight of Automated Interbank Payment system sets general principles on liquidity and operational risk management and the manner the banks should perform the supervision of the automated Interbank payment system.</p> <p>The BSRD Manual of examination requires that the bank supervisors verify that the bank's Board has established policies, practices and procedures related to liquidity and to a financing plan for contingent situations.</p>
Assessment	Largely Compliant
Comments	The NBM's onsite inspectors should ensure that banks undertake effective analysis of risk under currently valid, alternative stress test scenarios
Principle 15.	<p>Operational risk</p> <p>Supervisors must be satisfied that banks have in place risk management policies and processes to identify, assess, monitor and control/mitigate operational risk. These policies and processes should be commensurate with the size and complexity of the bank.</p>
Description	<p>The Recommendations on the internal control systems issued originally in November 1998, and last amended in July 2007 require banks to have in place their own internal risk control system. This includes policies and instructions covering the operational risk management and has as objective the prudent management of all business activities. The internal control system should be appropriate to the business of the institution and comply with the activity's structure, organization, and management, with the type of transactions and commitments, volume, number, and complexity.</p> <p>According to the above Recommendations, the bank's Board is obliged to approve and review periodically (at least once a year) the bank's policies. Art.18 of LFI specifies that the bank's Board has the function of supervising, updating, and ensuring the bank's policy enforcement. The Recommendations stipulate management's responsibility to revise, manage, control, and implement the appropriate policies.</p> <p>The supervisors verify that the executive management of the financial institution is responsible for the implementation of and adequate and efficient internal control system, approved by the Board of the financial institution.</p> <p>At the onsite examinations the BRSD supervisors determine whether the bank's Board established adequate policies, practices, and procedures with regard to the risks the bank is involved in, including the operational risk, and whether these procedures are being adequately enforced. At the same time, supervisors determine whether the bank has in place procedures ensuring the continuity of the bank's activities. The NBM supervisors also evaluate the bank's policy related to data keeping, information technology (IT) procedures, and the bank's recovery plan in case of a breakdown. In the event the supervisors are not satisfied with the scope of the policies or their implementation, specific comments are made in the report of examination and management is requested to implement corrective measures.</p> <p>When required, personnel of other areas of the NBM (primarily foreign exchange and IT) participate in a full scope examination of banks and work together with the SD</p>

	<p>supervisors. In order to carry out the analysis of banks' data center systems, specialists of the NBMs IT Department participate in the onsite inspections and review the procedures in place that ensure the continuity of activities, the IT systems, and networks administration, IT audit, IT management, and the bank's policies covering informational security, physical security, staff security, etc.</p> <p>According to the Recommendations on the internal control systems, banks are obliged to have in place procedures ensuring the regular and timely submission of the accurate information to the bank's management; procedures of identifying, reporting, and solving infractions or violations (e.g., limit excess); systems detecting the positions which are in excess of the admissible limits, in order to facilitate management's steps to address any problems or deficiencies. In addition, the bank is required to have in place procedures of planning, licensing, and initiating new types of activities, including a description of management's and the Board's understanding of the involved risk.</p> <p>The NBM supervisors indicate that none of the banks in Moldova has as of now entered into an outsourcing arrangement.</p> <p>The Regulation on oversight of the automated Interbank payment system sets general principles on liquidity and operational risks management, and the way participants' supervision to the automated Interbank payment system is performed.</p> <p>All criteria are generally met for this principle.</p>
Assessment	Compliant
Comments	
Principle 16.	<p>Interest rate risk in the banking book</p> <p>Supervisors must be satisfied that banks have effective systems in place to identify, measure, monitor and control interest rate risk in the banking book, including a well defined strategy that has been approved by the Board and implemented by senior management; these should be appropriate to the size and complexity of such risk.</p>
Description	<p>The Regulation on Managing interest rate risk issued in September 1999 specifies that because of existing differences among banks, each bank is required to develop its policy on management of interest rate risk according to its individual conditions. In order to ensure an efficient management of interest rate risk, the policy must include fundamental elements, such as appropriate supervision of the bank council and the executive function, as well as a complex process of risk management, which establishes, evaluates, and supervises the risk in an efficient way.</p> <p>The bank's Board should approve and re-examine periodically (at least once a year) the policy for interest rate risk management. This policy should include the combined management of interest rate risk, liquidity risk, maturity risk, measures of the observance by the bank of the regulatory acts provisions, and control of the policy's implementation.</p> <p>Also, the bank must create an appropriate system of information, which will ensure the receipt of complete and opportune information by the committee on assets and liabilities management in order to accomplish its obligations in compliance with this Regulation.</p> <p>In compliance with the instructions of the onsite Manual of Examination, at the onsite inspection, the NBM supervisors determine whether the bank's Board has established adequate policies, practices, and procedures and that any models or assumptions are validated on a regular basis.</p> <p>The NBM supervisors require that the banks periodically perform appropriate stress</p>

	<p>tests to measure the vulnerability to loss under adverse interest rate moves. In the event that the NBM supervisors consider that the policies, practices, and /or processes of liquidity and interest rate risk management are insufficient, the NBM requests their revision and modification.</p> <p>The bank's Board must review at least once a year the policy of assets and liabilities management, which determines whether the limits established for the bank's exposure to interest rate risk are in compliance with the current situation, taking into consideration the size of the total regulatory capital. Banks also prepare periodically, at least once per quarter, reports which reflect the observance of the limits of risks established by the bank's Board, including details of all exceptions from the Board's policy. In addition, they also determine the necessary size of the Total Regulatory Capital required to cover the interest rate risk exposure. These reports are submitted to the Board, the executive body, and /or the committee of assets and liabilities management.</p> <p>Banks with a higher level of exposure to interest rate risk and/or inadequate methods of risk management are required by the NBM to take corrective measures. These measures may include, depending upon the situation and the conditions existing in the bank, requirements to increase the Total Regulatory Capital, upgrade management's knowledge, improve the information and assessment systems, reduce the level of exposure to risk, or combine all these measures.</p> <p>The Regulation on interest rate risk management also specifies that the bank's Board must approve and re-examine periodically (at least once a year) the policy on interest rate risk management, which includes the combined management of interest rate risk, liquidity risk, maturity risk, measures of the observance by the bank of the normative acts provisions, and control of the policy achievement.</p> <p>In addition, and as required by the Regulation on interest rate risk management, the bank is required to submit regularly (at least once per quarter or more frequently) reports which reflect the bank's exposure to interest rate risk and submit them to the Board, the executive body and /or the committee of assets and liabilities management. These reports must include an analysis of maturity margins. Whatever system is used, it should include all the essential positions of the interest rate within the bank, all respective information on re-evaluation and maturities, and suggestions and well-grounded methodologies. The system should include an analysis of risk in the event of "worst possible case" scenario. The Regulation also specifies that in the event the BSRD supervisors determine that the bank has a high level of exposure to interest rate risk, or it has implemented an inadequate method of risk management, the NBM will prescribe the necessary remedial measures.</p> <p>The management of the smaller banks is of the opinion that their current activities, taking deposits, and granting short term loans, do not warrant the costs involved in the implementation of sophisticated risk measure systems.</p> <p>The three criteria for this core principle are generally met.</p>
Assessment	Compliant
Comments	
Principle 17.	<p>Internal control and audit</p> <p>At the onsite examination the NBM supervisor ensure that banks have in place internal controls that are adequate for the size and complexity of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent internal audit and</p>

	compliance functions to test adherence to these controls as well as applicable laws and regulations.
Description	<p>According to Art. 18 of LFI, the bank's governing body is represented by the general meeting of shareholders, the bank's Board, the executive body and the Audit Committee (AC).</p> <p>According to Art. 17, 18, 19, 20, 25, 29, 33 of the LFI and the Recommendations on internal control systems, the responsibilities of the bank's Board and of the executive body are well defined. Thus, the bank's Board is responsible for the periodic approval and review, at least once a year, of an adequate internal control system. The executive body is responsible for the implementation of an adequate and efficient internal control system, approved by the Board of the financial institution, while the AC is responsible for the oversight of the banking activity.</p> <p>Each institution must include within its own control systems and procedures at least the following objectives: organizational and administrative controls; management methods; segregation of functions and duties; procedures of authorization, approval, record keeping, protection, and evaluation.</p> <p>The NBM supervisors evaluate whether the internal control system of the bank represents an adequate and efficient system of measures, regulations and restrictions to comply with bank's management policies. The NBM supervisors take into account the transactions' volume, number, and type, the operations' diversity, the risk level associated with each field of activity, the frequency of controls conducted by the management with regard to the daily activity, the degree of centralization and decentralization, as well as the degree and the methods of electronic database processors to determine that internal controls are adequate to the nature and scale of the bank's business.</p> <p>Recommendations on the internal control systems stipulate requirements with regard to the bank's operational activity, independence of the internal audit function and direct reporting to the bank's Board by the AC. The AC supervises the internal audit, maintains relations with external auditors and informs the bank's Board accordingly. The financial institution's Board is responsible for the periodic approval and reviewing, at least once a year, of internal control systems, including the reporting requirements required by the NBM, as well as the internal normative documents. The Board is responsible for the approval of internal regulations in all fields of activity.</p> <p>Article 75 of the LNBM and Article 38 of the LFI grant to the NBM the right to apply supervisory and remedial measures in cases where: (a) the bank, its owners or administrators do not comply with the LFI, the NBM normative acts, the licensing conditions, and the fiduciary commitments; and (b) where the above-mentioned individuals are engaged in risky or doubtful operations, failed to report, reported with delay, or reported with erroneous data with regard to banking prudential indicators or other requirements provided for in the NBM normative acts, and did not observe the remedial measures applied by the NBM.</p> <p>Art. 38 of the LFI grants, among other, the authority to the NBM to revoke, in very serious cases, the confirmation given to the bank's administrators or the withdrawal of the bank's license. The NBM may also impose fines to the bank and dismiss one or more administrators.</p> <p>Within its internal control systems, the bank is required to segregate the following functions: authorization, execution, custody, and registration. In addition, a financial institution must have in place the necessary procedures in order to ensure: (1) the responsibility of different persons for keeping registers, for physical custody of assets,</p>

	<p>and authorization, initiation, and general supervision of transactions and assumed commitments; (2) the segregation in such a manner that none of the employees may deliberately or unintentionally appropriate assets illicitly, make a false statement with regard to liabilities or make incorrect entries of transactions without being tracked down. The Recommendations on the internal control systems include a very detailed breakdown of the functions of the internal auditor.</p> <p>The NBM supervisors evaluate whether the internal audit fulfils its functions related to: (1) the supervision of the financial and operational risk; (2) the analysis of the bank's internal control system and the observance of these controls; (3) ensuring that all procedures worked out for transactions processing are verified accordingly; (4) ensuring that the bank observes all applicable laws, the NBM regulations and requirements, as well as the bank's internal procedures; and (5) prevention and detection of frauds and crimes, including money laundering. At the annual onsite inspection the BSRD supervisors ensure that the internal audit function is well-trained and adequate for the size of the bank under examination.</p> <p>The scope of the NBM's inspection includes: (a) a determination of the adequacy of the resources of the internal auditing department and their expertise in understanding and evaluating the various areas of the bank that they are auditing; (b) adequate independence of the internal audit including reporting lines to the Board; (c) access and communication with any member of the staff and full access to records and files of the bank and its affiliates; (d) employs a methodology that identifies the material risks of the bank; and (e) preparation of an audit plan based on its own risk assessment.</p>
Assessment	Compliant
Comments	
Principle 18.	<p>Abuse of financial services</p> <p>Supervisors must be satisfied that banks have adequate policies and processes in place, including strict "know-your-customer" rules, that promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities.</p>
Description	<p>According to Article 8 of the Law of the Republic of Moldova on Money Laundering, Prevention and Combating Terrorism (AML Law), the NBM is required to determine that the banks establish written policies, practices, and procedures, including strict know-your-customer rules aiming to promote ethical and professional standards in the financial area and prevent the deliberate or non-deliberate use of banks by criminal elements and to determine if financial organizations comply with their own policies, practices, and procedures directed to detection of money laundering activity.</p> <p>The NBM issued Recommendations in May of 2002, last amended in July 2007, on developing programs by banks for the prevention and combat of money laundering and terrorism financing. The NBM considered among other, the provisions of the Basel Committee documents and general accepted principles on the international field of money laundering combating such as the 40 + 9 Financial Action Task Force on Money Laundering recommendations. These recommendations include specific guidelines for banks regarding the developing of own money laundering preventing and combating terrorism programs.</p> <p>The above Recommendations establish minimal requirements regarding the administration responsibility, the structure of the money laundering prevention and combating program, the "know your client" rules, procedures related to on-going monitoring of accounts and transactions, procedures regarding the keeping and storage of information, a system to ensure that it is conforming with the money laundering prevention and combating program, and suspicious operations reporting.</p>

	<p>The financial institution's Board and Executive Committee are responsible, within their fields of competence, for the compliance activity of the financial institution with the provisions of the legislation in force for the prevention and combat of money laundering and terrorism financing.</p> <p>According to the recommendations of the AML law, banks are obliged to report to the CFECC and to the NBM information on suspicious operations. In addition, the financial institutions should not establish a banking relationship until the identity of the new customer is verified. All information necessary for the adequate identification of each new customer, including the purpose and the nature of the business relationship, should be obtained. Financial institutions should be required to identify the beneficial owner, and take reasonable measures to verify the identity of the beneficial owner, using relevant information or data obtained from a reliable source. Special attention should be paid in the case of nonresident customers. Financial institutions should not maintain or open anonymous accounts or fictive name accounts. Decisions to enter into business relationships with higher-risk customers should be taken exclusively at the management level.</p> <p>Article 1.9 of the Instruction on opening foreign accounts abroad indicates that Moldovan bank should determine the foreign bank's physical location and its relevant supervising authority.</p> <p>In order to comply with the Recommendations on developing programs by banks on prevention and combat of money laundering and terrorism financing, banks must establish procedures for the on-going monitoring of accounts and transactions to have in place adequate management information systems to provide management and compliance officers with information needed to identify, analyze, and effectively monitor higher risk customer accounts. A senior bank officer should be appointed to be in charge of the prevention and combat of money laundering and terrorism financing in each bank.</p> <p>Financial institutions should follow adequate screening procedures to ensure high standards when hiring employees and should establish a permanent training program on anti money laundering procedures.</p> <p>The AML Law establishes that financial institutions and their employees must be exempt from moral, administrative, civil, and legal responsibility for property or moral damages as a result of compliance with the provisions of this law.</p> <p>According to Art. 8 of the AML Law, in order to combat money laundering, the authorities that control the legitimacy of operations carried out by financial organizations and are be obliged to:</p> <ul style="list-style-type: none"> (a) Submit to the CFECCP information documents, materials, and other data regarding individuals or legal entities practicing money laundering activities. This information is based upon operations where the financial organizations know or should have known about the illegal origin of income, this information can be inferred from objective factual circumstances. (b) Provide to the CFECCP, the criminal investigation authorities, prosecution authorities, and courts information (documents, materials, other data) about the results of their check-up of individuals and legal entities on the matter of receipt of illegal monies or assets, as well as provide the required support to the above mentioned authorities in the process of examination of the criminal investigation materials or criminal prosecution. <p>In June 2005, a Collaboration Agreement between the CFECCP and the NBM was</p>
--	--

	<p>signed in order to verify the compatibility of banks' activity with the legislation in force and with the standards of the money laundering prevention field, participate in the onsite inspections performed. The NBM has issued agreements regarding collaboration in the banking sector with bank supervisory authorities from central banks of Belarus, Romania, Russia, and the agency of the Republic of Kazakhstan on financial market and financial institutions regulation and supervision. In addition, an agreement covering collaboration in the field of financial and banking information and research was signed with the central bank of Kazakhstan.</p> <p>The NBM is currently in process of revising its Recommendation to the banks in the AML area.</p>
Assessment	Largely Compliant
Comments	<p>The assessment is applicable only to the 12 criteria of CP 18, covering the adequacy of policies and processes in place at the banks.</p> <p>Banks should have in place a system that ensures that non-customers using exchange facilities at more than one branch on the same day in exchanging foreign currency below US\$5,000 equivalent, are properly identified in order to ensure their transactions do not exceed the legal limit for exchanging foreign currency.</p>
Principle 19.	<p>Supervisory approach</p> <p>An effective banking supervisory system requires that supervisors develop and maintain a thorough understanding of the operations of individual banks and banking groups, and also of the banking system as a whole, focusing on safety and soundness, and the stability of the banking system.</p>
Description	<p>Articles 44, 47 of the LNBM and Articles 37, 53 of the LFI allow the NBM to conduct onsite examinations and request direct information from the banks, with the purpose of evaluating the financial position of banks and their compliance with provisions of the legislation in force.</p> <p>At least once a year, banks are subject to a full scope or target examination carried out by the NBM inspectors. At these inspections, supervisors review the documentation of the bank and ascertain the accuracy of the financial reports submitted by the bank to the NBM. In addition, the supervisors review the bank's compliance with the legislation in force, including the compliance with the regulations and recommendations issued by the NBM.</p> <p>The NBM issued Instructions on compilation and submission of financial reports by banks, which detail the reports that should be submitted to NBM and establish the system according to which the reports should be completed.</p> <p>Periodically (monthly, quarterly, per semester) commercial banks submit 20 financial reports that reflect the bank's management, operations, liquidity, profitability, and yield. At the same time, according to the Regulation on open foreign exchange position, banks submit monthly the report on open foreign exchange position. According to art. 44 and art. 47 of the LNBM, the NBM, is empowered to require necessary additional information in case there are certain bank risks highlighted in the reports. Currently, an additional set of reports related to credits to the wine making industry was also requested.</p> <p>This information is used to supervise the performance and the credit situation of the bank and determine the frequency and scope of onsite controls. At the same time, the supervision based on reports, is performed in order to determine the progress, or lack thereof, reached on problems that were discovered during the onsite examinations.</p> <p>Based on the data contained in the financial reports submitted by banks, the NBM</p>

	<p>performs the analysis of current development trends in each bank and of the whole banking system. In order to prepare this analysis, the offsite bank supervision system utilizes a computerized BOSS system. After the analysis is completed, a monthly report covering the financial position of the banking system is prepared for review by the CA of the NBM. In the event a negative trend in the bank's activity is detected, the CA approves a decision covering the enforcement measures to be taken in order to improve the financial position of the bank.</p> <p>The reports of the BOSS system also compare banks' performances or negative trends with the group of peer banks and with the banking system as a whole.</p> <p>At the onsite inspections the NBM inspectors verify the accuracy of the financial reports submitted by the banks to the NBM.</p> <p>In one case, a material adverse development was not immediately reported by a bank's management to the NBM.</p>
Assessment	Largely Compliant
Comments	<p>The BSRD should require banks to notify the NBM promptly of substantive change in their overall condition or of any materially adverse change, including breach of legal or statutory requirements.</p> <p>The NBM should consider introducing an early warning system that would enhance the abilities of the central bank to intervene in a timely and effective manner in response to potentially disruptive capital movements. The necessary information to implement an early warning system is already available at the NBM. NBM staff dealing with the analysis of capital flows should be able to draw the attention of management to large inflows or outflows early enough for monetary policy instruments to work. The supervisors and staff of the departments responsible for monetary policy decisions, reporting, currency controls, and financial sector supervision could meet monthly in order to exchange information and make operational recommendations.</p> <p>The early warning system should include the regular monitoring of at least the following data: (a) the detailed daily foreign exchange transactions of banks with nonresidents, undertaken both on their own account and on the account of clients; (b) exchange rate movements of the leu against the convertible and important nonconvertible currencies; (c) the net open position of banks; (d) correspondent account balances of banks held abroad; (e) external reserves of the NBM; (e) the balances of other resident accounts held abroad; (f) data on securities transactions of residents with nonresidents and residents abroad; (g) the unhedged positions of borrowers, as reported by banks; (h) borrowing in leu by enterprises/individuals for purchasing foreign exchange for non-trade transactions; (i) external vulnerability indicators, especially indices of short-term debt, including short-term debt incurred by the country, by the banking system, as well as by the corporate sector; in addition, the committee could also examine indices of short-term debt compared to imports, as well as to portfolio inflows; (j) margins between domestic and international interest rates; (k) Any other relevant data, updates of relevant issues in the banking system, including data on the soundness of the banking system, on individual banks, important regulatory developments, privatization, bank resolution, etc.</p>
Principle 20.	<p>Supervisory techniques</p> <p>An effective banking supervisory system should consist of on-site and off-site supervision and regular contacts with bank management.</p>
Description	A combination of onsite inspections and offsite monitoring process allows the NBM to continuously monitor and track changes in the risk profile of a bank. In general, a full scope onsite examination is conducted for all banks. Target examinations for individual banks are largely driven by their risk profile. Banks that pose a greater

	<p>concern to the BSRD supervisors are subjected to more frequent targeted onsite examinations.</p> <p>The NBM implements its supervisory functions through the BRSD that is headed by a director who reports directly to a deputy governor reporting to the governor of the NBM. For the purpose of effectively supervising banks, the BRSD is organized in two divisions: BRL and BSC. The Banking Activity Control Section (onsite examinations) is a section of the BSC Division; and the Reporting Section (offsite analysis) is a section of BRL Division. Two more Sections, the Licensing Section and the Methodology and Rating Section are part of the BRL Division. An Economic Analysis Section is part of the BSC Division. The staff of the BSRD totals 42.</p> <p>Articles 44 and 47 of LNBM and Art.37 of LFI, grant powers to the NBM to conduct onsite examinations and offsite control in order to evaluate the financial condition of the banks and ascertain their compliance with the legal provisions. The NBM is empowered to require from bank's administrators, employees, agencies, and branches any information regarding the activity and operations performed.</p> <p>The offsite supervision is performed on the basis of financial reports that are periodically submitted by the banks. In order to evaluate the financial situation of the bank and of its branches, banks submit to the NBM, in accordance with regulations, reports on management, operations, liquidity, and profitability of their branches, on an individual as well as on a consolidated basis.</p> <p>The onsite supervision is carried out primarily on an annual basis through a full scope examination for each bank. However, in the event that a bank becomes under special supervision, onsite target examinations are conducted as required.</p> <p>The NBM's Regulations and guidelines for appropriate onsite and offsite supervision are in place.</p> <p>The onsite inspection procedures are well documented in a comprehensive Manual. This manual specifies that, among others, the onsite supervisors are required to: (a) analyze the actions taken by bank management to address the recommendations made at the previous inspection; (b) evaluate the quality and performance of the Council and of management—this includes evaluation of management and supervision level of the council, sufficiency of bank policies, management competence of the bank, management succession; (c) issue a general conclusion of the quality of the bank and its management; (d) assign to each bank a rating covering CAMELS; and (e) determine the need for improvement and remedial actions or more intensive supervisory attention. The onsite examinations provide independent verification that adequate corporate governance (including risk management) is in place at individual banks, determine that information provided by banks is reliable, and monitor the bank's follow-up on supervisory concerns.</p> <p>The BRSD forwards the findings of the onsite examination, which includes an assessment of the quality of the Board and of management, in a written report that is discussed with the management of the bank. In addition, senior management of the BRSD maintains sufficiently frequent contacts with the banks' Board, senior management and the AC. Contacts with outside auditors occur primarily during the onsite examination.</p> <p>The outside auditors indicated that with the exception of the onsite examination phase of a bank, their contacts with the BRSD examiners are minimal.</p>
--	--

	A brief review of three of the latest reports of examination indicates that the onsite examiners are doing a competent job in providing an objective evaluation of the quality of an institution and identifying areas where corrective action is required to strengthen the bank. The evaluation of the various components used to analyze the financial institutions is a mix of quantitative and qualitative judgment. The onsite inspection includes a review of the AML process in place at the bank.
Assessment	Compliant
Comments	
Principle 21.	Supervisory reporting Supervisors must have a means of collecting, reviewing and analyzing prudential reports and statistical returns from banks on both a solo and a consolidated basis, and a means of independent verification of these reports, through either on-site examinations or use of external experts.
Description	<p>Article 44 of the LNBM and Articles 37 and 40 of the LFI, empower the NBM to require regulatory financial reports, conduct onsite inspections of commercial banks, as well as examine registries, documents, internal operational reports, management information reports, and the way the bank complies with regulatory legislation in force. Additionally, the NBM is empowered to require that bank's administrators, employees, agencies, and branches provide complete information regarding the activity and operations performed.</p> <p>Banks perform and submit to the NBM reports on management, operations, liquidity, profitability, individually by branch as well as consolidated for the bank as a whole, in order to evaluate the financial situation of the bank and its branches.</p> <p>In the event the banks' reports contain discrepancies and/or significant errors, the NBM requires banks to modify, correct, and resubmit them. The requirements for content and periodicity of financial reports are similar for all banks; this gives the possibility for an adequate comparison among banks. The instructions to the report clearly describe the accounting standards to be used in preparing the supervisory reports.</p> <p>The information thus provided is used to supervise the performance and the situation of the bank and determine the frequency and necessity of onsite inspections. At the same time, offsite supervision, based on reports, is performed in order to determine the progress or lack thereof in handling the problems discovered during the onsite examination.</p> <p>The banks submit to the NBM their annual financial report following its approval by the general stockholders' meeting. This report includes the adjustments recommended by the external auditors.</p> <p>According to art. 25(1) of the LFI, financial institutions must conduct their administration and operations in accordance with sound administrative and accounting procedures, the requirements of the law, and the regulations issued by the NBM. Based on art. 29 of the LFI, financial institutions prepare and maintain at the head office daily records of their operations and financial situation, including accounting records detailing clearly and correctly the state of business affairs, explaining its transactions and financial position, and records for each customer of the financial institution.</p> <p>According to art. 33 of the LFI, financial institutions must maintain at all times accounts and records and prepare periodic financial statements to reflect their operations and financial condition in accordance with consistently maintained sound accounting practices and according to the Instruction on the compilation and submission of</p>

	<p>financial reports by banks. These reports are submitted monthly to the NBM.</p> <p>Banks are required to comply with the National Accounting Standards which reflect the accounting rules and principles that are based on international practice.</p> <p>The Regulation on equity investments of banks in legal entities specifies that banks are required to submit financial reports (balance sheet and income (loss) statement) of the legal entities where they hold 25 percent or more of the capital of the entity.</p> <p>Based on Article 34. of LFI on External Audit and Regulation on the procedures for the preparation and submission of audit reports, banks are required to appoint an independent external auditor, accepted by the NBM, who will:</p> <ul style="list-style-type: none"> • assist the bank in maintaining proper accounts and records in the manner established by the NBM; • prepare an annual report together with an opinion as to whether the financial statements of the institution present a full and fair view of the financial condition in accordance with the provisions of this Law; • review the adequacy of internal audit and control practices and procedures and make recommendations for improvement; and • report to the NBM any fraudulent act by an employee of the bank or of the bank's branch offices and any irregularity or deficiency in its administration or operations that could result in a material loss for the bank or its branch office.
Assessment	Largely Compliant
Comments	The NBM has not issued guidelines as to the implementation of consolidated supervision within Moldova. The current legislation does not codify the possibility for conducting supervision on a consolidated basis. Also, the NBM's supervisors do not have the authority to request and obtain information on the makeup of a banking group or bank holding company and analyze the activities of the legal entities constituting them when such entities are non-financial companies.
Principle 22.	<p>Accounting and disclosure</p> <p>Supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with accounting policies and practices that are widely accepted internationally, and publishes, on a regular basis, information that fairly reflects its financial condition and profitability.</p>
Description	<p>1. The LIF (art. 29 e) makes mandatory that a bank "shall prepare and maintain at its head office accounting records exhibiting clearly and correctly the state of its business affairs, explaining its transactions and financial position:" and assigns (Art. 20(2)) to the AC (appointed by the shareholders and with a majority of its members <u>not</u> employed by the bank) responsibility to establish appropriate accounting procedures and accounting controls for the bank in accordance with applicable NBM Regulations, to supervise compliance with such procedures and to audit the bank's accounts and records. (The latter function may be delegated to an "audit company" (LFI Art.21)). The NBM has power to take action (LFI Art. 38(1)) against AC members in their capacities as "administrators" for failure to comply with requirements of the LFI and NBM Regulations.</p> <p>2., 3., 5. Banks ' accounts and financial statements, external audit requirements and publication of the bank's balance sheet, auditor's opinion and annual report are addressed in the LFI (Arts. 33, 34 and 35). A bank is required to "maintain at all times accounts and records and prepare periodic financial statements to reflect (its) operations and financial condition in accordance with consistently maintained sound accounting practices (LFI: art. 33(1))". Moreover, a bank's "accounts and financial statements shall be in accordance with accounting standards as established by the</p>

	<p>NBM respecting the preparation of the (bank's) accounts, including creation of appropriate provisions for bad and doubtful assets and timing of income receipts. The accounts, records and (bank's) statements shall also reflect the operations and financial condition of its subsidiaries and branch offices, both on an individual and on a consolidated basis (LFI: arts. 33(2) and (3))."</p> <p>A bank's independent external auditor "shall...prepare an annual report together with an opinion as to whether the financial statements present a full and fair view of the financial condition in accordance with the provisions of the (LFI)(LFI: art. 34 c))" and the bank shall "within four months of the end of its financial year, publish in the newspapers of general circulation.....its balance sheet and external auditor's opinion, and publish its annual report and provide copies to the public without charge (LFI: art.35)".</p> <p>The NBM has power to take action (LFI: art. 38(1)) if it determines that a bank or any of its owners or administrators have violated the LFI or NBM Regulations, including "failure to report; late reporting; reporting of erroneous data on banking prudential indicators or other requirements provided in the normative acts of the NBM". (As respects "Normative Acts of the NBM", these are "decisions, regulations, instructions and directives" which the NBM has the right to issue to implement its authority (LNBM; art. 11). Their observation is obligatory for those subject to them.)</p> <p>4., 5. The LFI (art. 40) provides a very broad power to the NBM: "For the purpose of supervision and regulation of the financial institutions (<i>sic</i>) activities, the NBM is empowered to issue such regulations, to control such institutions, to examine such accounts, books, other documents, and to take such other action to give effect to the provisions of the (LFI)" (emphasis added). This power appears sufficiently expansive to give the NBM the capacity to establish the scope of external audits and the standards to be observed in their conduct. Currently, the "Regulation on the Procedures for the Preparation and Submission of Audit Reports" (October 2, 1997, as amended on March 25, 1999 and June 3, 2004) provides (Section III.2: Audit Procedures) that " Audits shall be conducted in accordance with "International Standards on Auditing" and "National Accounting Standards" of the Republic of Moldova elaborated based on those international standards".</p> <p>At present, such areas as derivatives and asset securitizations are not significant enough to require coverage in the course of an audit of a bank. However, areas such as loan portfolio, loan loss reserves, non-performing assets, and asset valuations do receive coverage by auditors (almost totally local representatives of the "Big Four" international accounting firms). Moreover, the Regulation requires (Section III.2: Audit Procedures) that:</p> <p>"The "Management Letter" in accordance with audit standards is a document from the auditor addressed to the Council (i.e., Board) of the bank regarding internal controls and operating procedures of the bank, which were addressed during the audit. It is the prerogative of the auditor to mention any matter, which in the auditor's opinion should be brought to the attention of the Council (i.e., Board) of the bank. At a minimum, the Management Letter should meet the following requirements:</p> <ul style="list-style-type: none"> (1) provide comments and observations on the accounting records, operating systems, and internal controls that were examined during the audit; (2) identify specific deficiencies and areas of weakness in operating systems and internal controls, and make recommendations for their improvement; (3) communicate matters that have come to the auditor's attention during the audit which might have a significant impact on the operations of the bank, including any fraudulent act by an employee of the bank; and
--	---

	<p>(4) bring to the attention of the Council (i.e., Board) of the bank any other matters that the auditor deems to be pertinent."</p> <p>6. The LFI (art. 34(1)) provides that "Banks shall appoint an independent external auditor, accepted by the NBM (emphasis added). " The Regulation on the Procedures for the Preparation and Submission of Audit Reports" (Section VI: Appropriate Measures) provides that: "Pursuant to art. 38 of the LFI and art. 75 of the LNBM, the NBM may apply sanctions to banks and not accept future appointment of an independent external auditor by the banks which does not comply with the provisions of the LFI and this Regulation (emphasis added). The NBM will inform a bank and its audit company (accounting expert or certified accountant) of any objections resulting from its review of the Audit Report, Auditor's Opinion, Management Letter, and compliance with the provisions of the LFI and this Regulation, and will require an explanation and correction of violations that occurred during the audit process."</p> <p>7. The National Accounting Standards (see 4., 5., above) were developed on the basis of IAS in the period 1996-1998, but are now largely obsolete in light of IFRS (incorporating IAS not yet reflected in the National Accounting Standards) which have acceptance worldwide. (The National Standards of Auditing, developed in 2004, closely approximate the International Standards in Auditing (ISA)). The Accounting Law of April 2007 requires that all "public interest entities" (PIEs)—including banks—must maintain their financial accounts and prepare their financial statements in accordance with the IFRS. For banks, this requirement will come into force for financial years beginning in the year January 1, 2009. Provided that implementation is achieved in timely fashion, Moldova will be able to meet the requirements of this criterion when audited financial statements are produced in 2010.</p> <p>8., 9. Requirements for financial reporting are set out in the LFI, related Regulations and National Accounting Standards "Disclosures - Financial Statements of Banks and other Financial Institutions".</p> <p>Under the LFI (arts. 33 and 34) and related Regulations, banks must issue and submit financial statements to the NBM within four months after year-end. If the bank's assets exceed 20 million Moldovan lei, those financial statements are subject to external audit and the bank must also publish an abridged version of its balance sheet in a newspaper of wide circulation and make the financial statements available free of charge to the public upon request. Moreover, the bank is subject to quarterly reporting and public disclosure, including disclosure of its financial statements, detailed information on loans and deposits, and various financial ratios.</p> <p>The NBM's Regulation on Public Information on Financial Activity by Commercial Banks of December 2000 notes in Section IV-6 " Qualitative Characteristics of Transparent Information" that: "The information presented to the public shall be transparent, showing the real situation of the bank, as to allow the public to promptly assess the bank's financial state, obtained results, operational activity and related risks." Section IV-8 further provides that: "The published information (data) shall be authenticated by the signature of the bank's manager (in case when it is developed on the basis of accounting information- by the chief accountant, as well."</p> <p>Section VI-13 "Publishing of Information on Financial Performance" states that:</p> <p>"The bank shall quarterly publish the information on its financial activity as follows:</p> <ul style="list-style-type: none"> • The accounting balance sheet, income statement developed in compliance
--	---

	<p>with the instruction of the NBM on the way of compiling and submitting reports by banks) worked out in dynamics - current period and end of year preceding reported year.</p> <ul style="list-style-type: none"> The amount of the bank's regulatory capital; risk-based capital adequacy; the bank's liquid assets; liquidity ratio; interest bearing assets to total assets; total value of large exposures; total value of exposures to affiliated persons and/or group of persons acting in common with the bank's affiliated persons; overdue credits and non-accumulating credits; unfavorable credits; total credits to total assets; total unfavorable credits to total assets; total unfavorable credits to total credits; credit loss provision to total credits; deposits of individuals and legal persons to total assets; return on assets; return on equity; net income margin; efficiency ratio." <p>Insofar as risk management strategies and practices, management and governance are concerned, these are primarily addressed in the commentary on the audited financial statements.</p> <p>The NBM's BRL Division assesses banks' compliance with the provisions for required disclosure upon receipt of the quarterly reports. Further vetting is undertaken at the time of the onsite inspection by the NBM's BSC Division.</p> <p>11. The LNBM (art. 13) requires the NBM to publish an annual report, which contains a brief section on its supervision and regulation of banks' operations, including financial indicators of the banking system. Further, pursuant to the LNBM (art. 69):</p> <ul style="list-style-type: none"> monthly, information related to assets, liabilities and capital, as well as financial indicators of the banking system is published on the NBM website (www.NBM.org); monthly, information about the basic data of commercial banks operations is published in the media; and information about the development of the banking system for the previous quarter is published by the NBM in quarterly bulletins and on its website.
Assessment	Largely Compliant
Comments	The 2007 Accounting Law represents a major change for financial reporting and auditing practices, particularly for the banks and will, upon implementation, largely align practice in Moldova with that currently in effect in the countries of the EU. As part of the implementation process, it would be constructive for the NBM to undertake formal discussions with both external auditors and the banks to ensure that implementation proceeds smoothly. As a start, the NBM should consider revision of its own reporting formats to accommodate reporting under the IFRS. In this latter regard, reference should be made to the IMF Report to the NBM entitled "Banking Supervision and Foreign Exchange" dated December 2004 and, in particular, to the sections dealing with accounting consolidation.
Principle 23.	<p>Corrective and remedial powers of supervisors</p> <p>Supervisors must have at their disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability, where appropriate, to revoke the banking license or to recommend its revocation.</p>
Description	1., 2. Upon completion of an onsite inspection, the BRSD inspection team leader holds an "exit-meeting" with the bank's President of the Executive Body to present the overall findings and a draft report for the bank's comments within a specified (and short) time frame. If the draft report's contents are contested, a meeting will follow attended by the inspected bank's Board and Executive Body and the BRSD's representatives (the BRSD's director, the head of the BSC Division, the inspection

	<p>team leader, and the "core" team members, as well as those seconded to the inspection team from other areas of the NBM whenever issues have arisen in their particular areas of expertise) where the bank presents supporting materials/arguments, which may be taken into consideration by the BRSD. The meeting also provides the bank's Board and Executive Body members with comprehensive information on the course of the onsite inspection, setting out the underpinnings to the main conclusions and results of the evaluations of each inspected area, including a presentation of the shortcomings found and their causes. Particular attention is paid to shortcomings of a systematic nature and violations of the LFI and the NBM's "Normative Acts" (see CP 22, above). The NBM representatives explain the inspection's approach to the evaluation of the bank and inform the bank's representatives of the forthcoming delivery of the post-inspection report on the NBM's findings to the NBM's CA (LNBM art.26 i).</p> <p>Whenever serious issues for rectification are revealed by an inspection, the issues are formally presented to the NBM's CA, together with the BRSD's recommended plan of remedial action for the CA's approval, prior to its delivery to the bank's Board. A bank's performance against plan is monitored (offsite) from regular reports submitted to the BSC Division (Economic Analysis Section) and via "theme" or "follow-up" on-site inspections.</p> <p>Decisions on how and when to effect orderly resolution of bank problem situations rest squarely with the NBM, with the BRSD providing analysis and recommendation(s) on the basis of its on- and offsite monitoring and inspection procedures, and the CA providing the final decision on action.</p> <p>3., 4., 5. Unilaterally, the NBM is empowered to exact remedial measures (LFI: art. 38) whenever it determines, <i>inter alia</i>, that there exist infractions of the LFI and the NBM's "Normative Acts", or breach of conditions attached to an authorization for a bank to carry on business as prescribed, breach of a fiduciary duty or that there exist "unsafe or unsound operations". The NBM may, depending on its view of the seriousness, scope, duration, consequences, and nature of detected shortcomings take one or more of a broad selection of measures, as deemed appropriate. These include (art. 38(1)) the issuance of a warning to the licensee, the issuance of an order to the licensee to "cease and desist from such infractions, to undertake remedial actions", the withdrawal of the confirmation issued to an administrator or the withdrawal of the bank's license, as well as requiring (art. 38(2)) collateralization of loans, modification or termination of any activity deemed by the NBM to engender excessive risk, or divestiture of a risk judged by the NBM to present excessive risk to the licensee's well-being. Where a licensee is in an insolvency or "over-indebted situation, or (the) regulatory capital is determined to be less than two-thirds of the required minimum regulatory capital and (is) likely to face insolvency"... then the NBM shall (emphasis added) withdraw the license. (The NBM has made fairly extensive use of its dissuasive or coercive powers over the past seven years, including arranging the exit from the industry of a number of licensees.)</p> <p>6. Pursuant to the LFI (art. 38(1)), the NBM has capacity to "determine that the bank or any of its owners or administrators (emphasis added) are guilty of an infraction consisting of ...(<i>inter alia</i>) unsafe or unsound operations and, further, "may impose fines (art. 38(1)(d)) to the bank.... and/or administrator" (as the latter is defined, see LFI: art.3). (As noted in the paragraph above, the NBM may withdraw the confirmation issued to an administrator.) While indeed NBM—as the supervisor—may apply sanctions not only to the bank, but also to members of management (Executive Body) and the Board, monetary sanctions remain relatively modest.</p>
Assessment	Compliant
Comments	While an assessment of "Compliant" is given, it is noted that Law 235-XVI of 20 July

	<p>2007 (art. 17) (referred to as the "Guillotine Law") which is scheduled to be proclaimed in force on January 1, 2008, would provide for limitation of NBM's capacity to suspend activities of a licensee as a prudential and remedial measure. While imposition of a suspension of activities would still be available to the BRSD, its suspension order would immediately be subject to review by the court. Legal counsel has already brought to the attention of the government the reduction in the NBM's capacity to take timely corrective action that Law 235-XVI would entail. If the law is enacted in its present form, the assessment of this CP would necessarily change.</p> <p>While the NBM enjoys a broad range of remedial measures to which it can have recourse, their use is discretionary, save in the case of the loss of one-third of the regulatory capital of a bank which is also likely to be facing insolvency, when license withdrawal is mandatory. To-date, the concept of "early remedial action" has not been introduced in the supervisory regime. It would be constructive to consider making it mandatory for the NBM to act at various levels of regulatory capital (e.g., require that recovery measures be undertaken; forbid loans to affiliates). Equally, it would be useful to consider implementation of a prepayment dividend notification requirement so that the NBM have the opportunity to prevent unsound distributions, rather than to impose remedial action requirements after they occur.</p>
Principle 24.	<p>Consolidated supervision</p> <p>An essential element of banking supervision is that supervisors supervise the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential norms to all aspects of the business conducted by the group worldwide.</p>
Description	<p>1., 2., 3., 4., 6. For those licensees incorporated in Moldova which are not either wholly-owned or majority-owned by legal entities which are, themselves, components of "banking groups" established in Western Europe or elsewhere, the application of consolidated supervision addressed by this Core Principle is extremely limited.</p> <p>The ambit of the term "banking group" in Moldova envelops the bank and its offices, subsidiaries and those investee corporations in which the bank has a proprietary interest of 25 per cent or more, i.e., "downward consolidated supervision". (In this context, the NBM does have power to review the overall activities of the group, both domestic and foreign (LFI: arts. 37(1)(2)(3) and (4)). Moreover, the strictures imposed by the LFI (art. 26) on "financial activities" permissible for banks (CP 2) and by the LFI (art. 15(3)) on banks' holding equity interests (CP 5) do provide a framework for evaluation of the risk that non-banking activities conducted by a bank, either directly or indirectly, may represent, as well as a means for its limitation besides that provided by Remedial Measures (LFI: arts. 38(1)f and 38(2) e).) However, other entities representing the object of "upward and lateral consolidated supervision", e.g., significant-owner companies and non-bank (including non-financial) group entities are not considered, either by the legislation or in practice.</p> <p>5. As indicated in CP 1(6), above, pursuant to "letters of agreement" between the NBM and the NCFM, the latter provides NBM a quarterly report on the activities and operating performance of those securities and insurance companies related to banks. As yet, however, there is no defined mechanism in place for the NBM to receive information on the adequacy of risk management and controls in those entities now subject to the NCFM's supervision.</p> <p>7., 8., 9., 10. At present, those licensees incorporated in Moldova which are not either wholly-owned or majority-owned by legal entities which are, themselves, components of "banking groups" established in Western Europe or elsewhere, have not established branches or subsidiaries in foreign jurisdictions. However, as links with the EU strengthen, this situation could change rapidly. Were foreign operations, including branches, joint ventures, and subsidiaries, be established by such licensees,</p>

	application of current inspection procedures and practices—particularly those targeting the assessment of a licensee's performance against internal control system requirements—would be appropriate.
Assessment	Materially Non-Compliant
Comments	In anticipation of future developments, it would be constructive to develop primary legislation providing the NBM the capacity to undertake consolidated supervision both "upwards and laterally" as well as "downward" (as is now the case). In tandem, it would be constructive for secondary legislation to be prepared which would provide detail for reporting on a consolidated group or sub-consolidated group basis, including therein performance against prudential standards.
Principle 25.	<p>Home-host relationships</p> <p>Cross-border consolidated supervision requires cooperation and information exchange between home supervisors and the various other supervisors involved, primarily host banking supervisors. Banking supervisors must require the local operations of foreign banks to be conducted to the same standards as those required of domestic institutions.</p>
Description	<p>1., 2., 3., 7., 9. Currently, those licensees incorporated in Moldova which are not either wholly-owned or majority-owned by legal entities which are, themselves, components of "banking groups" established in Western Europe or elsewhere, have yet to establish branches or subsidiaries in foreign jurisdictions, so a practical role for the NBM in the capacity of a "home" supervisor in a "home-host relationship" has yet to be established.</p> <p>The NBM is, however, "host" supervisor for those wholly-owned or majority-owned licensees to which reference is made in the previous paragraph and which are now active in Moldova.</p> <p>Using as a template the Basel Committee publication "Essential elements of a statement of cooperation between banking supervisors", the NBM has concluded agreements for cooperation in banking supervision with peers in Belarus, Kazakhstan, Romania, and Russia. Of these four supervisors, only the latter has an entity under supervision with a controlling ownership position in a licensee incorporated in Moldova. However, there are no agreements for cooperation in place with those Western European supervisors with responsibilities as "home" supervisors for licensees holding—in aggregate—24 per cent of the Moldovan banking system's assets.</p> <p>5., 6., 7, 8. The LFI (art. 12(4)) provides that: "No foreign bank shall be permitted to engage directly in any financial activity in the Republic of Moldova unless the activity is undertaken through a branch office or subsidiary for which a license has been issued by the NBM." The licensing procedures are common between indigenous and foreign banks, save that—in the case of the latter—the LFI (art. 6 b) and c)) provides that: "Licenses concerning branch offices and subsidiaries of foreign bank (sic) shall be granted only if: b) the competent foreign authorities that supervise the financial activities at the head office of the foreign bank concerned have given their written consent to the granting of such license; c) the (NBM) determines that the foreign bank is adequately supervised on a consolidated basis by such foreign authorities."</p> <p>The LFI (Chapter V: Accounts, and Statements, Audit, Reporting and Inspection; arts. 33 through 37) provides for common treatment of indigenous and foreign banks, save in two respects. First, "with respect to a branch office of a foreign bank, an audit committee or other representative organ of the foreign bank may function as the AC of the branch office (art. 36(2))", and second, "The inspection of a bank that is a branch or a subsidiary of a foreign bank or has a significant interest in the foreign bank is made by the auditors charged with supervision of financial activities in that country."</p>

Assessment	Materially Non-Compliant
Comments	While the conclusion of agreements for cooperation in banking supervision with Belarus, Kazakhstan, Romania, and Russia is noted as a constructive initiative, it remains that there are no similar agreements in place with the home supervisors of those licensees with an increasing share of the banking system's assets. This omission should be rectified as soon as possible.

Table 2. Recommended Action Plan to Improve Implementation of the BCPs for Effective Banking Supervision

Reference Principle	Recommended Action
1 Objectives, Independence, Powers, Transparency, and Cooperation	<ul style="list-style-type: none"> • CP 1(2): Ensure that publication of the BRSD's objectives is matched with a subsequent report measuring performance against them. • CP 1(2): Separate the budget of the BRSD from the overall budget of the NBM. • CP 1(4): Amend the "Guillotine Law" to preserve the NBM's powers to suspend a bank's activities without requirement for immediate review of the action by the court (see CP 23, below). • CP 1(5): Amend the NBM Law to include legal protection for supervisors. • CP 1(6): Set up an agreement for cooperation between the NBM and the NCFM (i.e., above and beyond the exchange of reports).
3. Licensing Criteria	<ul style="list-style-type: none"> • Continue aggressive action to obtain transparency on suitability of banks' significant, beneficial shareholders, the ownership structure and the source of initial capital.
4. Ownership	<ul style="list-style-type: none"> • See above.
6. Capital Adequacy	<ul style="list-style-type: none"> • Begin revision of reporting formats to accommodate implementation of IFRS consolidated accounting in 2009. • Implement a capital charge for market risk. • Require pre-payment dividend notification to the NBM.
7. Risk Management Process	<ul style="list-style-type: none"> • Ensure all banks upgrade their risk management policies and processes.
8. Credit Risk	<ul style="list-style-type: none"> • The NBM's on-site inspectors should ensure that banks undertake effective analysis of risk under currently valid, alternative stress test scenarios (also CP 14). • The NBM should facilitate that the banking industry establish a Credit Registry—to be financed by, owned by and operated solely by financial institutions—and that it is operational without delay.
9. Problem assets, Provisions and Reserves	<ul style="list-style-type: none"> • Consider implementing delinquency reporting in greater detail (by "time buckets," i.e., 30, 60, 90+ days) rather than the 30-60 and 60+days now in effect. • Determine the impact of banks' required implementation of the IFRS and particularly use of IAS 36 "Impairment of Assets".

Reference Principle	Recommended Action
10. Large Exposure Limits	<ul style="list-style-type: none"> • Increase yield from currently available prudential reporting by developing a tool (to be used by both onsite and offsite supervision) to extract and combine details on large credits (also CP 20). • Continue aggressive action to have banks ascertain links between borrowers and shareholders. • Recommend that the internal control unit of each bank establish limits covering both deposits accepted (i.e., the “wholesale”/“retail” deposit liabilities mix) and “due from” deposits.
11. Exposures to Related Parties	See CP 10 (items 1 and 2).
12. Country and Transfer Risk	<ul style="list-style-type: none"> • Ensure accurate implementation of the new NBM recommendation covering off-balance sheet exposures in foreign currency.
13. Market Risks	<ul style="list-style-type: none"> • Continue to promote adequate policies and practices for risk management and encourage banks to perform effective stress testing covering significant risks. • Implement a capital charge on market risk (see CP 6, item 2).
14. Liquidity Risk	<ul style="list-style-type: none"> • The NBM's on-site inspectors should ensure that banks undertake effective analysis of risk under currently valid, alternative stress test scenarios (see also CP 8).
18. Abuse of Financial Services	<ul style="list-style-type: none"> • Revise the NBM's existing “Recommendations”/ “Regulations” to reflect amended AML legislation. • Banks should have in place a system that ensures that customers using exchange facilities at more than one branch on the same day in exchanging foreign currency below US\$5,000 equivalent are properly identified in order to ensure their transactions do not exceed the legal daily limit for exchanging foreign currency.
19. Supervisory Approach	<ul style="list-style-type: none"> • Introduce an early warning system to enhance its ability to respond in a timely and effective manner to potentially disruptive capital movements. All pertinent areas of the NBM should contribute information for the successful implementation of this system. • Require banks to notify the BRSD promptly of substantive change in overall condition or any materially adverse change (including breach of legal or statutory requirements).
20. Supervisory Techniques	<ul style="list-style-type: none"> • Increase yield from currently available prudential reporting by developing a tool (to be used by both onsite and offsite supervision) to extract and combine details on large credits (see CP 10, item 1).

Reference Principle	Recommended Action
22. Accounting and Disclosure	<ul style="list-style-type: none"> • Issue “Recommendations”/ “Regulations” for implementation of consolidated accounting requirements in 2009 (see CP 6, item 1). • Begin revision of reporting formats to accommodate implementation of the IFRS consolidated accounting in 2009 (see CP 6, item 1).
23. Supervisors’ Corrective and Remedial Powers	<ul style="list-style-type: none"> • Consider revision of statute to provide for “early remedial action” regime with defined thresholds.
24. Consolidated Supervision	<ul style="list-style-type: none"> • Revise statute to provide capacity to conduct consolidated supervision. • The BRSD already requires and reviews financial statements—and a “large exposures” report—of any legal entities in which a bank has a proprietary interest of 25 per cent or more (i.e., “downward”). This should be extended to making periodic analysis of the financial condition of a bank’s parent or controlling owner and of any significant “sister” companies (i.e., “upward” and “sideways”).
25. Home-Host relationships	<ul style="list-style-type: none"> • The NBM should formalize contacts with supervisors of those Western European Moldova.

F. Authorities’ response to the assessment

15. The authorities are in broad agreement with the BCP assessment and are determined to further improve the legal framework for banking and its supervision, and the supervisory methods. They also expressed their appreciation that the assessors noted the progress that took place in the area of bank supervision. Similarly to the comments given by them to the 2004 FSAP, they have noted that the budget requirements for bank supervision are fully met from the operating budget of the NBM and it would be inconvenient to determine a budget for the supervisors outside the aggregate. They disagreed with the recommendation that the NBM should ensure the setting up a credit registry by the banks (CP 8), contending that this is the task for the banking system and not its supervisor.

II. CORE PRINCIPLES FOR SYSTEMICALLY IMPORTANT PAYMENT SYSTEMS AND OF PAYMENT SYSTEM OVERSIGHT

A. The Committee on Payment and Settlement Systems Core Principles

General

16. **The assessment of the Moldovan payment and settlement system was performed as part of the FSAP update for Moldova.**² The main objective of the assessment was to determine the level of observance with the BIS Committee on Payment and Settlement Systems (CPSS) CPSIPS, and to suggest areas where further reforms may be appropriate. The staff of the NBM and other institutions cooperated fully with the mission and provided all the necessary clarifications and documents.

17. **The assessment was focused on the AIPS operated by the NBM.** The AIPS has two main components: the RTGS for large value and time-critical payments, and the DNS for low value payments. In general, the RTGS system accounts for about 5 percent of transactions and 85-90 percent of the total amount. Hence, formal assessment was carried out only for the RTGS. Nevertheless, because the NBM considers both components as systemically important, the DNS was also informally assessed against the same standards.

Information and Methodology Used for Assessment

18. **The assessments were based on the NBM's self-assessment of its observance of the CPSIPS, answers to the standard questionnaire on payment systems and discussions with representatives of the NBM, the Moldovan Stock Exchange, the National Securities Depository, the Banking Association, and commercial banks.** The self-assessment was made available prior to the mission's arrival. During the mission, the NBM provided further documents and statistics relevant for the assessment.

19. **In addition, the assessment took into account the legislation covering payment and settlement.** This includes the LNBM, the LFI, the Regulation on Credit Transfers, the Regulation on AIPS, the regulation on oversight for the AIPS, and all operational guidelines for payment system participants.

² The assessment was conducted by Mr. Alexandr Shishlov, Head of Payment System Development Department, Kazakhstan Interbank Settlement Centre of the National Bank of Kazakhstan.

B. Payment System Infrastructure—Overview

20. **The banking sector in Moldova consists of 15 banks.** While banks provide most of the payment services to the general public, the NBM plays the principal role in establishing regulations and basic rules governing the functioning of the AIPS. The AIPS operates only in domestic currency, while foreign exchange transactions are based on correspondent relations. According to the LNBM, the NBM may organize settlement facilities for interbank obligations and is responsible for overseeing payment systems to ensure their efficiency.

21. **According to regulations, all domestic inter-bank payments must be carried out through the AIPS.** In addition to the NBM, there are 17 participants in the AIPS, including 15 commercial banks, the Treasury of the Ministry of Finance (MOF), and the Tiraspol Settlement Centre. Each payment system participant has a current account at the NBM. Commercial banks may open and use direct correspondent accounts with each other in local currency MDL only for the settlement of payment cards and securities market transactions.

22. **Cash is still the major payment instrument in Moldova** (particularly for payments among individuals). In recent years, banks have introduced more advanced payment instruments, such as internet banking and payment card schemes. Credit transfers are the major payment instruments among legal entities. Checks are not used in the payment system.

23. **The use of electronic payment instruments has a strong growth trend.** Currently, 12 commercial banks issue payment cards of international brands (VISA and MasterCard). More than 96 percent are debit cards. Cards are mostly used for cash withdrawals from Automated Teller Machines (ATMs).

24. **There are two processing centers in Moldova: MoldMediaCard servicing three commercial banks and Victoria Bank's in-house processing, servicing nine banks.** Each center performs switching and clearing of transactions made only between its bank-members, within its own network. According to the information provided by each processing center, transactions are cleared on a bilateral basis and are settled by banks individually via the AIPS. As there is no interconnection between the two centers, an acquiring bank receiving a payment with a card issued by a bank serviced by the other network will settle this transaction via direct correspondent accounts abroad, according to the rules of the international payment systems.

25. **The electronic payment infrastructure is growing very fast.** The MoldMediaCard network comprises 132 ATMs and 655 EFT point-of-sale (POS) terminals, while Victoria Bank's network comprises 50 ATMs and 470 EFT POS terminals. Most of the POS terminals are owned by banks and distributed to merchants and other sales points willing to participate in the network.

26. **Government payments are organized through the Treasury in the MOF.** The Treasury has a single account within the NBM for all collections and disbursements and has direct access to the AIPS.

AIPS

27. **The AIPS, which is owned and operated by the NBM, has two main components: the RTGS for large value and time critical payments, and the DNS for low value payments.** In 2007, by October 5, the RTGS system processed a total of 392,265 payments with a value of MDL 172.6 billion, while the DNS system processed a total of 7,465,153 payments with a value of MDL 23.1 billion.

28. **The RTGS is a real-time gross settlement system, with a V-shape structure.** The RTGS system is operational from 9:00 am to 8:00 pm. In the RTGS payments are processed as follows: a payment message (employing SWIFT message formats) is submitted to the RTGS via one of the two alternative telecommunication networks available (SWIFT and a proprietary network maintained by a private company, supervised by the NBM). A digital signature is attached to each payment and payment messages are subject to encryption (based on a public key infrastructure scheme). Each transaction is mirrored to the general ledger of the NBM in real time.

29. **The RTGS provides irrevocable and final settlement in MDL on a real time basis if sufficient funds are available to cover a payment.** Debit and credit notifications are sent in parallel to, respectively, the ordering bank and the beneficiary bank. If a bank does not have sufficient funds to cover the payment it ordered, the transaction is sent by the system to a queue, where it is kept pending until funds become available as a result of incoming payments. At the end of the day, payments in the queue are cancelled. Queued payments are prioritized and processed by first-in-first-out (FIFO) principle within the same priority. In particular, in the RTGS, payment requests are allocated a 'Priority' number within the range of 1-99, where priority 1 is the highest. Priorities 1-11 are reserved for the settlement of central bank operations. The highest priority a participant may assign to a payment is 12 and the lowest is 98. The priority level is assigned by the originating bank.

30. **The RTGS system offers the possibility to "block" funds to be used for the DNS settlement.** During normal daily operations participants are not required to reserve funds for the settlement of net debit positions potentially arising in the DNS, however the feature exists in the system and might be activated by participants individually for liquidity management purposes and by the NBM to penalize participants that failed to settle DNS obligations in full. Reserved funds are "blocked" and cannot be used for the settlement of transactions other than those they are reserved for.

31. **Banks monitor their current balance in the RTGS, queued payments (only their own outgoing payments), and system status during the day, either through web interfaces or by submitting an electronic request.** The NBM is authorized to monitor the

technical accounts of all banks with the aim to oversee and supervise liquidity in the banking sector.

32. **The DNS is a batch system for low value payments based on multilateral netting.** The DNS is operational from 9:00 am to 8:00 pm and has two settlement sessions starting at 9:00 am and 02:30 pm with final settlement in the RTGS at 3 pm and 8 pm, respectively. Payments are settled with (T+0) finality.

33. **The DNS processes credit and debit payment orders.** Credit instructions are accepted with the current value date and debit instructions (only direct debits) only with the value date (T+1). A collection period is executed prior to each clearing and settlement session. During this phase, all incoming payments pass the technical verification and are kept in a queue until the time when preliminary positions are verified against the available liquidity in the RTGS.

34. **Preliminary net positions are calculated on a continuous basis and are available to participants through monitoring tools in real time.** The DNS uses the monitoring facilities of the RTGS system. If the available liquidity is not sufficient to cover a debit position in full, the DNS—according to a mathematical algorithm—rejects payments with the highest values achieving a settlement of the maximum number of small value payments. Only payments covered by available liquidity are considered as accepted for settlement and are finally settled. Rejected payments after the first session are pending in the queue until the second settlement. Those payments that fail to pass the financial acceptance criteria in the second session are cancelled.

35. **During the collection periods, participants are able to cancel payments from the queue.** Prioritization and FIFO principle are not applicable. The DNS does not require pre-funding in the RTGS and uses all available liquidity in the RTGS for the settlement at the end of each session. To minimize risks, a batch value should not exceed MDL 50,000.

36. **Reserve requirements may be used during an operational day for payment system purposes.** The current compulsory reserve requirements stands at 10 percent for bank liabilities in local and 15 percent in foreign currencies, calculated on a 15 days basis. Moreover, the NBM has a tool to provide intraday collateralized overdrafts to participants.

37. **In reforming the systems in 2005-2006, the NBM involved banks in a comprehensive discussion and invited them to express their business needs.** The close working relations established between the NBM and banks during the reform process seem to have created the foundation for a continuous cooperative approach. Meetings are held with banks from time to time and banks are consulted on proposed changes to NBM-operated payment systems. Also, the NBM maintains a dedicated e-mail channel at the payment system department. Banks' opinions are also sought on drafts of new legal acts.

Securities settlement system

38. **Even though the Securities Settlement System was not assessed, the mission examined some of the elements of the securities settlement system.** To enhance the safety and efficiency of the system, some recommendations are made in this area, as well.

39. **Government Securities Settlement:** Government securities transactions are settled in the NBM Depository on T+0 basis through the RTGS using Delivery versus Payment mechanism model 1. Primary market auctions are organized by the NBM according to the schedule agreed with the MOF. Participants submit their bids to the NBM on the date of trades. According to the auction results, the NBM automatically prepares a credit payment order on behalf of the securities buyer and submits it to the RTGS with a time-stamp of 16:30, meaning the deadline for settlement. As soon as the cash leg is settled, the securities are released to the buyer. In case of inability to settle, the deal is cancelled. Secondary market trades with government securities are settled in the same way, when the information about the deal is executed in the NBM Depository securities are immediately blocked on the seller's account and released to the buyer only if the cash leg has been successfully settled through the RTGS. The settlement confirmation in this case is automatically forwarded to the buyer, the seller, and the NBM.

40. **Corporate Securities Settlement:** Corporate securities are settled in the National Central Securities Depository (NCSD) with T+3, based on DVP Model 2. Brokers transfer securities to the trading accounts within the NCSD on (T-1), providing instructions to the NCSD in paper form. Simultaneously, brokers must ensure that they have availability of the funds on their accounts held at Victoria Bank, which is the settlement bank for the cash leg. On the day of trades the NCSD electronically sends information about the securities available for trading to the Moldova Stock Exchange (MSE), which also accumulates the information about brokers' cash positions provided by Victoria Bank. When trades are opened, brokers submit their bids to the MSE from computerized trading floor. Trading results are electronically returned to the NCSD at the end of the trading session. On T+1, the NCSD performs the multilateral netting of the cash legs and notifies participants about the positions to be paid on the next day (T+2) to the NCSD account also held in Victoria Bank. According to the legislation, all trades should be authorized by the securities market regulator within three days. If there is no objection to the trade outcome, securities are released to the buyer on (T+3) if the cash leg has been delivered. If brokers have not made available in advance either cash or securities, they are not eligible to execute trades. The average volume of daily trades is seven.

C. Principle-by-Principle Assessment

41. **The assessment was made according to the CPSIPS.** A five-level assessment system is used. A principle is considered **observed** whenever all essential criteria are generally met without any significant deficiencies. A principle is considered **broadly**

observed whenever only minor shortcomings are observed, which do not raise major concerns and when corrective actions to achieve full observance with the principle are scheduled within a prescribed period of time. A principle is considered **partly observed** whenever, despite progress, the shortcomings are sufficient to raise doubts about the authority's ability to achieve observance. A principle is considered **non-observed** whenever no substantive progress toward observance has been achieved. A principle is considered **not applicable** whenever, in the view of the assessor, the CP does not apply, given the structural, legal and institutional features of a jurisdiction.

Table 3 - Detailed assessment of observance of COMMITTEE ON PAYMENT AND SETTLEMENT SYSTEMS Core Principles for the RTGS and Central Bank Supervision Responsibilities in Applying the Core Principles

CP 1. The system should have a well-founded legal basis under all relevant jurisdictions.	
Description	<p>The legal framework of the payment system in Moldova is complete and comprehensive.</p> <p><u>Laws</u></p> <p>The LNB No.548-XIII of July 21, 1995 stipulates that the NBM may assist banks in organizing facilities for clearing and settlement of interbank payments, issue rules and regulations, and oversee the payments system to achieve its efficient and reliable functioning.</p> <p>The LFI No.550-XIII dated July 21, 1995, includes the basis for opening banks, branches, their liquidation and licensing.</p> <p>Electronic digital signature in Moldova has legal validity according to the Law on Electronic Document and Digital Signature No.264-XV of July 15, 2004.</p> <p>According to the Law on Insolvency No.632-XV of November 14, 2001, the zero-hour rule is not applicable, as a bank insolvency proceedings can be initiated only by the NBM, followed by the revocation of the banking license.</p> <p>The Civil Code of Moldova No.1107-XV of June 6, 2002, third book, Obligations, Section II, Chapter I, includes general definitions of netting arrangements.</p> <p>Other regulations related to the payments system are:</p> <p>Regulation on automated interbank payment system, approved by the Decision No. 53 of March 2, 2006, of the CA of the NBM, determines the structure and features of the AIPS, participants, admission and exclusion criteria, finality and irrevocability of payments, tariff policy, operational day schedule, etc. Article 5 of the Regulation defines finality and irrevocability ("...a payment instruction is final for the paying participant in the moment of debiting its settlement account and for the beneficiary participant in the moment of crediting its settlement account. The RTGS system does not revoke finally settled payments even if they were submitted to the RTGS by mistake.")</p> <ul style="list-style-type: none"> • Regulation on credit standing facilities extended by the NBM to banks,

	<p>approved by the Decision No. 70 of March 23, 2006, of the CA of the NBM, identifies conditions for the provision of intraday and overnight credits to financial institutions. The Regulation describes all elements related to intraday and overnight credits (types of securities accepted by the NBM, procedures, penalties, enforceability of collateral arrangement, etc).</p> <ul style="list-style-type: none"> • Regulation on oversight of the automated interbank payment system, approved by the Decision No.154 of June 28, 2007, of the CA of the NBM and registered by No. 496 of August 14, 2007, of the Ministry of Justice, set up the basis for conducting the oversight over the AIPS. • Technical document for the AIPS participants establishes the technical requirements and criteria for participation in the AIPS, guidelines of business continuity planning. • Business continuity plan of the NBM. • Regulation on credit transfer, approved by the Decision No. 373 of December 15, 2005, of the CA of the NBM. • Regulation on direct debiting, approved by the Decision No. 374 of December 15, 2005, of the CA of the NBM. • Regulation on transaction suspension, sequestration and incontestable collection of money funds from banking accounts, approved by Decision No. 375 of December 15, 2005, of the CA of the NBM and by No.106 of December 16, 2005 of the MOF, and registered by No. 428 of December 19, 2005, of the Ministry of Justice. • Regulation on use of E-banking systems, approved by the Decision No.376 of 15 December, 2005, of the CA of the NBM. • Contracts on participation in the AIPS between the NBM and each participant. <p>These laws and regulations properly cover all the necessary elements of the operation of the RTGS.</p>
Assessment	Observed
Comments	-
CP 2. - The system's rules and procedures should enable participants to have a clear understanding of the system's impact on each of the financial risks they incur through participation in it.	
Description	<p>The RTGS has clear rules and procedures for the clearing and settlement of payment instructions. These are properly documented and are available to all participants of the system.</p> <p>The rules and procedures clearly describe the responsibility of all participants and the financial risks to which that they may be exposed and how the various risks are monitored and managed.</p> <p>The Regulation on oversight of the automated interbank payment system, Decision No.154 of June 28, 2007 of the NBM states that AIPS participants are exposed to liquidity and operational risk, Credit risk is dealt with by the prudential regulations for banks, as explained in CP 8 of the Detailed Assessment of the BCPs.</p> <p>Based on discussions with the representatives of the NBM and AIPS participants, they are aware of risks and strive to meet the requirements laid down in the regulations..</p> <p>Updates and changes to the regulations and procedures are available through publications in the newspaper "Official Monitor of the Republic of Moldova", an</p>

	intranet web page accessible by participants. The NBM also organizes ad-hoc meetings and consultations, if necessary, to ensure a high transparency of the AIPS.
Assessment	Observed
Comments	-
CP 3. The system should have clearly defined procedures for the management of credit risks and liquidity risks, which specify the respective responsibilities of the system operator and the participants and which provide appropriate incentives to manage and contain those risks.	
Description	<p>Credit risks: The large value payment system RTGS is designed as a pure real time gross settlement system. The RTGS is acting on the basis of straight through processing (STP) and is settling real time. Participants therefore are not exposed to any credit risks. Moreover, participants have access to real time information regarding their balances at the NBM, their payments, and queues.</p> <p>Liquidity risks: In the RTGS there is a queuing system in place for participants to manage their liquidity. The queuing system offers multiple options to the participants so that they are able to arrange their payments in a way that best solves their liquidity problems (FIFO, prioritization, cancellation).</p> <p>The NBM assists RTGS participants with insufficient liquidity by providing collateralized overdrafts. The process is fully automated and may be activated immediately when needed. In practice, the NBM urges banks to obtain the necessary liquidity in the interbank market.</p> <p>Moreover, current compulsory reserve requirements stands at 15 percent for bank liabilities both in local and in foreign currencies and these may be used for settlement purposes during the operational day.</p> <p>The regulation on these risks lays down the following: For the management of liquidity risk, the NBM will: "... (a) provide the participants with necessary information relating to their activity in AIPS; (b) extend intraday/overnight credits...based on the monetary policy objectives; (c) initiate the gridlock resolution mechanism in case of gridlock arising in the AIPS." At the same time, participants have to perform: "... (a) the monitoring of the settlement account's balance and turnover, as well as the queue to the settlement account; (b) the monitoring of net position calculated by the DNS system; (c) the management of the queue to the settlement account, in the event of detecting insufficient funds available on the settlement account for the performance of payments."</p> <p>For the purpose of operational risk management, participants and the NBM have to ensure the efficient administration and use of the AIPS software and hardware and activity continuity in contingency situations.</p> <p>Prices are fixed in the RTGS during the day.</p> <p>General tools: The RTGS is monitored by the NBM and participants in real time. Participants are clearly informed of the risks and the consequences of a default.</p>
Assessment	Observed
Comments	According to statistics provided by the NBM, the volume of payments in AIPS is unequally distributed during the day, sharply rising from 12 pm until the end of the day. The NBM should consider introduction of a price-incentive scheme to smoothen the payment flow.
CP 4. The system should provide prompt final settlement on the day of value, preferably during the day and at a minimum at the end of the day.	
Description	Finality in the RTGS is technically and legally achieved.

	<p>The RTGS provides a real-time settlement. Debit and credit notifications are sent in parallel to, respectively, the ordering bank and the beneficiary bank immediately after the settlement.</p> <p>The legal rules of finality are the following: “The payment document is finally settled for the paying participant in the moment of debiting its settlement account and for the beneficiary participant in the moment of crediting its settlement account” (Regulation No. 53 on the AIPS).</p> <p>Irrevocability is regulated the following way: “The RTGS system does not initiate return of finally settled payment document even if it was sent by mistake” (Regulation No. 53 on the AIPS). The same regulation also gives instructions about paying back erroneously sent amounts (with the use of a new payment document).</p>
Assessment	Observed
Comments	-
CP 5. A system in which multilateral netting takes place should, at a minimum, be capable of ensuring the timely completion of daily settlements in the event of an inability to settle by the participant with the largest single settlement obligation.	
Description	In the RTGS, payments are settled on gross basis against available liquidity..
Assessment	Not applicable
Comments	-
CP 6. Assets used for settlement should preferably be a claim on the central bank; where other assets are used, they should carry little or no credit risk and little or no liquidity risk.	
Description	Payments are settled via the technical MDL-denominated accounts within the RTGS. The balances of those accounts are mirrored by the current accounts participants hold with the NBM. At the beginning of the day, the RTGS verifies the balances on technical and current accounts of participants.
Assessment	Observed
Comments	-
CP 7. The system should ensure a high degree of security and operational reliability and should have contingency arrangements for timely completion of daily processing.	
Description	<p>Regarding business continuity, a full back-up processing is in place as well as rules for emergency situations and a Business Continuity Plan (BCP)³. The back-up site is located out of the main building and BCP arrangements are tested annually or on ad-hoc basis if changes were made. Usually, tests are done at weekends involving NBM staff only. Both centers are linked via fiber-optic channel and data replication is organized in hot mode. The NBM maintains a 24/7 monitoring of the AIPS. Alarms are visualized on screens and information is distributed to relevant staff by e-mails and SMS. Access to the premises is limited to authorized personnel only and the area is remotely monitored. In case of fire there is a fire fighting system in place.</p> <p>There are three options of submitting payments to the AIPS:</p> <ul style="list-style-type: none"> • Interbank Network for Data Transmission – private network operated by the private company “Uniflux-Line S.A.” according to the contract with the NBM. • SWIFT network. • Dial-up access at the NBM.

³ The back-up site was not assessed as to whether its risk profile is significantly different from that of the main site.

	<p>Each participant establishes a VPN connection while accessing the AIPS. Messages are signed by two digital electronic signatures of the operator in the bank who created the message and the second signature belongs to the same bank, validating its message. Digital signatures are built on an asymmetric key with the length of 2048 bits. Keys distribution is based on the PKI technology. The PKI certification center is located in the Center of Special Communications—the only agency in the country authorized by Law.</p> <p>Moreover, the NBM established special requirements for the organization of the working place in banks, which are subject to close oversight by the NBM.</p> <p>The RTGS system just has been implemented and such issues like scalability and capacity were carefully addressed by the NBM for the long-term. Availability of the RTGS and the DNS is 100% according to the NBM and participants,</p> <p>Audit of the RTGS is continuously performed by the Internal audit department of the NBM.</p>
Assessment	Observed
Comments	Business Continuity Plan tests should involve payment system participants to ensure adequate reaction from their side in case of emergency.
CP 8. The system should provide a means of making payments, which is practical for its users and efficient for the economy.	
Description	<p>In general terms the AIPS is efficient. The system operates with modern payment instruments (i.e., electronic credit transfers) and its architecture allows for fully electronic straight through processing (STP) for both interbank payments as well as for payments on behalf of third parties. Settlement of government securities is also through STP and done through the RTGS on the DVP model 1. The fees for customers' and banks' payments are the same. Current fees for using the system cover only the operating costs of the AIPS. The RTGS system is operational from 9:00 am to 8:00 pm, which—taking into account the number of transactions—is more than ample..</p> <p>At present, the system runs smoothly because of the current high liquidity of banks as well as of the existence of an interbank money market. In case of liquidity shortages, however, the NBM offers free of charge intraday collateralized overdraft facility, as discussed above.</p> <p>The efficiency of the RTGS is supported by a real time access to the information about balances and payments and the queuing mechanism, allowing participants to efficiently manage their payments in queues, where FIFO principle, prioritization, and cancellation are applicable.</p>
Assessment	Observed
Comments	-
CP 9. The system should have objective and publicly disclosed criteria for participation, which permit fair and open access.	
Description	<p>Participation in the AIPS is restricted to institutions having an account with the NBM and the NBM mandates compliance of all participants with conditions described in the Technical Document. To become an AIPS participant, an eligible institution must sign a contract with the NBM. After signing the contract, the NBM performs tests of the participant's technical ability and approves participation only if the participant meets all the requirements specified in the Technical document. The exit criteria include insolvency or banking license revocation by the NBM and/or termination of the contract on AIPS participation. All criteria are specified in the "Regulation on automated interbank payment system" and are readily available to all participants.</p>

Assessment	Observed
Comments	-
CP 10. The system's governance arrangements should be effective, accountable and transparent.	
Description	<p>The RTGS is owned and operated solely by the NBM.</p> <p>The AIPS governance is based on the LNBM and on the "Regulation on oversight of the automated interbank payment system". The RTGS operates within the NBM and hence its management is accountable to the Board, the governor of the NBM, and the Board member supervising the payment system department (presently a vice governor). At present the divisions that operate the RTGS have no direct access to the supervising vice governor.</p> <p>There are no special financial targets that are set before the RTGS or the department (divisions) operating it.</p>
Assessment	Broadly observed
Comments	<p>As both the Operational Division and Oversight Division are under the umbrella of the Payment System Department, the Oversight Division should (at least) have a direct reporting line with a higher authority (e.g., the Vice Governor responsible for payment systems) to ensure full separation of operations from the oversight.</p> <p>The NBM oversight focuses more on individual participants, rather than on the payment infrastructure. The NBM should define minimum measurable requirements that the AIPS system has to comply with to ensure its safety and efficiency and change focus of its oversight.</p>
Central Bank Responsibilities in Applying the CPSIPS	
Responsibility A – The central bank should define clearly its payment system objectives and should disclose publicly its role and major policies with respect to systemically important payment systems.	
Description	<p>The LNBM gives the NBM responsibility for the oversight of the payments system, with particular reference to facilitating the efficient functioning of the AIPS. In the same Law it is also stated that the NBM may establish facilities for interbank settlements and issue the related regulations. The NBM's roles and objectives are available in current legislation and publicly disclosed.</p> <p>However, further discussion on the scope and objectives of the oversight function by the NBM is necessary. The oversight function, as currently exercised, does not appear to be well-defined compared to further needs of development of the payments systems in Moldova.</p> <p>The NBM successfully cooperates with participants either directly or through the Banking Committee. Participation in different discussions related to the payment system issues, organization of consultative workshops, and ad-hoc meetings with banks seem efficient. Any changes to the NBM regulations or news are published in the Official Monitor of the Republic of Moldova and placed on the NBM's official web-site.</p>
Assessment	Broadly observed
Comments	<p>Oversight function should be more clearly separated from the operational function. A clear set of minimum requirements for the AIPS to ensure its safety and efficiency should be defined.</p> <p>The scope of oversight is limited to the AIPS, but it should be extended to the securities settlement systems and to the retail area (card systems, remittances).</p>

	The NBM should prepare a White paper on payment system oversight in the country to redefine the oversight role and discuss the outcomes to the relevant stakeholders in the financial community.
Responsibility B – The central bank should ensure that the systems it operates comply with the core principles.	
Description	<p>For some years, the NBM has been working intensively in many areas to ensure full compliance of the AIPS with all core principles for the SIPS. In 2006, the NBM introduced a new AIPS system, which significantly improved processing of payment flows, in accordance with best practices worldwide. On a regular basis, the NBM performs self-assessments of the AIPS against the compliance with the 10 Core Principles for Systemically Important payment systems.</p> <p>The NBM also has made reasonable progress in developing its oversight capacity in the payment system area, but further improvements are needed. It has already created a division in charge of payment system oversight within its Payment System Department and developed the “Regulation on oversight of the automated interbank payment system”.</p>
Assessment	Observed
Comments	-
Responsibility C – The central bank should oversee observance with the core principles by systems it does not operate and it should have the ability to carry out this oversight.	
Description	<p>The NBM attention is focused only on the AIPS, which is considered to be the only systemically important payment system in Moldova.</p> <p>Other payment and clearing systems operated in Moldova (such as the card payment and settlement systems) are not considered systemically important. The NBM does not maintain any information about these systems and does not carry any oversight functions, although the card netting and settlement systems involve payment transactions in national currency and the number of payment transactions is significant.</p>
Assessment	Not Observed.
Comments	<p>In order to guarantee the integrity of the payment system infrastructure, the NBM should also apply to payment systems operating outside the central bank. The NBM should oversee these systems, even if they are retail in nature, if they are of national importance (e.g., card systems and the settlement mechanism for foreign exchange transactions), especially if the payment transactions in domestic currency.</p> <p>Hence, it is necessary to start developing the specific arrangements, tools, and the cooperative framework for the oversight of all relevant systems in the country.</p> <p>In addition, international remittances and cross-border payments of corporations are increasingly relevant for Moldova.⁴ The NBM should also monitor these flows and the systems/service providers that support them. In the regard, it is suggested that the focus on international remittance be broadened from the traditional areas of balance of payments and money laundering to include payment system issues, in particular issues related to efficiency, transparency, risks, and consumer protection (see the CPSS-World Bank’s General Principles for International Remittance Services).</p>

⁴ The value of incoming remittances to the country in 2006 was USD 1.1 billion that constitutes 33.3 percent of the GDP.

Responsibility D – The central bank, in promoting payment system safety and efficiency through the core principles, should cooperate with other central banks and with any other relevant domestic or foreign authorities.	
Description	<p>The NBM actively cooperates with the MOF and the NCFM through ad-hoc meetings, and through written communication with the Bankers' Association and other relevant domestic authorities in the payment systems area.</p> <p>If there is an on-going project under implementation, the meetings are scheduled on a more regular basis, as was the case with implementation of the single settlement account for the MOF of during the AIPS implementation.</p> <p>During the AIPS implementation, the NBM has actively cooperated with some other central banks, such as from Macedonia, the Netherlands, and Romania.</p>
Assessment	Partly Observed
Comments	<p>A structured cooperative body, such as a National Payments Systems Council, should be created to discuss issues related to further development of the payment infrastructure in Moldova, the systems safety and efficiency requirements, oversight aspects, etc.</p> <p>Cooperation with other authorities – and mutual responsibilities, for example in securities settlement area - should be formalized in Memoranda of Understanding.</p>

Table 4. RTGS System Observance of Core Principles for Systemically Important Payment Systems - Summary Table

Principle	Grading				
	O ¹	BO ²	PO ³	NO ⁴	NA ⁵
1. Payment systems' legal basis	X				
2. Payment systems' rules and procedures should enable participants to understand financial risks of participation	X				
3. Clearly defined procedures for management of credit and liquidity risks	X				
4. Prompt final settlement on the day of value	X				
5. Timely completion of daily settlements under multilateral netting in the event of inability to settle by the participant with the largest single settlement obligation					X
6. Assets for settlement	X				
7. Security and operational reliability, and contingency arrangements	X				
8. Practical for the markets and efficient for the economy	X				
9. Objective and publicly disclosed criteria for participation	X				
10. Governance of the system should be effective, transparent and accountable		X			

Table 5. Supervisory Responsibilities of the Central Bank in Applying the Core Principles

Responsibility	Grading				
	O ¹	BO ²	PO ³	NO ⁴	NA ⁵
1. Responsibility A – The central bank should define clearly its payment system objectives and should disclose publicly its role and major policies with respect to systemically important payment systems.		X			
2. Responsibility B – The central bank should ensure that the systems it operates comply with the core principles.	X				
3. Responsibility C – The central bank should oversee observance with the core principles by systems it does not operate and it should have the ability to carry out this oversight.				X	
4. Responsibility D – The central bank, in promoting payment system safety and efficiency through the core principles, should cooperate with other central banks and with any other relevant domestic or foreign authorities.			X		

¹ O: Observed.

² BO: Broadly observed.

³ PO: Partly observed.

⁴ NO: Non-observed.

⁵ NA: Not applicable.

Table 6 - Informal assessment of observance of COMMITTEE ON PAYMENT AND SETTLEMENT SYSTEMS Core Principles for SIPS for the DNS

CP 1. The system should have a well-founded legal basis under all relevant jurisdictions.	
Description	The legal framework of the payment system in Moldova is complete and comprehensive, These laws and regulations properly cover all the necessary elements of the operation of the DNS.
Comments	-
CP 2. - The system's rules and procedures should enable participants to have a clear understanding of the system's impact on each of the financial risks they incur through participation in it.	
Description	The DNS has clear rules and procedures for the clearing and settlement of payment instructions. These are properly documented and are available to all participants of the system. The rules and procedures are described in CP 2 for the RTGS.
Comments	-
CP 3. The system should have clearly defined procedures for the management of credit risks and liquidity risks, which specify the respective responsibilities of the system operator and the participants and which provide appropriate incentives to manage and contain those risks.	
Description	Credit risks: In the DNS system, to limit the credit risk exposure, a payment value must not exceed MDL 50,000. In addition, the NBM can apply a mandatory funds reservation for a participant whose preliminary net debit position was not settled in full by the end of the day. The reserve amount is equal to the maximum net debit

	<p>position of the participant for the previous fifteen days. This measure is used only as a penalty during the following ten days. In addition, the DNS rejects the unsettled payments at the end of the second clearing session. Rejected payments are not considered as accepted for settlement before they pass the financial acceptance criteria.</p> <p>The regulation and handling of these risks are described in CP3 of the RTGS.</p> <p>General tools: The DNS is also monitored by the NBM and participants in real time. Participants are clearly informed of the risks and the consequences of a default.</p>
Comments	Prices in the DNS are fixed during the day. According to statistics provided by the NBM, the volume of payments in AIPS is unequally distributed during the day, sharply rising from 12 pm until the end of the day. The NBM should consider introduction of a price-incentive scheme to smoothen the payment flow.
CP 4. The system should provide prompt final settlement on the day of value, preferably during the day and at a minimum at the end of the day.	
Description	<p>In the DNS there are two settlement sessions with T+0 finality. Within each stage there are three periods: collection, pre-clearing, and settlement. During the collection period payments are technically validated and kept in the queue. During pre-clearing period only payments covered by the available liquidity in the RTGS are accepted for settlement. Payments accepted for settlement are settled in the RTGS during the settlement period. Those payments that pass a technical validation but have not met the financial acceptance criteria after the second settlement session are cancelled.</p> <p>The legal rules of finality and irrevocability are the same for the AIPS as a whole and are described in CP 4 of the RTGS.</p>
Comments	As the DNS is a settlement system for small payments, the final settlement on the same day is not critical and generally not guaranteed for such systems.-
CP 5. A system in which multilateral netting takes place should, at a minimum, be capable of ensuring the timely completion of daily settlements in the event of an inability to settle by the participant with the largest single settlement obligation.	
Description	<p>For the DNS, the following measures are available: (a) mandatory financial acceptance criteria, which should be met before the payment acquires a status "accepted for settlement—this approach guarantees the full coverage of debit position by liquidity in the RTGS; (b) the NBM intraday collateralized overdrafts; (c) limitation of maximum payment value (MDL 50 000); and (d) twice a day settlement.</p> <p>If a participant does not have on its settlement account sufficient funds, it could cover its net debit position during the second clearing session. This participant, however, will have to maintain for 10 days the minimal debit cap set by the NBM. The minimal debit cap is the largest value of the participant's net debit positions within 15 days prior to the day of the calculation. If this cap is not placed on the account, the participant is allowed only to receive payments. Other participants are informed about this constraint. A Technical document sets out the details of the setting of the cap and the notification of participants.</p>
Comments	-
CP 6. Assets used for settlement should preferably be a claim on the central bank; where other assets are used, they should carry little or no credit risk and little or no liquidity risk.	
Description	For the DNS, the settlement of the net debit and net credit positions calculated by the DNS system are executed through the settlement accounts in the RTGS system.
Comments	-
CP 7. The system should ensure a high degree of security and operational reliability and should have contingency arrangements for timely completion of daily processing.	

Description	Issues of security and operational reliability are the same as for the RTGS (described above), because the system is the same and its operator is the same (the NBM).
Comments	Business Continuity Plan tests should involve payment system participants to ensure adequate reaction from their side in case of emergency.
CP 8. The system should provide a means of making payments, which is practical for its users and efficient for the economy.	
Description	<p>In general terms the AIPS is efficient. The system operates with modern payment instruments (i.e., electronic credit transfers) and its architecture allows for fully electronic straight through processing (STP) for both interbank payments as well as for payments on behalf of third parties. Settlement of government securities is also through STP and done through the RTGS on the DVP model 1. The fees for customers' and banks' payments are the same. Current fees for using the system cover only the operating costs of the AIPS.</p> <p>The DNS is operational from 9:00 am to 8:00 pm and has two settlement sessions starting at 9:00 am and 02:30 pm with final settlement in the RTGS at 3 pm and 8 pm, respectively. The DNS queue management is limited to message cancellation initiated by participants during the collection period. Prioritization and the FIFO principle are not applicable. The mathematical algorithm used by the DNS during queue optimization automatically prioritizes for settlement payments with small values, while high value payments, even if they are more important to a participant, are rejected if liquidity is insufficient. The current mechanism is not flexible and does not allow participants to efficiently plan and manage their payments outflows.</p> <p>Moreover, the operational day schedule for the DNS looks inefficient, as the second session ends at 8 pm and there is no time left for the submission of rejected payments for execution with the same value date to the RTGS as customer payments cannot be accepted any longer.</p>
Comments	To achieve full observance for the DNS, the NBM should improve queue management procedures and transparency for the DNS participants. Specifically, if the second settlement in the DNS is executed earlier, participants would get a chance to settle rejected payments with the same value date in the RTGS. -
CP 9. The system should have objective and publicly disclosed criteria for participation, which permit fair and open access.	
Description	Participation in the AIPS is restricted to institutions having an account with the NBM and the NBM mandates compliance of all participants with conditions described in the Technical Document. To become an AIPS participant, an eligible institution must sign a contract with the NBM. After signing the contract, the NBM performs tests of the participant's technical ability and approves participation only if the participant meets all the requirements specified in the Technical document. The exit criteria include insolvency or banking license revocation by the NBM and/or termination of the contract on AIPS participation. All criteria are specified in the "Regulation on automated interbank payment system" and are readily available to all participants.
Comments	-
CP 10. The system's governance arrangements should be effective, accountable and transparent.	
Description	The DNS is owned and operated solely by the NBM, as described in CP 10 for the RTGS..
Comments	See comments for CP 10 for the RTGS.

Table 7. Recommended Actions to Improve Adherence to the Core Principles for Systemically Important Payment Systems by the Real Time Gross Settlement and Designated-Time Net Settlement

Reference Principle	Recommended Action
3. Management of risks	<ul style="list-style-type: none"> Prices in the RTGS and the DNS are fixed during the day. According to statistics provided by the NBM, the volume of payments in AIPS is unequally distributed during the day, sharply rising from 12 pm until the end of the day. Considering the steady growth of the volume of payments in AIPS, a new price incentive scheme should be applied by the NBM to smooth the payment flow and attract liquidity early in the day.
7. Security and operational reliability	<ul style="list-style-type: none"> Business continuity plan tests should involve payment system participants to ensure adequate reaction from their side in case of emergency.
8. Efficiency and practicality of the system	<ul style="list-style-type: none"> The NBM has to improve the adherence of the DNS queue management procedures to best international practices. Moreover, those procedures must be transparent for the DNS participants. Specifically, by conducting the second settlement in the DNS earlier during the operational day participants would have a chance to settle rejected payments in the same value date in the RTGS.
10. Governance of the payment system	<ul style="list-style-type: none"> In order to guarantee the proper operations of the system, the NBM should have well defined oversight objectives, continue to further develop and implement a clear oversight concept, and establish a set of measurable minimum requirements. The Oversight Division should have a direct reporting line with a higher authority (e.g., the vice governor responsible for payment systems) to ensure full separation of operations from the oversight. The NBM should define minimum measurable requirements that the AIPS system has to comply with to ensure its safety and efficiency and change the focus of its oversight.

Table 8. Recommendations for the CPSIPS and the Responsibilities

Responsibility A	<p>Oversight function should be more clearly separated from the operational function. A clear set of minimum compliance requirements for the AIPS to ensure its safety and efficiency should be defined.</p> <p>The NBM should prepare a White paper on payment system oversight in the country to redefine the oversight role and discuss the outcomes to the relevant stakeholders in the financial community.</p>
Responsibility C	<p>In order to guarantee the integrity of the payment system infrastructure, the NBM should, at a minimum, extend its oversight over the Securities Settlement System.</p> <p>The NBM oversight powers should also apply to payment systems operating outside the central bank. The NBM should oversee these systems, even if they are retail nature, if they are of national importance (e.g., card systems and the settlement mechanism for foreign exchange transactions), especially if the payment transactions in domestic currency. Hence, it is necessary to start developing the specific arrangements, tools, and the cooperative framework for the oversight of all relevant systems in the country.</p> <p>In addition, international remittances and cross-border payments of corporations are increasingly relevant for Moldova.⁵ The NBM should also monitor these flows and the systems/service providers that support them. In the regard, it is suggested that the focus on international remittance be broadened from the traditional areas of balance of payments and money laundering to include payment system issues, in particular issues related to efficiency, transparency, risks, and consumer protection (see the CPSS-World Bank's General Principles for International Remittance Services).</p>
Responsibility D	<p>A structured cooperative body, such as a National Payments Systems Council, should be created to discuss issues related to further development of the payment infrastructure in Moldova, the systems safety and efficiency requirements, oversight aspects, etc.</p> <p>Cooperation with other authorities—and mutual responsibilities, for example in securities settlement area—should be formalized in Memoranda of Understanding.</p>

D. Authorities' response to the assessment

42. **The authorities were in broad agreement with the CPSIPS assessment.** They noted, however, that because the DNS cannot be considered systemically important and its requirements may be different from the RTGS, the implementation of a queue management system similar to the RTGS is not desirable.

⁵ The value of incoming remittances to the country in 2006 was USD 1.1 billion that constitutes 33.3 percent of the GDP.