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February 2016

DETAILED ASSESSMENT OF OBSERVANCE ON THE BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

This Detailed Assessment of Observance on the Basel Core Principles for Effective Banking Supervision for the Republic of Moldova was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in January 2016.

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DETAILED ASSESSMENT OF OBSERVANCE

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

Prepared By
Monetary and Capital Markets Department, IMF and Finance and Markets Global Practice, World Bank

This Report was prepared in the context of a joint IMF-World Bank Financial Sector Assessment Program (FSAP) Update mission in the Republic of Moldova during February 2014, and overseen by the Monetary and Capital Markets Department, IMF, and the Finance and Markets Global Practice, World Bank. Further information on the FSAP program can be found at http://www.imf.org/external/np/fsap/fssa.aspx, and www.worldbank.org/fsap.

INTERNATIONAL MONETARY FUND

THE WORLD BANK

CONTENTS

Glossary

AML/CFT	Anti-money Laundering and Combating the Financing of Terrorism
BCP	Basel Core Principles for Effective Supervision
BRSD	Banking and Regulation Supervisory Department
CA(M)ELS	(C), Assets Quality including Credit Risk Management Practices (A), Management (M), Earnings (E), Liquidity (L), and Sensitivity to Market Risks (S).
CCCEC	Center for Combating Economic Crimes and Corruption
CAR	Capital Adequacy Ratio
CEO	Chief Executive Officer
CIS	Commonwealth of Independent States
DGF	Deposit Guarantee Fund
ERM	Enterprise Risk Management
EU	European Union
FINREP	Financial Reporting
FIU	Financial Intelligence Unit
FX	Foreign Exchange
GDP	Gross Domestic Product
ICT	Information and Computer Technology
IFRS	International Financial Reporting Standards
LEL	Regulation on Large Exposure Limits
LFI	Law on Financial Institutions
LNBM	Law on the National Bank of Moldova
MDL	Moldovan Lei
ML/TF	Money Laundering/Terrorist Financing
MOF	Minister of Finance
MOJ	Minister of Justice
NBFI	Nonbank Financial Institution
NBM	National Bank of Moldova
NCFM	National Committee for Financial Market
NCFS	National Committee for Financial Stability
NPL	Non Performing Loan
OPCML	Office for Prevention and Control of Money Laundering
RBS	Risk-based Supervision
RM	Risk Management
RWA	Risk-weighted Asset
UBO	Ultimate Beneficial Owner

EXECUTIVE SUMMARY[1]

The National Bank of Moldova (NBM) has made significant progress in reinforcing its prudential and supervisory framework.

Two medium-term strategies have been designed in succession since 2008 to set a forward-looking approach for supervision. The most recent one spanning four years (2013–17) aims to ensure a higher level of efficiency, transparency, and performance of the NBM by bringing the best international practices, particularly, in the area of corporate governance.

The country is also in the process of transitioning from Basel I to Basel II. In the context of an Association Agreement to be signed with the European Union (EU),[2] the NBM plans to implement the standard risk-weighting model of Basel II as well as other elements of Basel III. The objective is to enhance the NBM's institutional capacity with the view to foster the banks' prudential regulatory framework. The association process will also enable NBM to gradually implement the EU Capital Requirements Regulation and Directive (CRR/CRD).

Capital requirements have also been tightened to increase bank's resilience. In 2013, the NBM increased the minim regulatory capital from Lei 100 to 200 mmillion (approximately EUR 12.3 million). In the same spirit, the level of Capital Adequacy Ratio (CAR) has been increased from 12 to 16 percent. As of January 2014, the average of risk-weighted capital adequacy in the banking system is maintained at about 23 percent.

Banks' accounting and reporting standards have also been improved through the recent adoption of IRFS. In February 2008, the Government adopted the Decision No. 238/29.02.2008 requiring the use of International Financial Reporting Standards (IFRS) in the Republic of Moldova. From January 1, 2012, banks have started to implement IFRS standards and submit to the NBM their financial statement using the FINREP templates.

Efforts have been pursued to increase the level of transparency in banks' structure. As recommended by the last FSAP, the NBM through its full-scope on-site inspections, has paid due consideration to transparency in bank ownership structure and concomitantly required banks to publish a significant number of data. NBM examiners have checked whether banks have set up proper internal control mechanisms to (i) identify people exerting significant influence; and (ii) determine ownerships structure as well as source of contributed capital. However, as noted in the report, significant challenges remain in ensuring full transparency of beneficial ownership of banks.

[1] This Detailed Assessment Report has been prepared by Pierre-Laurent Chatain, World Bank, and Lucretia Paunescu, IMF (consultant), in the context of an FSAP assessment led by Simon Gray, IMF and Brett Coleman, World Bank, and was overseen by the Monetary and Capital Markets Department, IMF, and the Financial and Private Sector Development Vice Presidency, World Bank.

[2] European Neighborhood and Partnership Instrument, "Strengthening the NBM's capacity in the field of banking regulation and supervision in the context of Basel III requirements.

The NBM has also adopted a set of new regulations and instructions in key areas as well as state-of-the-art methodologies for certain activities. The internal control system Framework for stress testing has been improved, requiring banks to perform stress-tests for every type of risk. Regulation on asset classification was changed to capture greater details by "time bucket" for delinquency reporting and new definitions of key concepts[3] were also introduced in the regulation on holding equity interest in banks (2013). In the area of preventing and combating money laundering and terrorist financing (ML/TF), two recommendations were issued on the implementation of risks-based approach to customers (2011) and on monitoring customers' transactions and activities (2013). The development and dissemination of detailed methodologies for identifying vulnerabilities in the banking sector and for conducting anti-money laundering and combating the financing of terrorism (AML/CFT) on-site inspection[4] is of particular relevance.

In sum, over the past years, Moldova has taken several initiatives to address a number of key recommendations from the last 2008 FSAP. Interviews with the NBM staff showed a strong professionalism within the Banking and Regulation Supervisory Department (BRSD) and a high degree of awareness of deficiencies in the banking sector. The quality of internal analysis and reports produced for Board members is outstanding and surpass what is often seen in other countries. The density and thoroughness of inspection reports are also noteworthy.

However, despite these very positive trends, implementation of effective banking supervision is still significantly handicapped by a series of external and internal factors as discussed below.

Some essential pre-conditions for effective banking supervision are not met, which creates a major burden on NBM supervision. The rule of law is absent in Moldova. Market participants, government officials and stakeholders have raised concerns about the levels of corruption in the judiciary.[5] There is not yet an effective/fully operational framework for financial stability policy formulation. In 2011, the NBM set up a small unit to deal with financial stability issues and also established a Financial Stability sub-Committee at the Board level to discuss macroeconomic stress tests. It is unclear however how the analysis and recommendations provided by the BRSD have translated into concrete actions. At the country level, a National Committee for Financial Stability (NCFS) was also established in June 2010 but its mandate is not well defined[6] and its capacity to take prompt actions in case of extraordinary financial shocks is yet to be tested. The framework for crisis management and resolution is in its infancy; the NBM has track records in dealing with problem banks but the conditions for its intervention are not well established. In addition, the

[3] Such as "dominant influence", "close link", and "persons acting in concert."

[4] With the TA of the U.S. Treasury.

[5] Moldovan is ranked 102 out of 177 according to Transparency International.

[6] When the Committee first met, instructions were directed to the NBM about establishing exchange rates.

Deposit Guarantee Scheme is insufficient to sustain a systemic problem.[7] Lastly, market discipline is a major concern as corporate governance in banks is extremely weak and sometimes driven by shareholders.[8]

The culture of Risk Management (RM) is poor and compliance functions in banks are almost nonexistent. The regulation on internal control systems is silent on the need to have proper Risk Management and compliance functions. Poor RM practices combined with voluntary breaches have led to excessive concentration risks in several banks and to significant losses in a few cases. There are no specific professional requirements for internal auditors.

NBM powers have been seriously hampered in many respects. The Ministry of Justice (MOJ) interferes in secondary legislation. Before getting into force, NBM regulations have to be registered by the MOJ which performs a legal revision, leading sometimes to substantial amendments. Not only does this interference undermine greatly NBM's powers and autonomy but it also creates unnecessary delays in implementing prudential policies.[9] NBM recommendations are not binding instruments and as a result not enforceable. Further, according to a recent Constitutional Court's ruling (October 1, 2013), all acts and decisions of the NBM—including those relating to safeguard measures, resolution, assessments of shareholders—can be challenged in court, leading to the suspension of the decision under certain circumstances,[10] by the lowest court in the country. Despite amendments made to the LFI to mitigate the impact arising from the ruling, there are still concerns about the capacity of the NBM to take prompt corrective measures in the area of supervision.[11]

The current legal regime does not provide enough independence to the NBM. In effect, the condition for dismissing the Governor and other Board members are unclear. The NBM law contains a provision[12] that leaves the door open to potential political interference. Even though in practice no such cases have been reported,[13] some revision to the law would be advisable to reinforce even further the NBM Board's independence. NBM Board members and employees, including staff

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[7] The size of the fund secured so far (MLD 171.9 million) represents only 0.37 percent of the total deposits in the banking sector.

[8] In three banks, one of which is systemically important, the CEO is directly appointed by the shareholders assembly, according to their charters.

[9] As a result, it may take about one year for a regulation to be issued.

[10] Until January 2014, the suspension of actions by the NBM was immediate. In order to mitigate this problem, amendments were made to the Law in respect of making administrative contention and the resulting NBML entered in force on January 24, 2014. Actions by the NBM can be suspended by the court, under the NBML at the request of the plaintiff, with the compulsory summoning of the parties, and after the act has been challenged before the Council of Administration of the NBM (art. 11[1] of the revised NBML).

[11] For example, some provisions of the regulation on Large Exposure Limit have been suspended.

[12] According to which the Governor and other members of the Council of Administration "*shall be removed from office (…) if they are incompatible, as established by a definitive act*" (LNBM, art. 27, f).

[13] The previous NBM governor enjoyed several successive mandates, spanning 18 years in one case, which indicates a fair degree of stability and autonomy.

appointed as bank's liquidator, do not enjoy enough protection against lawsuits while discharging their duties in good faith. Some amendments were made to the LFI as recommended by the 2008 FSAP but the new language is too general and does not include specific protection for Board members. Further, the current law does not indicate the nature of the liability for employees, civil and/or criminal. Lastly, staff does not receive any financial assistance in case of lawsuits.

Enforcement of prudential regulations is not optimal and the current legal regime contains serious limitations or flaws. Under Article 38 of the LFI, the NBM can use a wide range of instruments to address problems in banks or violations of regulatory obligations. In practice, NBM has adopted over the past years several measures as a result of multiple infringements, particularly in relation to (i) insufficient size of Tier I capital; (ii) assets quality; (iii) misreporting; (iv) deficiencies in internal control systems; and (v) violations in preventing and combating Money Laundering/Terrorist Financing (ML/TF). However, in case of persistent deficiencies in the same institutions, the NBM should have taken, in the assessors' opinion, more forceful actions. Further, in certain circumstances, the lack of protection as discussed above may lead NBM's management to refrain from taking tougher measures. On the other hand, sanctions contemplated in relevant law (e.g., LFI, NBML, and AML/CFT law) do not seem dissuasive enough, particularly when it comes to pecuniary sanctions. The NBM does not have in-house methods that could provide management minimum guidance on how to apply criteria for sanctions as defined in the law. This does not permit proportionate response. Lastly, according to the NBM law, sanctions taken by the NBM (Article $75^2(4)$) are subject to a legal prescription of 6 months[14] after the NBM report is submitted to the bank and the violation itself to a prescription of 3 years.

Transparency in banks' ownership structure is still a major problem that has cascading effects on several risk exposures. For several years, the NBM has been struggling to get a clear vision of banks' ownership structures. Regulations, internal processes and reporting mechanisms have been designed or reinforced to capture meaningful information and data on shareholders. Unfortunately, most of the recent changes in ownership of Moldovan banks have been conducted in a complete opaque manner[15] and did not receive previous NBM clearance or disapproval. As a result, undisclosed "raiders" acting in concert have been able to acquire or accumulate significant controlling stakes in banks which can impact the nature of the bank's business and potentially, their safety and soundness.[16] The issue of transparency in bank's ownership is a widespread problem; according to a prominent external audit company, only 2 banks out of 10 (excluding the foreign ones) "*have more or less a clear, transparent shareholder structure*". The lack of information on the

[14] After 6 months, it is understood that application of sanctions are not possible.

[15] In many cases, ownership was acquired piecemeal through stock market operations, in transactions just under 5 percent of the subject bank's capital, in order to intentionally circumvent the law and escape NBM vetting.

[16] See the Corporate Governance Review of the Moldovan Banking System, 2014.

ultimate beneficial owner of these stakes is also affecting the surveillance of related parties[17] and large exposure limits and may expose banks to excessive concentration risks.

The situation regarding ML/TF warrants close scrutiny. Moldova has taken several initiatives to address ML/TF related issues. The approval by the Parliament, of the National Strategy to combat ML/TF is a significant step forward in this regard. Also, key amendments made to the Penal Code will enter into force in 2014, reinforcing sanctions in case of AML/CFT violations. In addition, the Office for Preventing and Combating ML requested in November 2013 TA to carry out the ML/TF National Risk Assessment of Moldova based on the World Bank methodology. Efforts to equip NBM staff with advanced AML/CFT methodology have also been pursued. Despite these positive steps, the NBM is still facing important challenges that hamper the effectiveness of ML/TF surveillance in banks. The AML/CFT unit of the NBM seems to be understaffed. In addition, the issue of the lack of transparency in bank ownership and the difficulties faced by banks in identifying Ultimate Beneficial Owners (UBOs) are serious concerns. Moreover, two particular issues already well known by the NBM, warrant maximum attention. According to the Financial Intelligence Unit (FIU), cross-border transactions of major proportions (amounting to about 1 trillion LEI[18]) involving Moldovan banks have been detected. These transfers seem to be performed by companies operating from off-shore centers with undisclosed UBO, likely for tax evasion purposes. The second matter of concern relates to the situation with Transnistria.[19] Unrecognized by any United Nations member state, Transnistria is designated by the Republic of Moldova as the Autonomous territorial unit with special legal status. From an AML/CFT standpoint, the region is a *black hole* that led the authorities to declare suspicious any single transaction, irrespective of the amount, between Moldovan banks and Transnistrian banks. Besides, these outbound financial flows are quite significant (2 billion LEI in 2013) and are operated by companies with unknown beneficial owners. The authorities, at least at the NBM level that monitors on a daily basis these transactions, have little room for maneuver and to adopt remedial actions as it would bring immediate political reaction. Lastly, in 2012, Moneyval assessed the AML/CFT regime of Moldova and noted that in the absence of a risk assessment, the implementation of "adequate risk-based supervision was not demonstrated."

The NBM is understaffed. Assessors are of the view that there is a need to increase manpower within the BSRD. Considering the situation of four problematic banks, given also the effort to be made in the near future for adjusting the banking system to EU requirements and the migration to Basel II, the current level of human resources (including skills) for supervision is proven to be insufficient. Moreover, the conditions for allocating the budget to the BRSD are not transparent. In

[17] BCP assessors were told during their interviews with an external audit company that for 2013, three banks will receive a qualified opinion for not complying with the regulation on exposure to affiliated and connected parties.

[18] According to the NBM, this figure seems to be exaggerated.

[19] Located mostly on a strip of land between the River Dniester and the eastern Moldovan border with Ukraine. Assessors did not evaluate BCPs in this region.

the absence of a clear indication about the budget allocated to supervision, it is almost impossible for the Head of the BSRD to design a forward looking supervisory strategy.

Against this background, a series of essential legal and institutional reforms are indispensable to bring Moldova to a higher level of conformity with the International Standards for banking supervision. The recommendations are summarized in Table 2 below.

SUMMARY, KEY FINDINGS, AND RECOMMENDATIONS

A. Introduction

1. **This assessment of Moldova current state of compliance with the Basel Core Principles for Effective Banking Supervision (BCPs) was undertaken as part of a joint IMF-World Bank mission in connection with a broader Financial Sector Assessment Program exercise.** The current assessment was performed according to the revised content and methodology introduced in 2012, and is not comparable to previous assessments carried out in 2008 and 2005. This version of the Assessment has a greater focus on risk management policies and practices implemented by supervised institutions and their assessment by the supervisory authority as well as more emphasis on quality implementation of supervisory standards.

B. Information on the Methodology Used for Assessment

2. **The Assessment has been conducted in accordance with the revised BCP assessment methodology approved by the Basel Committee and was based on extensive discussions with officers and staff members of the Banking Supervision Department in NBM, and a review of internal supervisory documents, such as manuals, operating policies, examination reports, and external audit reports.** The mission reviewed the BCP self-assessment undertaken by NBM preceding this assessment, and detailed responses to a questionnaire addressing supervisory issues. The mission held meetings with representatives of the NBM, including the Governor, and with the Minister of Finance (MOF) and the Moldovan Banks Association. Meetings also were held with senior officials of several local banks and an external auditing firm. The mission also reviewed a number of laws and regulations governing banking supervision powers and activities, including the Law on Financial Institutions (LFI), the Law on the National Bank of Moldova (LNBM), and a number of regulations and decisions addressing prudential standards and risk management requirements, and other laws relevant to the operations of banking institutions. The authorities provided comments on a draft version of this assessment.

3. **The Moldovan supervisory regime was assessed and rated against both the Essential and the Additional Criteria, but the ratings assigned were based on compliance with the Essential Criteria.** The methodology requires that the assessment be based on (i) the legal and other documentary evidence; (ii) the work of the supervisory authority; and (iii) its implementation in the banking sector. Full compliance requires that all these prerequisites are met. The guidelines allow that a country may fulfill the compliance criteria in a different manner from those suggested as long as it can prove that the overriding objectives of each CP are achieved. Conversely, countries may sometimes be required to fulfill more than the minimum standards, such as in the event of structural weaknesses in that country. The methodology also states that the assessment is to be made on the factual situation of the date when the assessment is completed. However, where applicable, the assessor made note of regulatory initiatives that have yet to be completed or implemented.

4. **An assessment of compliance with the Core Principles is not, and is not intended to be, an exact science; reaching conclusions require judgments by the assessment team.** Banking systems differ from one country to another, as do domestic circumstances. Also, banking activities are changing rapidly around the world after the crisis and theories, policies and best practices are evolving rapidly. Nevertheless, by adhering to a common agreed methodology, the assessment should provide the Moldovan authorities with an internationally consistent measure of quality of their banking supervision relative to the 2012 revision of the Core Principles, which are internationally recognized as minimum standards.

INSTITUTIONAL AND MACROECONOMIC SETTING AND MARKET STRUCTURE

5. **The financial sector in Moldova is dominated by banks.** The banking sector comprises 14 commercial banks with assets equivalent to about 70 percent of GDP—small compared with its neighboring peers. The structure of the Moldovan banking system is based on universal banking.

6. **There is a high degree of interconnectedness on the interbank market and significant exposure to Russian banks**. In effect, cross-border financial linkages have increased dramatically since 2011 and have become more complex. During this period foreign placements of the Moldovan banking system almost doubled as a percent of GDP, while foreign liabilities increased by more than 50 percent. The increased interconnectedness, particularly in the context of geographical and historical factors, and increasing bank governance problems, makes the Moldovan banking system prone to systemic risks.

7. **There is significant concentration in the banking system at the end of December of 2013.** Out of 14 operating banks, the largest six banks (Peer group 1) hold about 77 percent of total assets, 74 percent of outstanding loans, and 77 percent of deposits. In contrast the three smallest (Peer group 3) hold three percent of total assets. Corporate loans are also concentrated in a few key economic sectors, with 45 percent channeled to the trade sector and 11 percent to food industry.

8. **Foreign ownership appears to dominate and there is considerable sectoral concentration in credit.** Almost 72 percent (end 2013) of the capital in the banking system is reported to be in foreign ownership 0.5 percent more than in 2012 but this feature reflects disguised ownership of banks discussed elsewhere in the report (see, for example, paragraph 17). There are seven banks with majority foreign shareholding, out of which four are subsidiaries of foreign banks. At the end of December 2013, subsidiaries represent about 17 percent of total banking sector assets. These subsidiaries are principally operations of European banks, with the largest presence held by French and Italian banks. Bank credit is concentrated in the corporate sector, representing 88 percent of loans at the end of 2013, and funded by local deposits. Loans to households are primarily consumer loans.

9. The sector wide average rate of nonperforming loans (NPLs), at 11.6 percent at the end of 2013, is trending down since 2012 but disguises a wide variation in individual bank portfolios. Specific banks have NPL ratios exceeding 60 percent of total loans. Additionally, very sharp volatility in NPLs has been witnessed in certain banks, reflecting banks' attempt to manage the situation with the use of collateral, both by requiring the lodging of cash collateral and by allocating residential property as collateral against loans showing signs of distress.

10. Liquidity and capital adequacy ratios of Moldovan banks seem to be satisfactory based on reported prudential data. In December 2013, the aggregate capital adequacy ratio stood at 23.4 percent, above the required minimum of 16 percent, with both liquidity ratios (0.7 for long-term liquidity and 33.8 percent for short-term liquidity) within the required limits (1 for long-term liquidity ratio and 20 percent for short-term liquidity ratio). NPLs net of provisions as a percentage of regulatory capital was 16.6 percent. As the NBM is still using the Basel 1 framework for capital adequacy, there are limited options for recognizing the impact of collateral practices in the capital ratios but it is clear that reported capital adequacy depends heavily on collateral being in place and the solvency of the banks in some cases may be heavily dependent on the ability to execute such collateral successfully. Liquidity risk is hard to measure, however, as in some cases the high reported level of liquid assets appears unreliable: some assets may be encumbered through undisclosed side agreements.

11. Nonbank financial institutions and markets are still small and underdeveloped. The equity and foreign exchange (FX) markets are shallow, and the nonbank financial institutions are small. Nonbank financial institutions, including 2 stock exchanges, 16 insurance companies, 80 insurance brokers, 83 microfinance institutions, and 338 savings and credit associations, are regulated and supervised by the NCFM.

PRECONDITIONS FOR EFFECTIVE BANKING SUPERVISION

A. Soundness and Sustainability of Macroeconomic Policy

12. Moldova's institutional framework supporting the conduct of macro-economic policy is led by the NBM and the MOF. Monetary policy is conducted by the NBM, and budgetary policy is conducted within a fiscal framework managed by the MOF. In 2010, the authorities set up the NCFS to discuss all financial stability related issues (see below for more details).

B. The Framework for Financial Stability Policy Formulation

13. The NBM is exclusively responsible for the licensing, supervision and regulation of the (banking) financial institutions activity. Its main responsibilities are (i) to conduct economic and monetary analyses and, based on them, to submit proposals to the Government, to publish the results of the analyses; (ii) to license, supervise and regulate the activity of financial institutions; (iii) to provide credits to banks; (iv) to supervise the payment system of the country and to facilitate the efficient functioning of the interbank payment system; and (v) to undertake obligations and perform transactions resulting from the participation of the country in the activity of international public institutions in the banking, credit and monetary areas pursuant to conditions of international agreements.

14. The NCFM is responsible for supervising and regulating the non-banking financial institutions. The NCFM was created in 2007 as the non-bank financial regulator to regulate and authorize the activity of professional participants to the non-banking financial market and supervise observance of legislation by them. Its main functions are (i) to enhance stability, transparency, security and efficiency of the non-banking financial sector, by adoption of an adequate regulatory and supervisory framework of the participants on the financial market; and (ii) to reduce systemic risks and to prevent disloyal, abusive and fraudulent practices in the financial sector with the scope of protecting the interests of investors.

15. A high-level financial stability group, known as NCFS, became operational in 2010 and meets periodically to monitor developments and risks to the financial system. The group is chaired by the Prime Minister and includes the Governor of NBM, Chairman of the NCFM, Minister of Economy, General Secretary of the Government, Minister of Finance, Chairman of the Commission on Economy, Budget and Finance, Parliament of the Republic of Moldova, General Executive Director of DGFBS.

C. A Well-developed Public Infrastructure

16. The general framework for debtor/creditor relationships has been the object of numerous reforms in Moldova. Most of the laws covered in the 2014 ICR[1] assessment are less than ten years old. Some have either been or are in the process of being further reformed. Despite those reforms, the insolvency and debtor/creditor regimes are not functioning as they should. A "rescue culture" will need to be developed and the institutional framework strengthened to make such procedures effective. Some aspects of the legislation will also require improvement, in particular in order to facilitate early filing and support going concern sales and reorganizations.

17. The lending activity of financial institutions is essentially based on secured lending. The practice of banks, as well as other financial institutions, is to grant loans primarily on the basis of security in real property. There is very little unsecured credit for enterprises, and secured lending against certain important types of moveable assets (inventory, receivables) is rarely used. Lending is based primarily on collateral value rather than on the viability of the borrower. The lack of a functional share registry severely constrains the use of pledges over shares as a viable form of collateral for lending. Overall, access to financing is consistently listed as a major constraint on entrepreneurial activity in Moldova.

[1] Insolvency and creditors'rights.

18. The mortgage regime is generally adequate and effective. However, the regime for secured transactions over movable assets requires further improvement. There is lack of confidence in taking security over pools of assets. Many economic and legal actors misinterpret basic concepts of the law, such as the requirement of sufficient description of the collateral, or the interaction between secured transactions law and data protection law. It is also relatively easy for debtors to challenge court orders for enforcement of security interests over movable assets. The current project to reform the law of pledge presents an opportunity to solve a number of technical issues in this area, in particular improving the registration system and introducing more efficient enforcement mechanisms.

19. A privately-owned Credit Bureau is operational since 2011, and it already provides information on most bank borrowers. However, given that it is presently the only provider of these services, vigilant oversight of the bureau and the reliability of data provided to it would be advisable. The bureau may usefully include other non-bank lenders, utilities and other service providers as its clients and information providers (loans from leasing companies, microfinance institutions, and savings and loans associations are not yet reported).

20. The legal framework for auditing and accounting has also undergone several reforms. However, a stronger focus needs to be placed on implementation and enforcement. The adoption by banks of IFRS in 2012 is a major improvement in this regard. In effect, the NBM issued a regulation and promoted amendments to applicable legislation, whereby IFRS reporting became mandatory for banks. As a result, the NBM reporting formats were revised and made consistent with the 2007 Accounting Law. Thus, since January 2012, the reports Balance Sheet (FIN1) and Profit and Loss (FIN2) have been filed according to the Instruction on FINREP financial situation at individual level, applicable to banks.

D. The Framework for Crisis Management, Recovery, and Resolution

21. Moldova has made progress in strengthening its financial crisis resolution framework. Significant in this respect was the establishment in June 2010 of the NCFS. The NCFS was established by the Government to promote a coordinated framework for responding to a financial crisis. It is chaired by the Prime Minister and comprises all the government agencies responsible for financial stability and crisis resolution, comprising: the Government; the Commission on Economy, Budget and Finance; the NBM; Ministry of Finance (MOF); Deposit Guarantee Fund (DGF); and the National Commission for Financial Markets (NCFM). A Technical Sub-Committee chaired by the Minister of Finance has been established to develop a coordinated approach to financial crisis resolution. In addition to this cross-agency framework, the NBM has established an internal committee on financial stability chaired by one of the Vice Governors, with responsibility for coordinating the NBM's crisis resolution policies and procedures.

22. Some of the laws required for bank crisis resolution are in place. In particular, the LFI provides the NBM with a range of powers to deal with bank distress situations. These include the ability to place a bank under special supervision to assist in identifying the bank's difficulties and formulating response options, the power to give binding directions to a bank in certain circumstances and the ability to appoint a special administrator to assume control of a bank. Once a bank is under administration, the NBM has powers to undertake a number of resolution options, including facilitating its recapitalization, transferring some or all of its business to another bank, and preparing the failed bank for liquidation. Deposit insurance arrangements under the oversight of the DGF provide protection to retail depositors, albeit only to a very low level of deposit (MDL 6,000—see below for more details). Nonetheless, there are significant gaps and deficiencies in the law that would impede the ability to implement a bank resolution cost-effectively and with appropriate credibility and certainty.

23. The NBM has made some progress in developing the internal frameworks needed for crisis resolution within the limitations of its powers. It has required banks to develop recovery plans. It has also developed internal guidance on aspects of crisis resolution policies and procedures. However, there is a need for much more to be done if the NBM is to achieve readiness for effective crisis resolution. In particular, it needs to refine its solvency assessment capacity (especially under time pressure), more closely assess the ability of banks to action their recovery plans, undertake resolvability assessments of all systemically important banks, develop crisis resolution strategies (including for bail-in, bridge bank and recapitalization), and develop bank-specific resolution plans.

E. The Adequacy of Systemic Protection (Public Safety Net)

24. Depositor protection is the lowest in Europe, at MDL 6,000 (the equivalent of some USD440) per depositor, and lacks the capacity for rapid payout in anything other than very small cases. The DGF is reasonably funded for the current level of coverage, which includes FX deposits, but only in the case of small bank failures. It lacks sufficient funds for paying out or funding deposit transfers in the case of medium to large bank failures without recourse to funding from the MOF. There are no established funding lines available at present. Moreover, the DGF lacks access to sufficient and timely data for more rapid payouts, and banks are not required to have the systems in place to calculate deposit balances on a single customer view basis. This hinders prompt and accurate pay-out. There are some small non-bank deposit takers (supervised by the NCFM), but deposits in these entities are not insured.

F. Effective Market Discipline

25. Moldova's corporate governance framework and practice exhibit major weaknesses. Recent ownership shifts have resulted in nontransparent changes in Board members and CEOs. Moreover, the roles and responsibilities of ownership, oversight (Board), and management are substantially blurred, resulting in no clear accountability. While most banks report that the CEO is accountable to the Board, in practice the CEO reports to the controlling shareholder either directly or indirectly, depending on operating practice. Boards lack objectivity and independence, and are not well qualified to oversee financial institution operations.

26. Transparency in banks' ownership structures is still a concern. The NBM led the drafting of amendments aimed at enhancing transparency of shareholders. The proposed legislation regulates ownership disclosure, including affiliated persons, their transactions, volume and quality of information to be supplied to the NBM by bank shareholders, and contains strict provisions on mandating banks and non-banking financial companies to publicly disclose their UBOs. In practice however, the identity of the UBOs of some of the largest banks in Moldova is not clear, and the control that they exert over these banks and their apparent motivations and actions do not seem to be in the best interest of the financial system, or banks' other stakeholders, including minority shareholders, depositors, and the public.

27. Although Moldova has a policy framework for tackling corruption and the country has made strides in closing the large implementation gap, serious issues related to governance and corruption remain. However, the country continues to face significant challenges in improving the enforcement and implementation of legislation adopted largely because of EU accession requirements. Moldova ranks 105 out of 178 countries in Transparency International's corruption perception index 2010, which is better than almost all former Soviet republics, yet lower than other countries in Eastern Europe. Corruption in the Judiciary has stemmed from malpractice by multiple stakeholders and as a result, the rule of Law does not apply.

MAIN FINDINGS

Table 1. Summary Compliance with the Basel Core Principles—Detailed Assessments

Core Principle	Grade	Comments
1. Responsibilities, objectives, and powers	**MNC**	NBM powers have been disminished by the country's Constitutional Court. The recommendations issued by the NBM are not binding. It is not clear whether the NBM has the power to increase banks' prudential requirements. There is no explicit provision in the law stipulating that the objective of banking supervision is to promote safety and soundness of the financial system Objectives of banking supervision may conflict with other objectives.

Table 1. Summary Compliance with the Basel Core Principles—Detailed Assessments (continued)

Core Principle	Grade	Comments
2. Independence, accountability, resourcing and legal protection for supervisors.	**MNC**	The Corporate Governance structure of the NBM is not satisfactory. The conditions for dismissing the Governor and other Board members are unclear. NBM Board members and employees do not enjoy enough protection against lawsuits while discharging their duties in good faith. NBM staffing seems to be insufficient in the context of growing activities. The BSRD budget allocation process is not transparent. Sanctions for breaching the Code of conduct and the Anti-fraud Policy are not specified. NBM staff is allowed to hold shares in banks. There is no requirement for the NMB to render account of its performance in regard to its supervision activities.
3. Cooperation and collaboration	**LC**	Delineation of responsibilities among members of the NCFS (including the NBM) is not clear.
4. Permissible activities	**C**	
5. Licensing criteria	**LC**	Full ownership details of certain banks licensed in the past, including details on the UBO, are still missing. Regulation does not specifically require individual Board members or the Board collectively to have a sound knowledge of the material activities that the bank intends to pursue, and the associated risks.
6. Transfer of significant ownership	**MNC**	Ownership structure is still opaque in several banks. Questionable rulings by Provincial courts undermine the integrity of the regime applied to transfer of ownership.
7. Major acquisitions	**C**	

Table 1. Summary Compliance with the Basel Core Principles—Detailed Assessments (continued)

Core Principle	Grade	Comments
8. Supervisory approach	**LC**	The current supervisory inspection planning does not take into consideration risk profile of each bank nor their systemic importance. The human resources allocated to both on-site and off-site supervision does not appear adequate.
9. Supervisory techniques and tools	**LC**	It sometimes takes up to a year to issue an on-site inspection report (this was the case in 2013). These delays may affect the ability of a bank to take timely corrective measures. The frequency and intensity of supervision should depend more on the systemic relevance of the banks and the risks identified.
10. Supervisory reporting	**LC**	In the absence of proper IT application, the BSRD devotes excessive resources to perform manually several off-site activities. Prudential returns are not provided on a consolidated basis.
11. Corrective and sanctioning powers of supervisors	**MNC**	The enforcement powers of the NBM have been diminished. Fines contemplated in relevant laws (e.g., LFI, NBML and AML/CFT law) do not seem dissuasive enough. The NBM does not have in-house methods that could provide management with guidance on how to apply criteria for sanctions as defined in the law. The prescription regime applicable to sanctions diminishes effectiveness of enforcement.[2] The NBM response is not increased in case of persistent breaches. The Special Supervision regime does not seem well designed.

[2] Sanctions taken by the NBM (art. $75^2(4)$) are subject to a legal prescription of six months after the submission of the report to the bank and the violation itself to a prescription of three years. Beyond this period of six months, sanctions cannot be applied. Also, if the commission of the violation is older than three years, it cannot be sanctioned.

Table 1. Summary Compliance with the Basel Core Principles—Detailed Assessments (continued)

Core Principle	Grade	Comments
12. Consolidated supervision	**MNC**	The NBM's approach to consolidated supervision is not comprehensive and effective.
13. Home-host relationships	**LC**	The ability of NBM to develop a resolution plan to address evolving bank problems and possible resolution in a cross-border situation, especially for the existing four subsidiaries of non-domestic banks, has not been developed due to the inaction of the home supervisor.
14. Corporate governance	**MNC**	The CG regime exhibits important weaknesses
15. Risk management process	**MNC**	No clear RM framework. RM functions have not been established in a large number of banks. The NBM approach to evaluating risk management in banks is heavily reliant on the on-site monitoring process.
16. Capital adequacy	**LC**	Exposures secured by Real estate mortgages do not receive proper capital charge. There is no capital charge for FX exposures (open positions).
17. Credit risk	**MNC**	Excessive reliance on collateral rather than on the financial capacity of the debtor.
18. Problem assets, provisions, and reserves	**MNC**	There are multiple cases of misclassification. The periodicity for classification is too long.
19. Concentration risk and large exposure limits	**MNC**	The current regulation on LEL does not contain a specific definition of risk concentration. Interbank exposures are not captured by the regulation on the LEL. Observance by banks of the risks concentration limits is questionable. Lack of transparency in ownership structure of certain banks undermines the understanding of connected lending and as a result concentration risks. Some provisions of the LEL regulations have been suspended by a Court.

Table 1. Summary Compliance with the Basel Core Principles—Detailed Assessments (concluded)

Core Principle	Grade	Comments
20. Transactions with related parties	**MNC**	The lack of information on the ultimate beneficial owner of banks' stakes is directly affecting the surveillance of related parties. There are still concerns about the effectiveness of the current supervisory regime for related parties.
21. Country and transfer risks	**LC**	Several banks are excessively exposed through inter-banking placements in cross-border banks.
22. Market risk	**LC**	Market risk from trading book not captured.
23. Interest rate risk in the banking book	**LC**	There are no requirements for banks to compute and submit to NBM the results of their internal interest rate risk measurement systems, expressed in terms of the threat to economic value, including using a standardized interest rate shock on the banking book.
24. Liquidity risk	**LC**	Off-balance sheets commitments are not included in prudential liquidity requirements; consequently the risk profile of the bank did not capture risks arising from these exposures.
25. Operational risk	**MNC**	OR not well captured in current regulation.
26. Internal control and audit	**LC**	Compliance functions nonexistent in banks. No professional qualification requirements and fit and proper assessment for head of internal audit.
27. Financial reporting and external audit	**LC**	Banks disregard qualified opinion expressed by external auditors.
28. Disclosure and transparency	**C**	
29. Abuse of financial services	**MNC**	Massive cross-border operations originating from and/or flowing to off-shore centers. All operations with Transnistria have been declared suspicious. Banks have not yet performed their own risk assessment of ML/TF risk.

RECOMMENDED ACTION

Table 2. Recommended Action Plan to Improve Compliance with the Basel Core Principles	
Reference Principle	**Recommended Action**
Principle 1	• Strengthen NBM power by removing any interference of the MOJ in the process of secondary legislation. • Include an explicit provision in the law stipulating that the objective of banking supervision is to promote safety and soundness of the financial system. • Include in the LFI an explicit stand-alone provision to grant NBM the power to increase the prudential requirements for individual banks and banking groups based on their risk profile and systemic importance.
Principle 2	• Reform the Corporate Governance structure of the NBM to ensure clear segregation of functions. • Restore full independence of the NBM by protecting members of the board from external influence; • Add in the NBM law a provision stipulating that no member of the NBM's Board can be replaced for reasons or following a procedure other than those stipulated in Article 27 • Provide full legal protection to all NBM employees in case of lawsuits for actions in good faith; • -Provide full indemnification benefits to NBM staff in case of litigation for action performed in good faith. • Specify in the law the types of liability NBM employees are subject to; • Improve transparency in budget allocation for Supervision activities; • Include clear sanctions in the code of conduct in case of breach; • Prohibit NBM's employee from holding an equity interest in banks; • Increase NBM manpower, particularly with respect to the transition to Basel II/Basel III and the establishment of an enhanced banking resolution mechanism. • Reinforce transparency by issuing 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).

Table 2. Recommended Action Plan to Improve Compliance with the Basel Core Principles (continued)

Reference Principle	Recommended Action
Principle 3	• Expand the NBM cooperation agreement with other relevant bodies such as the DGF and the Credit Bureau. • Clarify the conditions of exchange of confidential information among all members of the NCFS. • Explore the possibility for the Head of BSRD to attend meetings of the NCFS, at least as an observer, or, at the minimum provide him access to the minutes of the committee meetings. • Pursue efforts to finalize MOUs with home supervisors of foreign subsidiaries located in Moldova e.g. Italy, France, Germany and Austria.
Principle 4	
Principle 5	• Increase efforts in establishing full ownership details of certain banks licensed in the past, including details on the UBO. • Include in the regulation a provision requiring individual Board members or the Board collectively to have a sound knowledge of the material activities that the bank intends to pursue, and the associated risks.
Principle 6	• Intensify pressure on the NCFM about its duties and accountability vis-à-vis the national depository to ensure identification of the UBO. • Ensure alignment between the LFI and other NBM regulations on significant holdings in banks' capital and the law governing market activities. • Increase penalties in case of fraudulent acquisition of shareholdings. • revisit the language of Article 15^6 (4) of the LFI[3] by setting a specific timeframe for the prohibition contemplated under this article[4] and by banning the person from holding interest, directly or indirectly in other banks. • Perform due diligence to ensure that entities located in NCJ no

[3] Stipulating that a person who no longer meets the requirement for holding equity in a bank (e.g. when exercising an influence that might jeopardize bank's sound management), "*cannot further hold directly or indirectly new shares in that bank.*"

[4] The law does not indicate whether the prohibition will expire after a certain period of time.

Table 2. Recommended Action Plan to Improve Compliance with the Basel Core Principles (continued)

Reference Principle	Recommended Action
	longer hold directly or indirectly equity interest in the capital of a bank. • Explore the possibility to subject private registrars to systemic reporting obligations to NBM on shareholder transfers (and not only to the NCFM as planned).
Principle 7	
Principle 8	• Adopt a more risk-based approach, instead of relying on compliance based procedures. • Explore the possibility to enhance off-site and on-site resources. • Implement the framework for crisis management.
Principle 9	• Improve the examination process by shortening the delay between the end of the on-site visit and the official submission of the report to the bank. • Enhance on-site and off-site supervision for systemic important banks. • Improve supervisory methodologies to enable a timely intervention in banks. • Take a more active stance in influencing the quality of internal audit in banks and establishing a regular dialogue with the bank's internal auditors. • Engage more actively in a dialogue with external auditors.
Principle 10	• Amend the relevant secondary regulations in order to require banks to submit on a consolidated basis their prudential ratios and other important information, such as: capital adequacy, large exposure, transactions with affiliated parties; • Implement a new IT application for a better execution of the off-site function.
Principle 11	• Take more forceful action in case of persistent problems, and apply gradual response, including stricter remedial measures. • Amend the law to increase the level of fines that can be applicable to individuals. • Reconsider the prescription regime for sanctions, in particular by expanding the 6 months timeframe. • Set internal guidelines to assist NBM management in determining the most adequate response in case of breach or

Table 2. Recommended Action Plan to Improve Compliance with the Basel Core Principles (continued)

Reference Principle	Recommended Action
	violation. • Monitor the application of the new LNBM law by judges to assess whether the new legal amendments introduced to mitigate the consequences of the Constitutional Court ruling are having the desired effects and do not lead to major restrictions to NBM powers. • Distinguish between remedial measures/or corrective actions (that could apply when, in the NBM opinion, the risk exposure is too high) and sanctions that should apply if and only if a bank breached the law or a regulation. • For the Special Supervision regime: • establish objective criteria for subjecting banks to the special supervision regime; • set a time frame for adopting the SSC recommendations by banks • apply this regime with discernment, e.g., when the financial condition of the bank is not compromised.
Principle 12	• Develop consolidated prudential supervision rules for the domestic groups and pursue NBM's efforts to conclude agreements with home supervisory authorities.
Principle 13	• NBM to pursue its efforts to conclude agreements with home supervisory authorities.
Principle 14	• Foster the implementation of the amendments to the Regulation on internal controls as soon as possible to promote Corporate Governance. • Amend the LFI in order to broaden the executive functions (e.g., key executives—categories of staff whose professional activities have a material impact on the credit institutions' risk profile; heads of internal control functions-risk management, compliance, internal audit), that need prior approval of the NBM based on fit and proper standards. • NBM to take more intrusive action by challenging the risk appetite and risk tolerance of a bank and evaluate tone at the top. • Continue assessing the balance of power, the incentive system and the risk appetite of a bank using instruments such as assessing the leadership profile of an administrator. • Introduce a legal or regulatory obligation that calls for the

Table 2. Recommended Action Plan to Improve Compliance with the Basel Core Principles (continued)	
Reference Principle	**Recommended Action**
	banks to notify the supervisor as soon as they become aware of any material information that may negatively affect the fitness and propriety of a Board member or a member of senior management.
Principle 15	• Increase oversight intensity in banks where risk-management processes are poor. • Ensure that all banks continue to develop their risk management policies and processes. • Introduce a legal or regulatory obligation for banks to draw up annually a report about the conditions on which internal control is performed, with a distinct presentation of the aspects related to the risk management function, compliance function and internal audit function.
Principle 16	• Require banks to apply the correct RWA for loans secured by properties
Principle 17	• Enhance supervisory scrutiny of financial analysis and valuation of collateral through loan reviews; • Focus more on determining if banks credit underwriting policies are prudent; • Introduce in the Regulation on lending activity provisions requiring: • banks to have in place procedures for assessing collaterals, especially tangible ones, based on International Valuation Standards by certified evaluators; • banks to identify, assess and frequently monitor indirect FX risk as part of the credit underwriting and monitoring process; • Consider stricter collateral requirements (LTV ratios), different indebtedness ratio for unhedged individual borrowers, more restrictive requirements for unhedged legal entities and lower limits on concentration of large borrowers subject to FX risk. • In the new regulation on internal controls, define and distinguish between FX risk arising at the level of the borrower and the risk arising from the banking activity.
Principle 18	• Amend the provisions of the regulation on assets and conditional commitments classification to require a more frequent classification at least monthly and to increase the monitoring period from three to six months in case of extended or renegotiated assets and conditional commitments.

Table 2. Recommended Action Plan to Improve Compliance with the Basel Core Principles (continued)	
Reference Principle	**Recommended Action**
	• Revise banks' accounting policy on impairments of financial assets. • Perform more oversight over compliance with IFRS, particularly for impairments.
Principle 19	• Increase level of knowledge on banks' ownership structure; • Enforce, through greater sanctions, observance of risks concentration limits; • Improve language in the regulation on LEL with defining in more details the concept of risk concentration.
Principle 20	• NBM to pursue its effort to identify shareholders and UBO who own controlling interest in banks. • Enforce the regulation more forcefully in case of grave deviations from the rules; • Increase NBM monitoring on the terms and conditions applied to deposits of related parties.
Principle 21	• Continue to promote adequate policies and practices for country/transfer risk management. • Implement and require more stringent limits in terms of individual exposure lower than those related to large exposure.
Principle 22	• Continue to promote adequate policies and practices for market risk management, including an independent risk management function. • Include in the draft Regulation on internal control system requirements on managing market risks from the trading book.
Principle 23	• Prescribe clearer provisions for banks to calculate potential changes in their economic value resulting from changes in the levels of interest rates, in accordance with their risk profile and risk management policies. • Require banks to compute and report to the NBM the change in their economic value as a result of applying a sudden and unexpected change in interest rates standard shock prescribed by the NBM (for example, a 200 basis point shock, in both directions, regardless of the currency).
Principle 24	• Complete amendments to the Regulation on internal control system and in the liquidity risk management to prescribe banks to (i) regularly assess their capacity to sell liquid assets; (ii) have

Table 2. Recommended Action Plan to Improve Compliance with the Basel Core Principles (continued)

Reference Principle	Recommended Action
	in place an adequate liquidity buffer aligned with the risk tolerance of the bank; (iii) establish formal alternative funding plans; (iv) set limits to manage day-to-day liquidity; and (v) set limits on correspondent banks. • Amend the regulation on liquidity to take into account the off-balance sheet commitments when determining liquidity ratios.
Principle 25	• Speed up the issuance of the regulation on Operational Risks and subject banks to more detailed reporting obligations on OR, beyond the reporting of frauds.
Principle 26	• Require improvements in the internal audit function to enhance overall effectiveness. • Speed up the approval process of the new Regulation on internal controls. • Introduce in the regulation on internal controls an explicit requirement for professional qualification and fit-and-proper assessment for heads of internal audit and impose an obligation on banks to notify the NBM of the dismissal of the Head of internal audit. • Exchange, on a regular basis, views on the quality and independence of internal audit with the external auditors during tri-partite meetings.
Principle 27	• Take more forceful action for ensuring audit quality by actively challenging external auditors and banks' management when understatement of provisions is identified. • Arrange more frequent periodic meetings with the auditors to discuss issues of common concerns and exchange information on important accounting, financial and auditing matters. • Give NBM examiners the power to access external auditors' working papers, where necessary. • Increase level of expertise among NBM staff to deal with IFRS issues.
Principle 28	
Principle 29	• Perform targeted on-site visits—preferably in conjunction with OPCML—to determine the nature, magnitude and economic rationale of the cross-border transactions identified by the FIU and determine proper supervisory response;

Table 2. Recommended Action Plan to Improve Compliance with the Basel Core Principles (concluded)	
Reference Principle	**Recommended Action**
	• Increase level of scrutiny in banks by doing more targeted on-site inspections in the area of PEPs, UBO, correspondent banking relationships; • Instruct banks to perform their internal ML/TF risk assessments; • Increase sanctions in case of recurrent violations of AML/CFT regulation by the same institution; • Equip NBM examiners with proper software to conduct AML/CFT on-site visits. . • proper software to conduct AML/CFT on-site visits. • Implement without delay aspects of the AML/CFT National Strategy that relates to the NBM mandate. In effect, this strategy for 2013-2017 that was approved by the Parliament in June 2013 contains several activities that are directly under the ambit of the NBM.

AUTHORITIES' RESPONSE TO THE ASSESSMENT

28. The National Bank of Moldova, as a banking regulation and supervision authority, highly appreciates the contribution of the International Monetary Fund and World Bank within the Financial Sector Assessment Program performed in the Republic of Moldova regarding the alignment with international standards in the respective area.

29. The mission's results and recommendations have helped to receive an independent and objective opinion on the real position of the banking sector in the Republic of Moldova, as well as to highlight the issues that require maximum attention and action from the banking regulation and supervision authority.

30. At the same time, it seems necessary to comment on the following issues:

31. As regards the independence of the National Bank of Moldova, since the last FSAP mission from 2008 and till now, the legal framework has been completed and amended as to strengthen the independent and autonomous statute of the National Bank of Moldova, including with regard to banking regulation and supervision activities. It is obvious that a series of issues shall be aligned to the best international practices in the nearest future, but at the same time the present situation demonstrates the existence of a positive tendency in ensuring the highest level of independence of the banking regulation and supervision authority as it is provided by the Basel Core Principles.

32. **Furthermore, the National Bank of Moldova would like to point out that according to the mission's recommendations, the transparency in ownership structure represents a subject of major importance in the supervision process.** Hence, the National Bank of Moldova acknowledges the need to increase the level of knowledge on the banks' ownership structure that could be performed by applying the measures required to comply with the best international practices in force.

33. **Additionally, a major objective of the National Bank of Moldova is to create and implement regulations on banking risks management, both financial and non-financial, which at the moment is an ongoing process.** Simultaneously, the positive results in achieving the respective objective shall lead to a significant improvement of the normative framework related to the corporate governance, which, also, represent a key area within the banking regulation and supervision process.

34. **In conclusion, the National Bank of Moldova will continue to develop and improve the normative framework and financial institutions' supervision methodologies as to comply with the Basel Core Principles.**

DETAILED ASSESSMENT

Table 3. Detailed Assessment of Compliance with the Basel Core Principles

	Supervisory Powers, Responsibilities and Functions
Principle 1	**Responsibilities, objectives and powers.** An effective system of banking supervision has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups.[5] A suitable legal framework for banking supervision is in place to provide each responsible authority with the necessary legal powers to authorize banks, conduct ongoing supervision, address compliance with laws and undertake timely corrective actions to address safety and soundness concerns.[6]

[5] In this document, "banking group" includes the holding company, the bank and its offices, subsidiaries, affiliates and joint ventures, both domestic and foreign. Risks from other entities in the wider group, for example non-bank (including non-financial) entities, may also be relevant. This group-wide approach to supervision goes beyond accounting consolidation.

[6] The activities of authorising banks, ongoing supervision and corrective actions are elaborated in the subsequent Principles.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
Essential criteria	
EC1	The responsibilities and objectives of each of the authorities involved in banking supervision[7] are clearly defined in legislation and publicly disclosed. Where more than one authority is responsible for supervising the banking system, a credible and publicly available framework is in place to avoid regulatory and supervisory gaps.
Description and findings re EC1	In Moldova, the provisions relating to responsibilities, objectives and powers can be found in two major legislations; (i) the Law on the NBM (hereafter LNBM); and (ii) the LFI (hereafter LFI) that governs the activity of financial institutions. According to Article 5 (d) of LNBM, the NBM is vested with the power to license, supervise and regulate the activity of financial institutions. In addition, pursuant to art 44 of the same law, the NBM has sole responsibility for banking supervision. In effect, the NBM is exclusively responsible for the licensing, supervision and regulation of the financial institutions activity. To that end, and according to the provisions contained in Article 44 mentioned above, the NBM is empowered: (a) to issue the necessary regulations and to take the proper actions in order to perform its powers and duties under this law, by way of licensing financial institutions and elaborating supervision standards and establishing the way of implementing the regulations and measures mentioned above; (b) to perform, through its staff or other qualified professionals involved for this purpose, inspections over all financial institutions, and to examine these institutions' books, documents and accounts, conditions in which the business is carried out and financial institutions' compliance with the legislation; (c) to require any employee of the financial institution to provide the NBM with the information necessary. (d) Further, Article 44 provides clear enforcement powers to NBM, including remedial measures and sanctions against banks or their employees. In order to achieve its attributions, the NBM has also the right to issue regulations and recommendations. In effect, articles 11 and 44 of LNBM stipulate that the NBM has the right to issue normative acts related to supervision which shall be approved by the NBM's Council of Administration and are mandatory for all financial institutions. (e) Other provisions on the responsibilities of the NBM can be found in the LFI. Article 4 grants the NBM exclusive right for licensing banks. Article 28 on prudential measures subject banks to regulations issued by the central bank. Moreover, Article 37 of the same law subjects banks to NBM's staff inspection while Article 37 (1) establishes NBM special "supervision powers" to deal with problem banks. These supervisory functions are performed by the BRSD.

[7] Such authority is called "the supervisor" throughout this paper, except where the longer form "the banking supervisor" has been necessary for clarification.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	In the particular area of AML/CFT, the NBM has the power to supervise AML/CFT compliance in banks. The FIU can also perform on-site assessments at the request of the NBM. The NBM has no responsibilities over non-bank financial institutions. This functions lies with the National Commission for Financial Markets, which regulates licenses and oversees participants to the non-banking financial market. The responsibilities and objectives of the NBM are also clearly disclosed on the Central Bank website; for example, it is indicated that "*The NBM is responsible for the authorization, the supervision and the regulation of financial institutions' activity. These attributions are exercised taking into account the Core Principles of Basel Committee for an efficient banking supervision*." In addition, all relevant legislation and regulations that set out the duties of the NBM are available on line (http://www.bnm.org/en/home). On the other hand, the normative acts of the NBM, which are compulsory for financial institutions (with the exception of recommendations, see below comment section) are published in the Official Monitor of the Republic of Moldova and come into force either on the date of their publication, or on another date stipulated in the text of the respective normative act, provided that the public is informed accordingly.
EC 2	The primary objective of banking supervision is to promote the safety and soundness of banks and the banking system. If the banking supervisor is assigned broader responsibilities, these are subordinate to the primary objective and do not conflict with it.
Description and findings re EC2	According to Article 4 of the LNBM, the primary objective of the NBM is to "ensure and maintain the price stability". The same provision stipulates that without prejudice to this primary objective, the NBM shall promote and maintain a financial system based on market principles and shall support the general economic policy of the State. Other critical responsibilities and objectives are articulated in Article 5 of the same Law, including the "basic" tasks of licensing and supervising banks. However, there is no explicit provision either in the LNBM or the LFI stipulating that these activities (primary and basic tasks) are performed with the goal of achieving banking system safety and soundness. Here, the reference to stability is strictly confined to price, not to financial stability as a whole. During interviews with the team, authorities observed that, according to Articles 1 and 28 of LFI, banks are required to comply with prudential measures provided by the NBM, to protect the interests of household depositors and information on deposits, to prevent excessive risk to the financial system, to promote a strong and competitive financial sector and to facilitate the market forces to provide financial services. The tasks of the NBM are set out in the LNBM and LFI and are subordinated to its primarily objective.
EC3	Laws and regulations provide a framework for the supervisor to set and enforce minimum prudential standards for banks and banking groups. The supervisor has the power to increase the prudential requirements for individual banks and banking groups based on their risk profile[8] and systemic importance.[9]

[8] In this document, "risk profile" refers to the nature and scale of the risk exposures undertaken by a bank.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
Description and findings re EC3	In Moldova, laws and regulations provide a framework for the NBM to set minimum prudential standards for banks and banking groups. In effect, Article 6, 7, 15-158 and 21 of LFI lay down instructions for banks requiring them to observe prudential standards determined by the NBM relative to capital, assets, liquidity and other necessary matters. For example, according to Article 28 of the LFI, banks are subject to the following maximum limits as prescribed by the supervisor: (a) the maximum ratios and exposures to be maintained by a bank concerning its assets, risk weighted assets, and off-balance sheet items and different categories of capital and reserves; (b) the maximum aggregate amount of loans granted and contracted relative to the regulatory capital, which a bank shall be permitted to grant to a person or group of persons in a special relationship with the bank; (c) the maximum amount of loans granted and contracted relative to the total amount of bank loans of which can benefit from the ten largest borrowers (including groups of persons in a special relationship with the bank). In the area of liquidity, and according to the NBM regulations, a bank shall observe the requirements regarding the minimum amount of liquid resources or specific categories of such resources in relation to the value or change in value of assets (including guarantees and collateral received) or specific categories thereof, or in relation to the amount or change in amount of liabilities or specific categories of liabilities. The law also provides a framework for the NBM to enforce the minimum prudential standards detailed above. As indicated above, Article 44 of the LNBM grants enforcement powers to the NBM, including remedial measures and sanctions (for further details, please see CP 11). However, it is noteworthy that the legal framework does not explicitly grant the NBM power to increase the prudential requirements for individual banks and banking groups <u>based on their risk profile</u> and <u>systemic importance</u>. In their self-assessment, the authorities refer to the possibility (provided by Article 44 of LBNM) to use remedial measures or sanctions as a mean to increase prudential requirement for banks. In assessors' opinion, this is not how EC3 should be interpreted. A bank may not be in trouble, but its risk profile or systemic importance may warrant, for example, a higher CAR. This possibility is not explicitly mentioned in the law, except under Chapter V (2) of the LFI on Special Administration Regime where Article 37 (9) on "financial recovery measures" allows NBM to increase bank's capital. To lift any doubt, it would be advisable, through an explicit stand-alone provision in the law, to grant NBM the power to increase the prudential requirements for individual banks and banking groups based on their risk profile and systemic importance.

[9] In this document, "systemic importance" is determined by the size, interconnectedness, substitutability, global or cross-jurisdictional activity (if any), and complexity of the bank, as set out in the BCBS paper on *Global systemically important banks: assessment methodology and the additional loss absorbency requirement*, November 2011.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
EC4	Banking laws, regulations and prudential standards are updated as necessary to ensure that they remain effective and relevant to changing industry and regulatory practices. These are subject to public consultation, as appropriate.
Description and findings re EC4	Since the last FSAP (2008), the legal and regulatory framework for banking supervision has been updated multiple times, with several amendments over the last years in laws and subsequent regulations. The most prominent changes to the laws governing banking and banking supervision since the previous IMF/WB assessment are as follows. In the LFI, changes were made in 2008 to the requirement on the minimum amount of subscribed and filed capital of a bank. In 2009, the same law was supplemented with a new chapter governing the liquidation process. New provisions regarding the regime of special administration and the voluntary liquidation were also introduced in 2010. In the area of enforcement, the LNBM was amended to establish the so-called special supervision regime that deals with problem banks (more details can be found under CP 11) and to include new provisions relating to the withdrawal of a bank license by the NBM. Other amendments were made to the law in the areas of banking secrecy and fiduciary obligations, in particular the conditions for supplying information constituting bank secrecy. On AML/CFT, more developments were added to the LFI. The conditions under which transfer of significant ownership are made were also complemented, including provisions empowering the NBM to assess the quality of a potential acquirer of shares through an examination of qualification and experience. The regulatory regime relating to transfer of ownership also underwent several improvements with the introduction of new key concepts like "potential acquirer", "beneficial owner", "supervision relationship", "indirect acquisition/holding", "parent company", etc. As indicated by the authorities, these amendments and supplements made to the LNBM and LFI are continuously updated and so are the NBM's regulations and instructions. Projects of amendments and additions to the regulations are also ongoing, with the view, for example, (i) to promote appropriate corporate governance in the banking system (amendment to the Regulation on the requirements to Bank's administrator,[10] decision No.220 of 14.11.2013); (ii) reduce risks exposure (new provisions to the regulation on large exposures); and (iii) increase financial transparency through new processes for prudential returns, including more information on bank's financial performance, financial position, management activities, accounting policies, transparency of ownership structure etc. Moldova is also in the process of issuing a new regulation on internal control systems in banks that will incorporate detailed elements on risk management and their supervision by NBM. Last but not least, the NBM is moving towards the implementation of the Basel II Capital Agreement (with the Standardized Approach), that will lead to the modification of the existing

[10] In Moldova, the concept of administrators is quite extensive and includes not only a member of the Board, but also members of the executive body, auditing committee, the chief accountant, the manager of a branch of a legal entity, as well as any other person entrusted by law or statute to assume obligations on its own or together with others, in the name of the entity.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	legal framework and the elaboration of new legal rules related to a Bank's capital adequacy ratio that will be brought in line with EU requirements. Besides, Moldova is considering strengthening the NBM's capacity in the field of banking regulation and supervision in the context of Basel III through an agreement with the EU (European Neighborhood and partnership Instrument). In Moldova, the public is informed about the latest developments. Pursuant to Article 69 of the LNBM, the NBM publishes its annual financial report, which contains a chapter on banking activity regulation and supervision, including the amendments to the NBM's normative acts. This chapter however is very general and does not provide details on the number of inspections nor indications on the supervisory approach and strategy. The information is published on the official website of the NBM (www.bnm.md, both in Romanian and English), as well as in the annual bulletin. Moreover, according to the Law on transparency in the decision-making process, all laws and regulations are subject to public consultation.
EC5	The supervisor has the power to: (a) have full access to banks' and banking groups' Board, management, staff and records in order to review compliance with internal rules and limits as well as external laws and regulations; (b) review the overall activities of a banking group, both domestic and cross-border; and (c) supervise the activities of foreign banks incorporated in its jurisdiction.
Description and findings re EC5	The NBM has the power to have full access to banks and banking group's information for supervisory purposes. In effect, pursuant to Article 44 of the LNBM, the NBM is empowered to: (a) perform, through its staff or other qualified professionals involved for this purpose, inspections over all financial institutions, and to examine these institutions' books, documents and accounts, conditions in which the business is carried out and financial institutions' compliance with the legislation; (b) require any employee of the financial institution to provide the NBM with the information necessary for the purpose of supervision and regulating the activity of financial institutions; (c) prescribe to any financial institution remedial measures or to apply the sanctions foreseen in the LFI. The LFI also contains relevant provisions granting NBM's staff full access to banks' information. Under Article 37, NBM inspectors—or auditors appointed by the Central Bank—can require relevant banks' staff and to their subsidiary to furnish information that the Central Bank may consider necessary for the purpose of the examination or require the bank to produce for examination any books, records or other documents in his possession. It is not clear however, whether these power also cover banking groups. Both laws (LFI and LNBM) refer to financial institutions and banks, but not explicitly to banking groups.
EC6	When, in a supervisor's judgment, a bank is not complying with laws or regulations, or it is or is likely to be engaging in unsafe or unsound practices or actions that have the potential to

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)

Supervisory Powers, Responsibilities and Functions	
	jeopardize the bank or the banking system, the supervisor has the power to: (a) take (and/or require a bank to take) timely corrective action; (b) impose a range of sanctions; (c) revoke the bank's license; and (d) cooperate and collaborate with relevant authorities to achieve an orderly resolution of the bank, including triggering resolution where appropriate.
Description and findings re EC6	The LFI and the LNMB grant powers to the NBM to take (and/or require a bank to take) corrective actions, impose sanctions and revoke a bank's license. Several key provisions should be distinguished. Article 44 (d) of the LNBM allows the central bank to prescribe to any FI remedial measures or to apply sanctions contained in the LFI if the bank or its employees has violated the provisions of the LFI or a regulation issued by the NBM, has infringed its fiduciary duty or has engaged in unsafe or unsound operations. Article 75 of the LNBM also empowers the NBM to apply sanctions and other corrective measures whenever a bank does not comply with the law or NBM regulations, does not meet the licensing conditions, or fails to conform with the sanctions or remedial measures imposed by the authorities. In such cases, the NBM can, among other measures, issue a written warning, suspend activities—partially or totally—withdraw the license and/or impose a fine. Broader enforcement powers can also be found in the LFI. Pursuant to Article 38 the NBM may apply sanctions if it determines that the bank or any of its shareholders or administrators breaks the law (including obligations stipulated by the legislation regarding the prevention and combating money laundering and terrorism financing) or regulations of the NBM. The same sanctions will also apply if the bank endangers the interests of depositors or engages in risky activities; fails to meet its reporting obligations, reports false data on banking prudential indicators or fails to comply with remedial measures. In those cases, the NBM can (i) issue written warning; (ii) impose fines to the bank up to 0.5 percent of its capital and/or direct or indirect holders of shares in bank capital—up to 10 percent of the size of their shareholding and/ or to the administrator within 1 to 10 average salaries. The NBM can also suspend or dismiss an administrator, limit certain activities, and withdraw the license or authorization. Lastly, the LFI provides the NBM with other enforcement power under the so-called "Special Supervision" regime (Article 37). According to the law, the NBM may establish a special supervision procedure concerning a bank if it finds that the bank is in a "precarious financial situation". In such case, a Special Supervision Commission will be appointed and will formulate recommendations, including, but not limited to, the suspension of certain decisions of the bank's management bodies, amending/ supplementing the bank management framework, strategies, processes and mechanisms implemented by the bank; limitation and/or suspension of some bank activities and operations for a certain period of time; and any other measures deemed necessary to remedy the situation. Also, and as a result of this procedure, the NBM may decide, depending on the concrete situation, to establish special administration procedure or apply other measures set by law, including the withdrawal of license and the forced liquidation of the bank (for more details on this regime, see CP 11). Conditions for cooperation and collaboration with relevant authorities can be found under the Memorandum of understanding regarding the maintenance of financial stability dated February

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	28, 2011. The Memorandum sets the following: a) principles for maintaining financial stability and systemic financial crisis management; b) obligations and responsibilities of respective public authorities for maintaining financial stability and systemic financial crisis management; c) policy for the exchange of information; d) principles for managing the application of anti-crisis measures. Also, at the national level, the National Committee for Financial Stability has responsibilities related to ensuring an adequate coordination between public authorities, clear delimitation of responsibilities, as well as realization of prompt actions in case of extraordinary financial shocks.
EC7	The supervisor has the power to review the activities of parent companies and of companies affiliated with parent companies to determine their impact on the safety and soundness of the bank and the banking group.
Description and findings re EC7	As indicated by the Moldovan authorities, the NBM has no powers to review the activities of parent companies and companies affiliated with parent companies, in order to determine their impact on the safety and soundness of banks and banking groups. If the NBM, in the exercise of its supervisory function, identifies vulnerabilities in banks' activity as a result of parent company policies, it is empowered to require the bank to submit necessary information for the identification of the inherent risk. In that case, the NBM communicates to the home supervisory body about the situations detected through official letters or based on the existing agreements.
Assessment of Principle 1	**MNC**
Comments	Even though the legal framework currently in place reasonably provides the necessary powers to authorize banks, conduct ongoing supervision, address compliance with laws and undertake corrective actions, the current mission found a series of issues that undermines significantly NBM powers and lead to MNC for CP1. **The Ministry of Justice interferes in secondary legislation**. Before getting into force (once published in the official gazette of the Republic of Moldova), NBM regulations have to be registered by the Ministry of Justice. This is not a registration process just consisting in attributing a number to the proposed regulation. It is in fact a process that allows the MOJ to suggest or impose amendments to regulations that have in fact already been approved by NBM Board. The rationale of this intervention is "to protect human rights". The MOJ wants to make sure that the general public will not get confused by ill-designed regulations. This situation is aggravated by the fact that MOJ staff has little knowledge in banking issues, something that can seriously compromise the content of foundamental regulations. An example of this is the regulation on banks' administrator that was designed to reinforce the conditions for appointing banks' administrators. In the original version of the NBM text that was sent for registration, the language specified that a candidate needed to have at least 3 years of professional experience in economic and financial field. At the request of the MOJ, the reference to "finance was removed". Another example relates to AML; the NBM submitted for registration a regulation # 172 dated August 8, 2011, dealing with AML/CFT. The MOJ required to amend a provision in this text that was in fact an exact transcription (word by word) of the AML law. Not only does this interference undermine greatly NBM powers and its autonomy but it also creates unnecessary delays in implementing prudential policies. The mission was told that it may take about one year for a regulation to be issued because of the back and forth between NBM and the MOJ departments involved.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	NBM powers have been disminished by the country's Constitutionnal Court. According to a recent Constitutionnal Court's ruling (October 1, 2013), all acts and decisions of the NBM—including those relating to safeguard measures, resolution, assessments of shareholders—can be challenged in court, leading to the suspension of the decision under certain circumstances.[11] Despite amendments made to the LFI (LFI) to mitigate the impact arising from the ruling, there are still concerns about the capacity of the NBM to take prompt corrective measures in the area of supervision[12] (for more details, see CP11). **The recommendations issued by the NBM are not binding.** Articles 11 (3) of LNBM stipulates that NBM's normative acts are mandatory for financial institutions. The LFI also stipulates that the NBM has the right to issue normative acts related to supervision which shall be approved by the NBM's Council of Administration and are mandatory for all of the financial institutions. In this regard, the NBM issues several types of acts, namely decisions, regulations, instructions and recommendations, howeverthey are not binding unlike the other acts issued by the NBM and as a result, not enforceable (Article 2 of the LNBM). This can be problematic when recommendations are issued in areas that are of significant importance such as AML/CFT.[13] **It is not clear whether the NBM has the power to increase banks' prudential requirements.** To lift any doubt, it would be advisable, through an explicit stand-alone provision in the law, to grant NBM the power to increase the prudential requirements for individual banks and banking groups based on their risk profile and systemic importance. **There is no explicit provision in the law stipulating that the objective of banking supervision is to promote safety and soundness of the financial system**. The NBM is of the opinion that this objective is implicitly contained in the law. In this regard, a clear reference, in the law, to safety and soundness as the primary objective of banking supervision would be desirable to lift any doubt. **Moreover, objectives of banking supervision may conflict with other objectives.** Article 7 (2) of the NBM law, in the section on "International Cooperation" stipulates that the NBM may provide banking services to foreign governmental, financial and banking institutions and to public international organizations in which the NBM participates. The notion of "banking services" is not defined in the law or in any other subsequent regulation and it is understood that the NBM has never granted such facilities. However, the provision could result in conflicts between "international cooperation" and safety and soundness objectives. It is therefore recommended to:

[11] Till January 2014, the suspension of the NBM acts was immediate. In order to mitigate this problem, amendments were made to the Law on administrative contentious and the NBML that entered in force on January 24, 2014. The NBM acts can be suspended by the court, at the request of the plaintiff, with the compulsory summoning of the parties, and after the act has been challenged before the Council of Administration of the NBM (art. 11^1 of the revised NBML).

[12] For example, some provisions of the regulation on Large Exposure Limit have been suspended.

[13] The NBM issued in 2011 and 2013 two recommendations in this area, the recommendation on monitoring by banks of transaction and clients' activities to prevent ML/TF and the recommendation on bank's risk-based approach actions taking in relation to their customers in the context of preventing ML/TF.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	• Strengthen NBM power by lifting any interference of the MOJ in the process of secondary legislation; • Include explicit provision in the law stipulating that the objective of banking supervision is to promote safety and soundness of the financial system. • Include in the LFI an explicit stand-alone provision to grant NBM the power to increase the prudential requirements for individual banks and banking groups based on their risk profile and systemic importance.
Principle 2	**Independence, accountability, resourcing and legal protection for supervisors**. The supervisor possesses operational independence, transparent processes, sound governance, budgetary processes that do not undermine autonomy and adequate resources, and is accountable for the discharge of its duties and use of its resources. The legal framework for banking supervision includes legal protection for the supervisor.
Essential criteria	
EC1	The operational independence, accountability and governance of the supervisor are prescribed in legislation and publicly disclosed. There is no government or industry interference that compromises the operational independence of the supervisor. The supervisor has full discretion to take any supervisory actions or decisions on banks and banking groups under its supervision.
Description and findings re EC1	In accordance with NBM's Statute, the NBM is independent in exercising its powers and will not seek or receive instructions from public authorities or from any other authority. As stipulated in Article 1 of the LNBM, the "NBM is the central bank of the Republic of Moldova, an autonomous public legal entity". Moreover, Article 6 (4) of the same law states that the "NBM shall be independent in exercising its tasks conferred upon it by the present law, and shall neither seek nor take instructions from public authorities or from any other authority". In the same spirit, it is stated on the NBM website, that "The NBM is independent in exercising its attributions established by the Law on the NBM and neither requires, nor receives, according to the same law, instructions from public authorities or from any other authority". In terms of accountability, pursuant to Article 1 paragraph (2) of the LBNM, the NBM is responsible to the Parliament. Besides, the NBM has to report on its policy as mentioned in Article 8 (3) of the LNBM ("the Governor of the NBM or the members of the Council of Administration shall explain to the Parliament or to its standing committees the policy of the NBM"). Normative acts issued by the NBM are legally binding. As set forth in Article 11 of the LNBM, in order to exercise its tasks, the NBM shall have the right to issue decisions, regulations and instructions and these normative acts are mandatory for the financial institutions and other legal entities and natural persons (see the exception of recommendations discussed under CP1). However, it is noteworthy that, according to the Law on acts of the Government and other central and local public administration authorities, the NBM submits its normative acts (elaborated and approved by the decision of its Council of Administration) to the Ministry of Justice of the Rep. of Moldova for legal expertise and state registration. As a result of that, the NBM does not enjoy full autonomy which creates obstacles for overall application of its decisions regarding the supervision of financial institutions.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
EC2	The process for the appointment and removal of the head(s) of the supervisory authority and members of its governing body is transparent. The head(s) of the supervisory authority is (are) appointed for a minimum term and is removed from office during his/her term only for reasons specified in law or if (s)he is not physically or mentally capable of carrying out the role or has been found guilty of misconduct. The reason(s) for removal is publicly disclosed.
Description and findings re EC2	The process for the appointment and removal of the supervisory authority, which is the NBM, is contained in the NBM Law. All members of the Council of Administration—CA—(which exercises power) are appointed by the Parliament. The CA is composed of 5 people, 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 Bank Regulation and Supervision Department (BRSD)). The Governor is appointed by parliament on the recommendation of the Chairman of the parliament (Article 23 of the Law). The First Vice-Governor and the three vice-governors are appointed by parliament on the recommendation of the Governor. Candidates for the position of member of the Council of Administration may be individuals who are citizens of the Republic of Moldova, residing in the country, with an excellent reputation and work experience of 10 years in the financial and monetary areas. The Governor and other members of the CA are appointed for 7 years and the conditions for removal are identified in the Law. As stipulated in Article 27 of LNBM, the Governor and other members of the Council shall be removed from office upon the proposal of the Chairman of the Parliament if, for example, they: (i) have been convicted of a criminal offence through the definitive sentence of a court; (ii) have become insolvent; (iii) have been disqualified or suspended by the competent authorities from practicing a profession, on grounds of personal misconduct; or (iv) in the case of physical or mental incapacity. As set forth in Article 27(3) 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 Article 27(2)) on the proposal of the Governor, confirmed by a simple majority of votes of the total number4 of members of parliament (50 percent+1). The mission was told that NBM's previous leaders (Governor, Deputy Governors and heads of regulatory and supervisory divisions) fulfilled their terms according to the conditions set forth in the LNBM and other laws. Following the dismissal, they were hired to work in the banking sector (after a cooling off period), the Association of Banks in Moldova, as well as in international financial organizations such as the World Bank. Appointments/dismissals of the governor, the first vice governor and three vice-governors are announced in the Official Monitor (OM). However, the NBM law contains a provision (Article 27 f) according to which the Governor and other members of the Council of Administration "shall be removed from office (…) if they are incompatible, as established by a definitive act". This concept of "incompatibility" is not defined in the law or in any subsequent act and raises concerns. Pursuant to Article 5 of the LNBM, the NBM licenses, supervises and regulates the activity of financial institutions. The implementation of this function is exercised through the BRSD. Management of BRSD (directors, heads of divisions) is appointed by the Governor of the NBM, according to HR policy of the NBM and taking into account their education background, qualifications and professionalism.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
EC3	The supervisor publishes its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives.[14]
Description and findings re EC3	There are several provisions in the LNBM relating to transparency and accountability. The primary objectives and the so-called basic functions of the NBM (including licensing, supervision and regulation of banks) are contained in the LNBM, Article 4 and 5. Article8 of the same law stipulates that the Governor or the members of the Council of Administration shall explain to the Parliament or to its standing committees the policy of the NBM. Along the same lines, the NBM shall periodically inform the public on the results of the macroeconomic analysis, the evolution of the financial market and on statistical information, including with regard to monetary supply, crediting, balance of payments and the state of the FX market. Art, 69 of LNBM also subjects the central bank to reporting obligations. In effect, the NBM shall submit to the Parliament on an annual basis, within four months from the conclusion of each financial year, a report that includes, among other things, information on the activity and operations for the concluded financial year as well as on the economic situation of the State. The section on supervision activity is, however, rather general. This part of the reports provides granular data on banks' condition (capital, liquidity, LEL, exposures to affiliates) but does not stipulate what has been done in terms of supervision. The annual financial situations, accounts and records of the NBM are also subject to annual external audit, in accordance with international standards on auditing, conducted by an external audit organization, which shall be independent, with a recognized reputation and experience in the auditing of central banks and international financial institutions. The external auditor's report shall be published together with the annual financial situations of the NBM. The supervisor requires banks to rotate the auditing firm every seven years.
EC4	The supervisor has effective internal governance and communication processes that enable supervisory decisions to be taken at a level appropriate to the significance of the issue and timely decisions to be taken in the case of an emergency. The governing body is structured to avoid any real or perceived conflicts of interest.
Description and findings re EC4	As described above, the corporate governance structure of the NBM is not satisfactory. The Board is composed only of executive members. Changes are being introduced to ensure a better governance system by appointing a mix of executive and non-executive members. The law and other regulations contain provisions that aim to avoid any conflict of interest. Further to Article 23 of the LNBM, upon the appointment and subsequently each year, members of the Council of Administration shall be obliged to file the statement on income and ownership, as provided by the law. In addition, during the term of office, members of the Council of Administration do not have the right to be members of parties or social-political formations, to perform activities of political character or to participate in such activities. Furthermore, upon the appointment and annually thereafter, members of the Council of Administration shall disclose to the Council all their direct or indirect financial interests and those of their family members, in the manner established by the Council. Article 35 of the same

[14] Please refer to Principle 1, Essential Criterion 1.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	law refers explicitly to conflicts of interest by requiring members of the Council of Administration and the staff of the NBM not to represent business, commercial, financial or other interests, if such interests conflict with their duties at the NBM. NBM's Code of Conduct (2012) prohibits conflicts of interest and all employees are subject to its restrictions. It addresses the standards for conduct of personal affairs, the appearance of conflicts of interest and the disclosure of potential conflicts. The code requires staff members to maintain their integrity and loyalty and to withdraw from participation in activities or decisions that would either compromise or appear to compromise their position. It is noteworthy that personnel involved in supervision (Article 14) are required to declare whether or not they have shareholding in banks. However, it is unclear what due diligence are made and how the case is addressed in case of absence of declaration. The code does not contain any sanction in case of breach. As a good practice, it would be good to clearly prohibit staff from holding shares in banks or other FIs.
EC5	The supervisor and its staff have credibility based on their professionalism and integrity. There are rules on how to avoid conflicts of interest and on the appropriate use of information obtained through work, with sanctions in place if these are not followed.
Description and findings re EC5	The Moldovan legal and regulatory regime contains a series of norms that aim to promote professionalism, integrity and avoid conflict of interests, as already discussed above. The code of conduct for the employees of the NBM (approved by the Decision of the Council of Administration of the NBM, No 162 of June 28, 2012) requires employees to act with honesty, independence, impartiality and avoid situations likely to create doubts about their integrity, such as unlawful disclosure of professional secrecy or the lack of declaration of conflict of interest. It is important to note that staff involved in supervision of banks must declare any case of conflict of interest, in particular any shareholdings in financial institutions using a specific template (attached to the Code of conduct). The person submitting this declaration is responsible for its timely submission, truthfulness and completeness of information. The subdivision of the declarant is responsible for managing the declarations. The code of conduct, however, does not contain any sanction or enforcement section. On the other hand, further to article 35 of the Regulation on secure use of information within the NBM, when hired, all employees of NBM sign a Privacy Commitment according to which all employees are obliged to keep confidential the information they took or will take knowledge of in the exercise of their duties. Similar restrictions can be found in Article 36 of the LNBM whereby members of the Council of administration, employees of the NBM, and other specialists appointed by the NBM for supervision purposes are obliged to preserve the professional secrecy over any information that represents banking secrecy, fiscal, commercial or other secrecy protected by law. These persons are required to keep professional secrecy even after the termination of their activity at the NBM. Additionally, the NBM has issued an Anti-fraud policy in 2010 that contains provisions requiring staff members who have received or are being offered gifts or benefits from third parties during the fulfillment of their duties to report immediately to the management. Further, staff is not allowed to get additional remuneration from external activities, except in the case of teaching or publication. It is also noteworthy that Moldova passed in 2013 a Law on

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	Professional Integrity (No. 325/23-12-2013).
EC6	The supervisor has adequate resources for the conduct of effective supervision and oversight. It is financed in a manner that does not undermine its autonomy or operational independence. This includes: (a) a budget that provides for staff in sufficient numbers and with skills commensurate with the risk profile and systemic importance of the banks and banking groups supervised; (b) salary scales that allow it to attract and retain qualified staff; (c) the ability to commission external experts with the necessary professional skills and independence, and subject to necessary confidentiality restrictions to conduct supervisory tasks; (d) a budget and program for the regular training of staff; (e) a technology budget sufficient to equip its staff with the tools needed to supervise the banking industry and assess individual banks and banking groups; and (f) a travel budget that allows appropriate on-site work, effective cross-border cooperation and participation in domestic and international meetings of significant relevance (e.g., supervisory colleges).
Description and findings re EC6	The NBM carries out its Supervisory functions through the BRSD, led by a director assisted by an authorized staff of 47 persons deployed in three main divisions as indicated in the chart below: (i) Bank Regulation and Licensing Division (14 staff); (ii) Special and Off-site Supervision division (17 staff); and (iii) the Division for Banking control and monitoring including AML (16). The Special and Off-site supervision division has under its ambit the Special Supervision Section made of 7 who deals with 4 problematic banks. One staff out of these 7 has been appointed as liquidator. AML/CFT compliance surveillance is covered by a small unit comprising 3, 2 of who are very junior (respectively 22 and 23 years old with almost no previous professional experience). The BRSD is also in the process of liquidating 10 banks, 8 of which went bankrupt in the late nineties. Three in-house liquidators have been appointed by the NBM Board and 1 of these is responsible for liquidating 5 (small) banks. Overall, BRSD staff consists of 50 people. Considering the situation of 4 problematic banks, the assessors are of the opinion that the NBM is understaffed. (a) For supervision, funding is provided from the NBM's general budget—as determined by the Council of Administration of the Central bank (LNBM Article26 s). During the 2008 FSAP, the budget was not an issue. At that time, management indicated that, in general, current salary scales were sufficient to attract and retain suitable staff for BRSD. The situation has changed and the current mission is of the view that more resources should be allocated both in terms of budget and qualified personnel (see discussion below). In practice, according to Article 21 of the LNBM, all expenses of the NBM shall be included in an expenditure estimate approved by the Council of Administration. Then, the general NBM budget (including BRSB) is submitted to the Budget and Finance Committee of the Parliament for approval.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)

Supervisory Powers, Responsibilities and Functions

(b) In their self-assessment, authorities indicated that the current payroll does not attract experienced staff in the banking and finance field. The NBM cannot face the competition with the private sector and the level of qualified staff is still low in comparison with the banking industry. The NBM has hired new personnel over the past few years (as shown below in the table) but most of the new entrants have just graduated from university. According to the Head of the BSRD, "this is a huge problem". Moreover, three staff in the BSRD have been on maternity leave for almost three years.[15]

Year	Supervisory Staff
2010	45
2011	48
2012	49
2013	50

(a) The law grants the NBM the power to commission external experts, even though, in practice, this is rare. In effect, Article 44 (section b) stipulates that supervision of banks can be performed, through NBM staff or other qualified professionals. The latter enjoy the same power as that of NBM personnel, including the examination of institutions' books, documents and accounts. External experts are also subject to the same restrictions in terms of confidentiality, ethics and independence to conduct supervisory tasks. Currently, the country has signed, with the assistance of the WB, a contract with KPMG to perform an independent and thorough special audit and a diagnostic study of a major domestic bank. The purpose of this exercise is to provide an accurate picture of the condition of this bank, in particular with reference to the quality and performance of the bank's assets, the adequacy of its provisions and reserves, and the quality of its earnings.

(b) BSRD has an annual budget for training of MDL 200 000 (approximately US$ 15 thousand), equivalent to US$ 285 per employee, which is considered to be low. BRSD staff participated in training programs both within the country and abroad.

	2010	2011	2012	2013
No. of seminars	29	34	31	37
No. of participants	21	23	27	29

(c) As indicated by the authorities, the technological budget seems to be sufficient for the performance of supervisory functions. This was already observed during the last FSAP.

(d) There is no separate budget for on-site visits, mainly because the NBM's inspectors do not participate in controls outside the country's borders.

It should be noted that the NBM has established a set of actions—the so-called "Transform NBM" project for 2015 and beyond that aim to change the organization in the long run, by

[15] The Labor code in Moldova is particularly favorable as it allows maternity leave for a period of six years. The staff still receives her paycheck from the State during the first three years.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	implementing modern HR systems and procedures (e.g., performance management evaluation, career development, and skills profiles, payroll, etc.) and to implement a system of bonuses based on performance as well as other measures of nonfinancial motivation.
EC7	As part of their annual resource planning exercise, supervisors regularly take stock of existing skills and projected requirements over the short and medium term, taking into account relevant emerging supervisory practices. Supervisors review and implement measures to bridge any gaps in numbers and/or skill-sets identified.
Description and findings re EC7	As indicated by the authorities, each year, when determining the annual budget, BSRD formulates a resource request for training, computers and software solutions for adjusting and improving the supervisory process. There is no forward looking budget approach to align the budget request (including in terms of skills) with future supervisory needs. The BSRD is mindful of the growing pressure on staff in the perspective of the transition to Basel II/III but has been informed that this transition would be done with no additional resource.
EC8	In determining supervisory programs and allocating resources, supervisors take into account the risk profile and systemic importance of individual banks and banking groups, and the different mitigation approaches available.
Description and findings re EC8	There is not such approach in Moldova. All banks are subject to a full scope on-site review every year, irrespective of their risk profile or systemic importance. More focus can be exercised on certain areas when there is a particular concern. The number of people assigned to the inspection team may however vary according to the magnitude of the bank. In the near future, under the new institutional framework for supervision (see executive summary), with a more risk-based approach, the BSRD will take into account the risk profile and the importance of individual banks in determining the supervisory program and the required resources.
EC9	Laws provide protection to the supervisor and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith. The supervisor and its staff are adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith.
Description and findings re EC9	According to Article 38 of the LFI, the NBM's employees, members of the special supervision commission, special administrator, liquidator and persons employed to assist them, shall not be liable for damages, actions or omissions that occurred when exercising their duties, unless it is proven that their acts were intentional and unlawful. The law also stipulates that the court shall establish the legality of action undertaken under the LFI and shall decide whether the actions were intentional or unintentional. However, Article 38 does not include Board members, which is a major flaw. During interviews with the NBM, including with top management, there was a strong general sentiment within the staff that the law is too vague and does not provide enough protection. This opinion was also confirmed by the President of the Banking Association who is a former governor of NBM.
Assessment of Principle 2	**MNC**
Comments	**The Corporate Governance structure of the NBM is not satisfactory**. As discussed above, there is no segregation between the executive function on the one hand and the supervisor function on the other. These powers are all concentrated in the hands of Board members. The

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	NBM is aware of the situation and is working on a new structure with a new Board consisting of 3 executive members and four non-executive members. The 4 non-executive members will be appointed by the Parliament, the President and the Government. In addition, an Executive Committee will be set up with five people (the Governor of NBM, the Deputy Governor and three Vice Governors). **The condition for dismissing the Governor and other Board members are unclear.** The NBM law contains a provision (Article 27 (f) according to which the Governor and other members of the Council of Administration "*shall be removed from office (…) if they are incompatible, as established by a definitive act*". This concept of *incompatibility* is not defined and raises concerns about the absolute independence of the governing body of NBM. According to the conversation with NBM, the Parliament could do "whatever it wants." Moreover, the conditions for removing the Head of the BSRD are not clearly specified in any law. In the BSRD's opinion, the code of labor may apply. In practice, the mission was told that previous governors enjoyed several successive mandates, sometime spanning 18 years, which indicates a fair degree of stability and autonomy. However, for the future, it is advisable to define in the law the circumstances under which this "incompatibility" contemplated in Article 27 (f) may apply. Also, to reinforce even further Board 's independence, Moldovan authorities may wish to add a provision stipulating that no member of the NBM's Board can be replaced for reasons or following a procedure other than those stipulated in Article 27. **NBM Board members and employees do not enjoy enough protection against lawsuits while discharging their duties in good faith**. There has been some progress since the 2008 FSAP during which it was observed that NBM employees were not explicitly protected in case of lawsuits. The revision of the LFI is an important progress in this regard but the language is too general and does not include specific protection for Board members. Further, the current provision of Article 38 (7) d) of the LFI stipulates that NBM employees "*shall not be liable for damages*" for their lawful actions; however, the law does not indicate the nature of the liability, criminal and/or civil. It is therefore recommended to amend the law in order to clearly stipulate that members of the NBM's Board and employees shall not be subject to any civil or penal sanctions, as the case may be, if the competent court finds that these persons acted or failed to act in good faith during the fulfillment of their duties. Also, the NBM does not provide an internally employed counselor to assist with the lawsuit or financial support to retain an outside counselor to cover the costs of defending employees' actions while discharging their duties in good faith. This was the case for an NBM staff appointed as a liquidator who was sued and ordered by a court to pay damages to the plaintiff. It is advisable to add in the law a new provision indicating that the costs associated with the judicial proceedings instituted against NBM staff shall be borne by the NBM. The BCP assessors are of the opinion that these recommendations are key in order to provide a higher degree of confidence to the NBM employees. During the discussion with the team there was a strong general sentiment among staff that the law does not offer enough protection. As a result of that, there have been situations where the NBM refrained from taking remedial measures or sanctions. This sentiment is aggravated by another provision of the LFI (Article 38, (7, a)) stipulating that measures and penalties applied by the NMB may be appealed. In that case, "*if the (competent) court determines that the actions applied by the NBM towards the bank are "illegal", the NBM "shall pay all material claims and the withdrawal of license remain valid*". The concept of "illegality" seems to be subject to the judge's interpretation, which creates a

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	personal risk for NBM employees (see above the absence of Rule of Law in the section on pre-conditions). Also, for the same reasons, no one in the NBM wants to be appointed as liquidator.[16] **NBM staffing seems to be insufficient in the context of growing activities.** Assessors are of the view that there is a need to increase manpower within the BSRD. Considering the situation of 4 problematic banks, given also the continued growth of banks' assets and the types of services provided by these (which involve new risks), as well as taking into account the effort to be made in the near future for adjusting the banking system to EU requirements and ensuring banks' shareholders transparency, the current human resources (including skills) for supervision are proven to be insufficient. In the BSRD, three staff have been on maternity leave for about three years and have not been replaced. It would also be advisable to make an estimation of additional staffing that the transition to Basel II/III would require. **The BSRD budget allocation process is not transparent.** As discussed above, the BSRD submits request annually to NBM top management for logistics, IT, training etc, but does not submit any figure. The request is reviewed by the management and the total final budget is approved by the NBM Board before it goes to the Parliament. The Head of BSRD does not know the amount of budget allocated to supervision in the overall envelop. The only information on budget allocation disclosed to him concerns training (200 K LEI for the entire staff, which is a fixed number). As a result, it is almost impossible for the Head of the BSRD to design a forward looking supervisory strategy in the absence of data on the budget allocated to supervision. **Sanctions for breaching the Code of conduct and the Anti-fraud Policy are not specified.** As discussed above, the NBM is equipped with a series of internal policies that set up clearly the level of expectations for staff in relation to ethics, integrity and adherence to professional values. Staff has to disclose in writing any conflict of interest. However, neither the code of conduct nor the Code of Ethics contains clear provisions on possible sanctions applicable in case of breach. As a result, the enforceability of these policies is questionable. **NBM staff is allowed to hold shares in banks**. Under the 2011 Code of conduct, NBM staff has to declare in a specific form any relationship with a bank that would create a conflict of interest. This includes the possession of shares. The Code does not prohibit NBM staff from holding interest in banks. The NBM is satisfied as long as the conflict is disclosed. As a good practice It would be advisable to prohibit NBM personnel form holding ownership in banks. **There is no requirement for the NMB to render account of its performance in regard to its supervision activities.** While the NBM publishes analysis of activities of the supervised licensees in the market in its annual report, there is no information on the way supervision is conducted and achieved. The report does not set 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).[17]

[16] A Bank's liquidator is always an NBM employee. There is no external liquidator for banks in Moldova.

[17] The BRSD prepares a Strategic Plan setting out goals and objectives for the forthcoming year (e.g., preparation of Regulations/Recommendations; regulatory issues recently encountered). There is a review of performance against

(continued)

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	In order to improve the compliance rating for CP2, the authorities may wish to consider the following recommendations: • Reform the Corporate Governance structure of the NBM to ensure clear segregation of functions; • Add in the NBM law a provision stipulating that no member of the NBM's Board can be replaced for reasons or following a procedure other than those stipulated in Article 27 • Restore full independence of the NBM by protecting members of the board from external influence; • Provide full legal protection and assistance to all NBM employees in case of lawsuits for actions in good faith; • Specify in the law the types of liability NBM employees are subject to; • Improve more transparency in budget allocation for Supervision activities, in particular by disclosing to the Head of the BSRD the total budget allocated to supervision in the overall NBM budget. • Include clear sanctions in the code of conduct in case of breach; • Prohibit NBM employees from holding equity interest in banks; • Explore the possibility to increase NBM manpower, particularly with respect to the transition to Basel II/Basel III and the establishment of an enhanced banking resolution mechanism.
Principle 3	**Cooperation and collaboration.** Laws, regulations or other arrangements provide a framework for cooperation and collaboration with relevant domestic authorities and foreign supervisors. These arrangements reflect the need to protect confidential information.[18]
Essential criteria	
EC1	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with all domestic authorities with responsibility for the safety and soundness of banks, other financial institutions and/or the stability of the financial system. There is evidence that these arrangements work in practice, where necessary.
Description and findings re EC1	Article 6 of the LNBM contains provision on "cooperation of the NBM with State bodies". It stipulates that the NBM shall cooperate with the Government in pursuing its objectives and shall, in accordance with the present law, take the necessary actions in order to promote such cooperation. To that end, the central bank shall provide to the economic and financial bodies of

objectives by BRSD's top management following year end. However, both the Strategic Plan and the review of performance are internal to BRSD.

[18] Principle three is developed further in the Principles dealing with "Consolidated supervision" (12), "Home-host relationships" (13) and "Abuse of financial services" (29).

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	the Government, upon their request, information on monetary and financial matters. Conversely, these bodies shall also provide to the NBM, upon its request, information concerning macroeconomic, monetary or financial matters. In the same vein, pursuant to Article 24 of the LNBM, the NBM is authorized to engage in cooperative arrangements with several State bodies and supervisory agencies. In the furtherance of its collaborative efforts, NBM has entered into agreements with a host of domestic authorities, including those with regulatory authority over non-bank financial institutions. For example, NBM and the National Commission for Financial Market (NCFM) have signed a Joint Action Plan for the coordination of regulation and supervision activities of non-banking financial organizations (07.03.2012) and a Cooperation Agreement on the exchange of information (27.12.2010). This was in fact a recommendation from the 2008 FSAP report. The NCFM 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. Both institutions (NBM and NCFM) are part of the NCFS, the functioning of which is established by the Memorandum of Understanding on maintaining Financial Stability (28.02.2011). The Prime-minister is the chair and the Governor of NBM the deputy-chair of this Committee that includes also the Vice-Prime minister, the MOF, the Deposit Guarantee Fund and other parties. The NCFS discusses a wide range of financial stability related issues, such as placement of a bank special administration or liquidation regime, indicators of financial soundness and any particular concern relating to banks, e.g., transparency in ownership. In this regard, this Committee has held several meetings during the present mission to discuss major concerns in relation to raider attacks. The Committee meets quarterly. It is unclear whether the Department of banking Regulation and Supervision in charge of on-going and on-site surveillance has access to the minutes of the NCFS. NBM also signed a number of cooperation agreements with other relevant Government agencies, the National Commission for Securities, the State Chamber of Registration (SCR); the Tax administration, State enterprise "Cadastru" (property registry) and the General Prosecutor's Office. These agreements establish the areas of collaboration, the information to be presented by the NBM, as well as the information to be obtained by it. The NBM does not have access to the Credit Bureau.[19] In the particular area of combating money laundering and terrorist financing, NBM signed a MoU with the Office for Prevention and Control of Money Laundering (OPCML), which is an independent Unit within the Center for Combating Economic Crimes and Corruption.
EC2	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with relevant foreign supervisors of banks and banking groups. There is evidence that these arrangements work in practice, where necessary.

[19] In the law governing the Credit Bureau, NBM is not mentioned in the list of authorities that have access to it.

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Description and findings re EC2	Articles 7, 24, and 36 of the LNBM provide powers to the NBM relative to engaging in collaborative arrangements with foreign bank supervisory authorities. As a result, the NBM has signed letters of agreements with foreign supervisors in the domain of supervision, especially with countries which banks have acquired significant interest in the capital of local banks or have opened branches on the territory of the Republic of Moldova, namely Romania, Russia, Belarus, Kazakhstan and Georgia. These letters of agreement incorporate confidentiality provisions as well as requirements for use of information obtained solely for supervisory purposes, as contemplated in the provisions of the BASEL Committee document titled "Essential elements of an Agreement of cooperation between supervisors". The NBM is also in the process of signing an agreement for cooperation and exchange of information with Germany. Also, the NBM has approached Italy and France but no agreement with either country has materialized yet. The same attempt was made with Austria. The Austrian authorities are still reluctant to enter in to an MOU apparently on a legal technicality concerning the preservation of the confidentiality of information provided rather than on substantive issues related to NBM's capacity as a supervisor. This concern might be lifted since Moldova just passed a law on the protection of personal data in line with the EU directive. The mission got copies of a sample of cooperation agreements signed with foreign authorities. It was observed that they generally address the exchange of information for licensing and authorization purposes, the exchange of information as part of ongoing supervision, and exchange of experience on regulating reporting entities in the area of Know Your Customer. It is also noteworthy that Moldova is a member of the Group of Banking Supervisors from Central and Eastern Europe (BSCEE) The members of BSCEE consist of banking supervisory authorities from Albania, Austria, Belarus, Federation of Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Montenegro, Poland, Romania, Russia, Serbia, Slovak Republic, Slovenia, Ukraine, and Moldova. The BSCEE Group aims to, among other things, (i) promote and maintain close cooperation and communication among the Central and Eastern European banking supervisory units, (ii) facilitate the Central and Eastern European banking supervisory authorities for a better performance of their supervisory functions, (iii) provide possibility for exchange of supervisory techniques, experiences, information and know-how, and (iv) help with the integration to the European banking supervisory system.
EC3	The supervisor may provide confidential information to another domestic authority or foreign supervisor but must take reasonable steps to determine that any confidential information so released will be used only for bank-specific or system-wide supervisory purposes and will be treated as confidential by the receiving party.
Description and findings re EC3	The LNBM contains several provisions on confidentiality and determines the condition under which bank secrecy can be lifted, including with foreign supervisors. Article 36 stipulates that the information covered by professional secrecy can be disclosed or provided in certain situations, including in the framework of cooperation agreements with other public authorities or on the NBM's initiative, for the purpose of carrying out specific tasks of supervision. Confidential information can also be shared at the request of central banks, and supervisory bodies from other states. The same law stipulates that the persons and bodies empowered to request and receive information covered by professional secrecy are obliged to keep it

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	confidential and may use it only for the purpose for which they have requested it or for which it was provided to them, according to the law or the agreements concluded, and shall not provide it and nor disclose it to third parties. Further, the same Article 36 determines that Information that constitutes professional secret may be provided to central banks and supervisory bodies of a foreign state on the basis of the reciprocity principle in the manner prescribed by international treaties to which Moldova is a party and by the agreements concluded between the NBM and these bodies.
EC4	The supervisor receiving confidential information from other supervisors uses the confidential information for bank-specific or system-wide supervisory purposes only. The supervisor does not disclose confidential information received to third parties without the permission of the supervisor providing the information and is able to deny any demand (other than a court order or mandate from a legislative body) for confidential information in its possession. In the event that the supervisor is legally compelled to disclose confidential information it has received from another supervisor, the supervisor promptly notifies the originating supervisor, indicating what information it is compelled to release and the circumstances surrounding the release. Where consent to passing on confidential information is not given, the supervisor uses all reasonable means to resist such a demand or protect the confidentiality of the information.
Description and findings re EC4	NBM staff is required to observe professional secrecy obligations that are intended to protect the confidential of supervisory information. These obligations are laid out in Article 36 of the LNBM. Accordingly NBM may use confidential information only in the performance of supervisory tasks. The NBM seems very strict on protecting classified information. An example of this is the request received from the Ministry of Foreign affairs who was looking for information regarding a bank; the request was rejected on the grounds that the motivation was not indicated and that such request needed judicial approval (LFI Article 22, 5 (6)). Also, as set forth in Article 36 of the LNBM, when the information covered by professional secrecy comes from a foreign body, it may be disclosed or provided only with the express consent of the competent body which has provided the information and, where applicable, only for the purpose for which the consent has been given. In this regard, each of the MOU reviewed by the mission which the NBM is a signatory also contains a provision addressing the treatment of confidentiality information. The language is relatively standard (although details of language vary from one agreement to another) and governs information acquired by NBM in the course of performing its duties and information received from other supervisors.
EC5	Processes are in place for the supervisor to support resolution authorities (e.g., central banks and finance ministries as appropriate) to undertake recovery and resolution planning and actions.
Description and findings re EC5	In Moldova, the resolution authority is the NBM. In accordance with Article 44 of the LNBM, the NBM has the authority to resolve a problem bank by placing it under conservatorship (the so-called special administration regime) or pursuing liquidation proceedings. The NB is currently in the process of liquidating 10 banks (most of which went bankrupt in the late nineties). Within the NBM, the Special supervision Unit deals with resolution of banks. Decision to place a bank under conservatorship or liquidation is made by the NBM Board which appoints the liquidator, who is in practice a staff member of the NBM. These processes are contemplated in detail in the LFI law (Article 37 on Special Administration and Article 38 on forced liquidation). If a resolution is necessary, the NBM is obligated to inform the National Committee for Financial

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	Stability—NCFS—about banks that are in need of special administration, liquidation or other measures. According to the Governmental Decision no.449 as of June 2, 2010, the NCFS was created precisely to ensure adequate coordination between the public authorities, in the area of bank resolution as well as in case of systemic financial shocks. In the same spirit, to promote cooperation among financial institution regulators and to manage a financial crisis, a Memorandum of Understanding on maintenance of financial stability was signed on February 28, 2011. This Memorandum sets out several principles, in particular the policy of information exchange and the delineation of responsibilities among the public authorities involves in crisis management.
Assessment of Principle 3	**LC**
Comments	The MoU signed between the NBM and a wide range of public authorities for the establishment of the National Committee for Financial Stability should be revisited. There is a need to delineate clearly the responsibilities and duties of the NCFS to avoid any political interference in the decisions to be made by the NBM. The NCFS should be responsible for coordinating adequate response in case of major crisis but every supervisory body (namely the NBM) should keep full control over its decision making. Also, it is extremely important to set clear rules on the extent and nature of information that can be exchanged in that context, to ensure integrity of confidential data.[20] The BSRD should also be informed on a timely basis about the decisions that are made by the Committee on bank related issues. Cooperation with the FIU seems to be adequate. The NBM and staff from the FIU have performed—and will continue—to perform on-site visits in banks. However, the exchange of information does not seem to work so well. The FIU has compiled a significant amount of information on cross-border transactions involving companies in off-shore centers with undisclosed UBO that has not been shared with the NBM. The NBM may wish to consider expanding its cooperation agreement with other relevant bodies such as the Deposit Guarantee Fund and the Credit Bureau. At the international level, it is also advisable to pursue efforts to finalize MoUs with home supervisors of foreign subsidiaries operating in the country e.g. Italy, France, Germany and Austria.
Principle 4	**Permissible activities**. The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined and the use of the word "bank" in names is controlled**.**
Essential criteria	
EC1	The term "bank" is clearly defined in laws or regulations.
Description and findings re EC1	In this area, there has not been any particular change since the last FSAP. As already observed in 2008, the LFI (Article 3) defines a bank as a financial institution accepting deposits or their equivalents of individuals or their entities, transferable by different payment instruments and

[20] When the committee first met, requests were made to the NBM for sharing on-site inspection reports.

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	utilizing these funds in whole or in part for lending and investing on its own account and risk. The same article, on the other hand, defines a financial institution as a legal entity engaged in the business of accepting deposits or their equivalent, non-transferable by any payment instrument and using such funds either in whole or in part to make loans or investments for its own account and risk.
EC2	The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined either by supervisors, or in laws or regulations.
Description and findings re EC2	Permissible activities of institutions that are licensed and subject to supervision as banks are defined under the LFI. In effect, Article 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 Article 6, 7, and, 26 of the LFI and under the terms stipulated in Regulation No. 23/09-01 on Bank Licensing. Pursuant to Article 26 (3) of the LFI, a bank may not engage in financial activities that are not included in the authorization.
EC3	The use of the word "bank" and any derivations such as "banking" in a name, including domain names, is limited to licensed and supervised institutions in all circumstances where the general public might otherwise be misled.
Description and findings re EC3	As already observed in 2008, 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 (Article 12 (3)). No person may engage in financial activities, including the acceptance of deposits or their equivalent, without a license issued by the NBM (Article 12(1) and (2)).
EC4	The taking of deposits from the public is reserved for institutions that are licensed and subject to supervision as banks.[21]
Description and findings re EC4	According to Article 12 paragraph (2) of the LFI, no person other than a bank shall accept household deposits or their equivalent.
EC5	The supervisor or licensing authority publishes or otherwise makes available a current list of licensed banks, including branches of foreign banks, operating within its jurisdiction in a way that is easily accessible to the public.
Description and findings re EC5	The NBM maintains a list of current licensees which it displays on its website (www. NBM.org) under the heading: List of authorized banks of the Republic of Moldova. A register of authorized banks—open to the public—is maintained by the NBM (LFI Article9).
Assessment of Principle 4	

[21] The Committee recognizes the presence in some countries of non-banking financial institutions that take deposits but may be regulated differently from banks. These institutions should be subject to a form of regulation commensurate to the type and size of their business and, collectively, should not hold a significant proportion of deposits in the financial system.

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Comments	
Principle 5	**Licensing criteria.** The licensing authority has the power to set criteria and reject applications for establishments that do not meet the criteria. At a minimum, the licensing process consists of an assessment of the ownership structure and governance (including the fitness and propriety of Board members and senior management)[22] of the bank and its wider group, and its strategic and operating plan, internal controls, risk management and projected financial condition (including capital base). Where the proposed owner or parent organization is a foreign bank, the prior consent of its home supervisor is obtained.
Essential criteria	
EC1	The law identifies the authority responsible for granting and withdrawing a banking license. The licensing authority could be the banking supervisor or another competent authority. If the licensing authority and the supervisor are not the same, the supervisor has the right to have its views on each application considered, and its concerns addressed. In addition, the licensing authority provides the supervisor with any information that may be material to the supervision of the licensed bank. The supervisor imposes prudential conditions or limitations on the newly licensed bank, where appropriate.
Description and findings re EC1	The LNBM (Articles 5, 11, and 44) and the LFI (Article 4) provide the statutory requirements for the licensing of a financial institution. The NBM has the exclusive right for the issuance of bank licenses and no person shall engage in financial activities without a license issued by the NBM. Foreign banks wishing to establish a subsidiary on the territory of Moldova shall also receive a license from the central bank. The NBM has the right (LFI, Article 7) to reject an application if the criteria are not fulfilled or if the information provided is inadequate. The power of withdrawing the license also belongs to the NBM. The LFI, Article 10 sets the conditions for the withdrawal, including when the bank becomes insolvent, the bank conducts unsound practices, the license has been obtained on the basis of false information, the bank has not commenced operations within twelve months after receiving the license, the financial activities of the bank during its first three years of operation differ substantially from those presented in the application for a license, etc. The procedures for granting the license are detailed in the "Handbook on Licensing of banks" from 1999 that has been updated and amended several times and provided to the assessors. The manual is very detailed and comprehensive.
EC2	Laws or regulations give the licensing authority the power to set criteria for licensing banks. If

[22] This document refers to a governance structure composed of a Board and senior management. The Committee recognizes that there are significant differences in the legislative and regulatory frameworks across countries regarding these functions. Some countries use a two-tier Board structure, where the supervisory function of the Board is performed by a separate entity known as a supervisory Board, which has no executive functions. Other countries, in contrast, use a one-tier Board structure in which the Board has a broader role. Owing to these differences, this document does not advocate a specific Board structure. Consequently, in this document, the terms "Board " and "senior management" are only used as a way to refer to the oversight function and the management function in general and should be interpreted throughout the document in accordance with the applicable law within each jurisdiction.

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	the criteria are not fulfilled or if the information provided is inadequate, the licensing authority has the power to reject an application. If the licensing authority or-supervisor determines that the license was based on false information, the license can be revoked.
Description and findings re EC2	Criteria for licensing banks are prescribed by the LFI and subsequent regulations. Articles 6, 7, and 8 of LFI and Regulation no.23/09-01 on licensing of banks, set requirement to be met in order to obtain authorization to conduct banking business. The Handbook on Licensing of banks of February 26, 1999, further details the necessary requirements and content of the application for authorization. Other important provisions relevant to licensing can be found in the following regulations and NBM norms: (i) regulation on holding equity interest in the capital of banks; (ii) regulation on the calculation of voting rights and registration of the transfer of ownership of bank shares; and (iii) the regulation on the requirements for Bank's administrators. The LFI allows the NBM to suspend a bank's business or revoke authorization for banking business if the authorization was based on false information or if the bank is no longer able to meet the conditions for performing its business. Recently, the LBM used its legal power to revoke the license of B.C Universalbank S.A (decision N°29) as a result of multiples problems and breaches including insolvency, failure to comply with NBM remedial measures and violations of several provisions (e.g., on shareholdings -78.61 percent of the bank's capital being owned by a legal entity located in an offshore center).
EC3	The criteria for issuing licenses are consistent with those applied in ongoing supervision.
Description and findings re EC3	Necessary requirements to be met while applying for a banking license are broadly consistent with those applied in ongoing supervision. As detailed below, criteria include complying with shareholding limits, executives (which includes Board members) to meet fit and proper criteria, the entity to meet prudential standards, have adequate internal control systems, human resources, etc.
EC4	The licensing authority determines that the proposed legal, managerial, operational and ownership structures of the bank and its wider group will not hinder effective supervision on both a solo and a consolidated basis.[23] The licensing authority also determines, where appropriate, that these structures will not hinder effective implementation of corrective measures in the future.
Description and findings re EC4	As already observed in the 2004 and 2008 BCP reports, the LFI read in conjunction with the regulation on licensing banks enables, in theory, the NBM to determine that the proposed legal and managerial structures of the bank will not hinder effective supervision. The Regulation on the requirements for bank administrators (chapter II) and the Regulation on holding significant interest in a bank (chapter IV) help the NBM to determine the suitability of the bank's administrators and shareholders that hold significant interest. Regarding the administrators, the LFI in its Article 6 stipulates that applicants should submit criminal records as well as information about qualifications and experience of the administrators

[23] Therefore, shell banks shall not be licensed. (Reference document: BCBS paper on shell banks, January 2003).

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	of the proposed financial institution, including professional history for the past ten years. Further, regulation 23/09-01 on licensing requires all administrators to meet the requirements imposed by the NBM. These NBM rules can be found in the Regulation on the requirements to bank's administrator number134 of July 1, 2010. In particular, administrators have to submit evidence of lack of criminal history along with documents establishing their education, past experience and professionalism, and good reputation. Prospective administrators are also required to fill a detailed questionnaire to prove their fitness and properness including information about their income, assets, equity and liabilities. The law also requires applicants to submit a business plan for the proposed financial institution, setting out the organizational structure, and the types of financial activities envisaged, and projected financial statements for the first three years. Regarding the bank's ability to meet prudential requirements, especially if the bank will be part of a financial group, the NBM determines whether the financial group has a structure that will allow effective supervision; effective information exchanged between competent authorities and determines the distributions of powers between them (as described in this principle, the basic criterion 4). Lastly, as part of the licensing process, the LFI and other subsequent NBM regulations prescribe the collection of data on shareholders. As part of the application, the NBM receives details on the identity of all founding shareholders (Annex 1, Article III, of the NBM regulation 23/09) with amount and percentage of their declared ownership interests. In practice however, the determination of the ownership structure is much more challenging than it looks in the regulations. Interviews with NBM staff and with other stakeholders have shown that ownership interests are not well captured. As indicated in the FSAP report on Corporate Governance, ownership is complex and UBO are not known. Banks are owned by a series of fronting companies. In conclusion, in light of the above, the NBM faces difficulties to determine that the proposed ownership structure will not hinder effective supervision. It is now in the process of mapping better ownership structures of banks that were licensed a long time ago, but NBM acknowledges that this is going to take time.
EC5	The licensing authority identifies and determines the suitability of the bank's major shareholders, including the ultimate beneficial owners, and others that may exert significant influence. It also assesses the transparency of the ownership structure, the sources of initial capital and the ability of shareholders to provide additional financial support, where needed.
Description and findings re EC5	The legal basis for identifying and determining the suitability of the bank's major shareholders, including the ultimate beneficial owners, and others that may exert significant influence can be found in the LFI Articles 3, 7 (2)), and 15[3] as well as in the NBM regulation 23/09–01 on licensing and regulation 42/09–01 on holding significant interest in a bank.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	As indicated above, the NBM will grant a license only when several conditions are met. In particular, the NBM will determine if the qualification, experience and integrity of the administrators, shareholders with significant interest and prospective "acquirers"[24] are appropriate to ensure "a sound and prudent management" and are consistent with the business plan of the bank. Bank's major shareholders are also subject to NBM scrutiny. As stipulated in the regulation 23/09, each person who intends to own shares in the bank shall submit a list of precise information (name, address, membership in other economic entities) including data on the number of shares to be subscribed and the resulting percentage of ownership in the bank. The same requirements apply to legal entities. Also, the list of persons affiliated[25] to this legal entity is presented, including the list of shareholders who owns 5 percent or more of the capital of the applicant if the affiliated person is a bank. The LFI and NBM regulations provide a definition of indirect holding and beneficial ownership in order to determine ultimate ownership and outside influence. Pursuant to Article 3 of the LFI, "indirect holding" is defined as holding a stake in a bank by means of a third party over whom the acquirer/holder, including the beneficial owner, exercises control. The beneficial owner is defined as the person who ultimately holds or controls the proposed shareholder who directly or indirectly owns a holding in the bank's capital equal or exceeding the significant interest. In all cases, for both individual and legal entities, information should be provided on the source and amount of funds used to acquire bank's shares. In particular, the applicant will submit supporting documents or affidavit, where it is not possible to provide supporting documents that should include, inter alia, information on the means and the network used for transferring the funds. In this regard. As indicated by the authorities, the NBM determines whether the capital does not originate from persons resident in jurisdictions that do not implement the international standards of transparency (Article 15 paragraph (6) of LFI, item 10 of Regulation on holding equity interests in the capital of banks and decision of the Council of Administration of the NBM no.91 of 05.02.2013). During the on-site interviews the NBM authorities informed the assessors that during the licensing procedures the AML/CFT department is consulted to check whether there are any ML/TF concerns in relation to the applicant. Regarding the fit and proper qualifications of directors and senior management, the LFI contains provisions on the qualifications, experience and integrity of its administrators in the context of the licensing procedure. These requirements are further detailed in the NBM Regulation on the requirements of bank's administrators (Decision of the Council of

[24] any person to acquire, by any means, directly or indirectly, a significant interest in the share capital of a bank or to increase its significant interest so that the proportion of its voting rights in the share capital to reach or exceed the level of 20 percent, 33 percent or 50 percent or so that the bank to become a branch.

[25] For example, a person who has control over the entity, or a Board member or someone from the audit committee of the legal person.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	Administration of the NBM No. 134 of July 1, 2010). The NBM Regulation contains an extensive list of information to be submitted by the bank to the NBM in order to obtain the confirmation of the NBM for the position of an administrator (including criminal record checks). The information that must be provided to the NBM appears adequate to assess the fit and proper qualifications of an applicant for the position of an administrator.
EC6	A minimum initial capital amount is stipulated for all banks.
Description and findings re EC6	The Regulation on Risk Weighted Capital Adequacy stipulates that banks must have a minimum initial capital of at least MDL 200 million (about 7.4 US$ million).
EC7	The licensing authority, at authorization, evaluates the bank's proposed Board members and senior management as to expertise and integrity (fit and proper test), and any potential for conflicts of interest. The fit and proper criteria include: (i) skills and experience in relevant financial operations commensurate with the intended activities of the bank; and (ii) no record of criminal activities or adverse regulatory judgments that make a person unfit to uphold important positions in a bank.[26] The licensing authority determines whether the bank's Board has collective sound knowledge of the material activities the bank intends to pursue, and the associated risks.
Description and findings re EC7	As stipulated in the NBM regulation on administrators, prospective banks are required to submit information to assess administrators' fitness and properness. In Moldova, the concept of administrators is quite extensive and includes non only a member of the Board, but also members of the executive body, auditing committee, the chief accountant, the manager of a branch of a legal entity, as well as any other person entrusted by law or statute to assume obligations on its own or together with others, in the name of the entity. The Regulation on the requirements to Bank's administrators, under Article 21 of LFI, establishes the fit and proper requirement, including the criteria on qualification, work experience, reputation in business circles, and probity (criminal background). When assessing the fitness criteria, the NBM due diligence includes determining whether the elected members of the Board and those of the executive body have the relevant academic background and past professional experience (e.g., at least 3 years of professional experience in the last five years as administrators in the economic field). Stricter diligence is applied to senior managers (elected members of the executive body) who are required to have longer professional exposure in relevant fields. For assessing the "properness" of prospective administrators, the NBM will collect information establishing that the candidates have no criminal records and/or have not been involved in doubtful activities, in financial fraud or tax evasion. This due diligence also extends to legal entities managed by elected members of the Board. In practice, NBM staff also conducts an interview with the prospective administrator to evaluate further the bank's proposed Board members and senior management as to their expertise and integrity.

[26] Please refer to Principle 14, Essential Criterion 8.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	Regarding potential conflict of interest, the NBM will determine, based on information provided, the personal interests of the applicants, including financial interests, and the possible existence of any relationship of the elected members of the Board with other persons in relation to the bank. Also, in the application, the prospective bank should provide details on planned transactions with affiliated persons. There is no specific requirement for the individual Board members or the Board collectively to have a sound knowledge of the material activities that the bank intends to pursue, and the associated risks. However, according to the NBM, the comprehension of banks activity and their associated risks is tested through professional interviews conducted during the application process.
EC8	The licensing authority reviews the proposed strategic and operating plans of the bank. This includes determining that an appropriate system of corporate governance, risk management and internal controls, including those related to the detection and prevention of criminal activities, as well as the oversight of proposed outsourced functions, will be in place. The operational structure is required to reflect the scope and degree of sophistication of the proposed activities of the bank.[27]
Description and findings re EC8	In the LFI, Article 6, prospective banks should submit to the NBM a business plan, setting out the organizational structure of the future institution, the types of financial activities that will be conducted along with projected financial statements for the first three years. The NBM regulation no. 23/09-01 on licensing of banks also contains a list of documents that should be provided to support the request; it includes (i) a business plan for the first three years of operation, which shall provide the NBM an understanding of the bank's objectives and proposed operations; (ii) the organizational structure; (iii) information on the internal audit function; and (iv) a plan for the Board to monitor the bank's performance under the business plan. During the interviews, NBM indicated that staff verifies whether corporate governance is to be implemented in the bank, with sufficiently disclosed relationships between managing bodies, including between shareholders; whether there are clear policies and procedures of risk management; whether there is an appropriate system of Risk management and internal control. It was also indicated that the organizational structure should reflect the scope and level of sophistication of the activities proposed by the bank.
EC9	The licensing authority reviews pro forma financial statements and projections of the proposed bank. This includes an assessment of the adequacy of the financial strength to support the proposed strategic plan as well as financial information on the principal shareholders of the bank.
Description and findings re EC9	As contemplated in the LFI, Article 6 and NBM regulation #23/09-01, the financial statements and projections for the first three years of operations of the proposed bank have to be produced. According to the NBM, these materials are reviewed and analyzed with particular attention focused on the reasonableness of assumptions. Depending upon the case, the

[27] Please refer to Principle 29.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	supervisors may run their own assumptions as well. The business plans, projections and financial information provided would be discussed with the applicant. Qualifying shareholders are assessed as to their financial capacity in terms of their financial strength at the time of the application, and prospective capacity to provide additional capital to the bank in the event it is needed. Each such prospective qualifying shareholder must provide financial information that demonstrates an appropriate level of financial capacity.
EC10	In the case of foreign banks establishing a branch or subsidiary, before issuing a license, the host supervisor establishes that no objection (or a statement of no objection) from the home supervisor has been received. For cross-border banking operations in its country, the host supervisor determines whether the home supervisor practices global consolidated supervision.
Description and findings re EC10	The provisions contained in annex 3 of the NBM regulation #23/09-01 on licensing is fairly straight forward and clear. It stipulates that in the case of a foreign banks establishing a subsidiary in Moldova, the application for a license should contain a written opinion from the home supervisor stating that: (a) the applicant is licensed to collect deposits from the public; b).the applicant has been operating for at least two years; and (b) the applicant is a bank in "good standing" with no formal outstanding or pending enforcement action. In addition, the application for the license must be accompanied by a no objection letter from the home supervisor. NBM has not evaluated formally the capacity of a home country supervisor to practice comprehensive consolidated supervision, as there have been no new foreign bank entries in recent years.
EC11	The licensing authority or supervisor has policies and processes to monitor the progress of new entrants in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the license approval are being met.
Description and findings re EC11	As indicated by the NBM, the Manual for an on-site examination contains provisions whereby the NBM staff monitors the progress of new entrants in meeting their business and strategic goals. In effect, the inspection department will perform on-site visits to assess whether the bank is implementing the business plan approved by the founders, whether the proposed objectives and policies are achieved and whether the activities are performed according to the terms of the license. Also, pursuant to Article 10 paragraph (1) letter i) of LFI, the NBM may withdraw the license if the financial activities of the bank during its first three years of operation differ substantially from those presented in the application.
Assessment of Principle 5	**LC**
Comments	The legal and regulatory framework has been amended to provide NBM more leverage to ensure that the licensing process is sound, particularly in relation to ownership structure and governance. However, and despite the willingness and efforts of the NBM to capture all the relevant information, the lack of shareholder transparency in banks is still a matter of concerns. From their interviews, assessors come to the conclusion that the NBM does not have a full picture of ownerships in banks and is still struggling to determine who is the UBO. This has

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	been confirmed during the Corporate Governance assessment (part of the FSAP) and also by a prominent external audit company. Recent amendments have been made to permit deeper analysis of UBO but enforcement is still lagging behind. The WB is providing TA to Moldova with the aim to review and strengthen regulations covering the disclosure of the UBO and to bolster the enforcement powers of the NBM and other relevant regulatory agencies. On the other hand, the department of licensing within the BRSD is also responsible for approving change in ownership as well as new administrators (and as discussed above, the notion of administrators is very wide). There are only 6 people in this unit, which might be a bit tight considering the complexity of ownership structures in Moldovan banks. In conclusion, despite progress made in amending licensing procedures, the assessment of "Largely Compliant" reflects the continuing challenges that the BRSD confronts in establishing full ownership details of certain banks licensed in the past. It would be advisable to increase efforts in establishing full ownership details of certain banks licensed in the past, including details on the UBO. Some enforcement measures could be considered such as the prohibition of distribution of dividends or the suspension of voting rights that belong to those shares whose UBO is not known to the Board. • Use licensing in a more proactive manner to obtain commitments from the UBOs and to impose conditions on them and their related parties.
Principle 6	**Transfer of significant ownership.** The supervisor[28] has the power to review, reject and impose prudential conditions on any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.
Essential criteria	
EC1	Laws or regulations contain clear definitions of "significant ownership" and "controlling interest."
Description and findings re EC1	Under the LFI (Article 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. Other useful provisions can be found in the recent NBM regulation on holding equity interest in the capital of banks (No. 127 of June 27, 2013) that provides definition of concepts like "dominant influence", "close link" and "persons acting in concert". The LFI also defines the concept of indirect acquiring/holding as the acquisition or holding of a share in a bank's capital through a person over which the acquirer/holder, including its beneficial owner, exercises control.
EC2	There are requirements to obtain supervisory approval or provide immediate notification of proposed changes that would result in a change in ownership, including beneficial ownership,

[28] While the term "supervisor" is used throughout Principle 6, the Committee recognizes that in a few countries these issues might be addressed by a separate licensing authority.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	or the exercise of voting rights over a particular threshold or change in controlling interest.
Description and findings re EC2	Article 15 (1) of LFI and NBM Regulation #127 of June 27, 2013 on holding equity interest in the capital of banks stipulate that prior NBM authorization is required before seeking to acquire a qualifying holding in a bank or to increase a qualifying holding so that the proportion of the share capital or votes in the bank held by the acquirer exceeds the level of 20 percent, 33 percent or 50 percent. Such transactions are made upon the written approval of the NBM, which is issued in accordance with Article 7 (2), which gives the NBM the power to enforce the "fit and proper" requirement. Moreover, the regulation indicates that for the purpose of applying these principles above to affiliated persons (as defined in the LFI, Article 3); their equity interests are defined by aggregating these interests. In practice, prospective acquirers are required to submit a written request to the NBM (by using a specific template) for getting permission to hold/increase the equity interest in the capital of the bank. The request and the set of supporting materials have to be submitted to the Governor of the NBM. If the proposed acquirer is a group of persons acting in concert, a joint request shall be submitted along with the list of these persons and the relevant supporting material for each of these persons. Residents of jurisdictions, which according to regulations of the NBM are classified as jurisdictions that do not implement the international standards of transparency, and/or groups of persons acting in concert and involving a person from those jurisdictions are de facto prohibited to hold directly or indirectly equity interest in the capital of a bank (NBM Regulation No. 127, Article 10). Further, the Moldovan Law and regulation also requires immediate notification to the NBM of proposed changes that would result in a change in ownership. Pursuant to Article 59 of the NBM regulation #127, any direct or indirect holder of a significant interest in the capital of the bank that has decided to dispose of a significant interest in a bank or to reduce the significant interest, so that the proportion of the voting rights or equity interest in the capital of the bank fall below 5 percent, 20 percent, 33 percent, 50 percent, shall notify in writing the NBM about this decision. The notification shall be made prior to the transmission of ownership of securities, in writing.
EC3	The supervisor has the power to reject any proposal for a change in significant ownership, including beneficial ownership, or controlling interest, or prevent the exercise of voting rights in respect of such investments to ensure that any change in significant ownership meets criteria comparable to those used for licensing banks. If the supervisor determines that the change in significant ownership was based on false information, the supervisor has the power to reject, modify or reverse the change in significant ownership.
Description and findings re EC3	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 Article 7(2)). NBM regulation No. 127 stipulates in its Article 6 that if someone acquires ownership without NBM permission, the shareholder(s) involved are denied the right to vote. Other measures include the prohibition to receive dividends. Within 3 months as of the date of acquisition, persons that have violated the regulation shall sell the shares wrongfully

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	acquired. If, after the expiry of the 3 months term, the shares were not disposed, the bank's executive Board shall cancel the respective shares. As a result of the quality assessment of the proposed acquirer, the NBM will issue or refuse to issue the permission. Clearance will be given only the NBM is assured of the suitability and adequacy of the quality of the proposed acquirer, including its financial strength in relation to the proposed acquisition in order to ensure sound and prudent management of the bank (NBM regulation No. 127, Article 20). In particular, NBM due diligence will be comparable to those applied for licensing. The assessment of the quality of the proposed acquirer will be based on a set of criteria, including the following: (i) qualifications, reputation and experience of any person who will act as the administrator of the bank as a result of the proposed acquisition; (ii) financial soundness of the proposed acquirer; and (iii) the bank's ability to meet prudential requirements (especially a structure that does not hinder effective supervision. Further attention will be given to the beneficial owner of the proposed acquisition if it is a person other than that declared to the NBM. Fit and proper test will be performed on the proposed acquirer, which includes assessment of integrity (including criminal checks) and professional expertise among others. Due consideration is also given to the legitimate origin of funds for the acquisition of the equity interest in the capital of the bank (NBM Regulation No. 127, Article 55). According to the Law and regulation, the NBM is empowered to assess the qualifications, reputation and experience of any person that will act as an administrator of the bank as a result of the proposed acquisition.[29] If the proposed acquirer is a non-resident legal entity, prudentially regulated and supervised by the supervisory authority of the country of which the prudential regulations are considered equivalent, the NBM shall take into account the assessment of the financial situation of the proposed acquirer made by its supervisory authority, supported with the documents sent directly by the supervisory authority of the proposed acquirer to the NBM. During the last five years, 14 permissions for holding/increasing the significant interest in the share capital of a bank have been issued and seven requests have been rejected.
EC4	The supervisor obtains from banks, through periodic reporting or on-site examinations, the names and holdings of all significant shareholders or those that exert controlling influence, including the identities of beneficial owners of shares being held by nominees, custodians and through vehicles that might be used to disguise ownership.
Description and findings re EC4	On a monthly basis, banks are required to submit to the NBM reports detailing bank's shareholders who hold equities of 1 percent or more. Banks should also indicate in these reports shareholders and groups of shareholders acting in concert, which hold a significant interest in the bank's share capital. Information should provide details on the identity of the shareholder (the true beneficial owner) and not on the custodian (by virtue of Article 8 paragraph (10) of the Law no.199 – XIV on Securities Market of November 18, 1998 and Article 47 paragraph (7) of the Law no.171 on Capital Market of July 11, 2012).

[29] Only where the proposed acquirer has the power to appoint the administrators of the bank.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	Moreover, in order to better track ownership structure, banks must submit to the NBM the lists of affiliated persons, at least once a year. In the lists of banks' affiliated persons, are included shareholders, indirect owners, and beneficial owners of significant interests held in the bank's share capital. Also, as indicated during the mission, NBM staff will check whether the bank keeps updated all details regarding its shareholding structure, the identity of the shareholders and the existence of possible concerted action.
EC5	The supervisor has the power to take appropriate action to modify, reverse or otherwise address a change of control that has taken place without the necessary notification to or approval from the supervisor.
Description and findings re EC5	The NBM regulation No. 127 (Articles 67 and 68) contains some enforcement provisions that allow the NBM to take appropriate actions. In addition to using its sanctioning power—as contemplated in Article 38 of the LFI—the NBM can withdraw the prior permission of holders of significant interest in share capital of the bank and may also suspend voting rights attached to those shares. The withdrawal of the license cannot be ruled out in the extreme scenario.
EC6	Laws or regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material information which may negatively affect the suitability of a major shareholder or a party that has a controlling interest.
Description and findings re EC6	The 2013 NBM regulation on holding equity interest in the capital of banks contains provisions aimed at keeping the NBM abreast of any material change in ownership. In effect, within 3 working days of the date on which it became aware, the bank shall notify the NBM about: (1) any direct or indirect acquiring of equity interests in the share capital of the bank that reaches or exceeds 5 percent, 20 percent, 33 percent, 50 percent (2) any direct or indirect disposal of equity interests in the share capital of the bank which are below 5 percent, 20 percent, 33 percent, 50 percent (3) any facts or circumstances giving rise to the suspicion that such acquiring or disposal of was conducted without previous clearance of the authorities. Same requirement to inform the NBM also applies to the acquirer(s) of equity. The NBM should also be informed of any agreement on concerted action (regulation 127, Article 65).
Assessment of Principle 6	**MNC**
Comments	In 2008, this rating was rated LC but the report indicated that the true ownership of three shareholders of a bank with an aggregate 27 percent interest had not been determined with certainty. If progress has been made in certain areas since the last FSAP, (through the issuance of new regulations as discussed above), the NBM is still struggling to address deficiencies in ownership structures. Moreover, the situation has worsened to a great extent as explained below. **Ownership structure is still opaque in several banks.** There have been recent developments on the market that raise questions about the effectiveness of the Moldovan regime to ensure transparency in ownership structure. As described in a technical annex to the Corporate Governance Review of the Moldovan Banking System, the ownership structures of banks, including the largest 6 institutions, have been the target of dramatic shareholder changes over

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	the past two years. Most of the recent changes in ownership of Moldovan banks have not been conducted in a transparent manner and did not receive NBM review and (disapproval as stipulated in the NBM regulations described above). As a result, as indicated in the technical note, "*shareholder changes have resulted in de facto changes in control and subsequent changes in Board and certain key management which have impacted the nature of the bank's business and potentially, their safety and soundness.*" In many cases, ownership was acquired piecemeal through stock market operations, in transactions just under 5 percent of the subject bank's capital, in order to intentionally circumvent the law and escape NBM vetting, thereby accumulating significant controlling stakes in banks and the financial sector. It is believed that the predominant ownership of many of these small stakes is a series of shell companies that, according to local stakeholders, have common ultimate beneficial owners (UBOs) who have remained undisclosed. Moreover, there are assumptions that certain of these acquirers might be located overseas, in off-shore centers. Besides, it is extremely difficult to prove concerted actions (when prior clearance has not been requested. Last but not least, the Markets Commission has supervisory powers over the National Depository. The level of supervision of the National Depository is very poor and there is practically no control over significant shareholdings and transparency. According to the NCFM, it is the role and function of the Central Bank to investigate who are the ultimate shareholders of banks. **Questionable rulings by Provincial courts undermine the integrity of the regime applied to transfer of ownership.** From the discussion that the FSAP team had with multiples shareholders, acquisition of share packets in Moldovan banks (and also in insurance companies) was ultimately transferred without knowledge of their owners, apparently following court decisions. In effect, in certain complex transactions through public authorities, bailiffs and share registries, the expropriation of minority shareholders has been made possible with the "support" of judges. The NBM is well aware of the situation described above. Over the last 5 years, it intervened 10 times by notifying individual and legal persons, as well as groups of persons acting in concert, about the infringement of the LFI's provisions regarding the holding of significant interests in bank's capital and about the necessity to comply with those provisions. The NBM has also taken several actions both by suspending voting rights of shareholders who illegally acquired illegally ownership in banks and also by issuing new regulations aimed at fostering the conditions for holding equity interest in the capital of banks (No. 127 of June 27, 2013). At the NCFS level, decisions have also been made to tackle the problem. The most recent decisions aim to, inter alia: (i) limit participations of financial institutions (including commercial banks and insurance companies) in the capital of other banks, including overseas, by introducing the obligation to obtain prior permission of the NBM. (ii) establish a stricter record of shareholders, obliging the independent registrars to report to NCFM about all changes in the shareholders' structure of the largest Joint Stock Companies (including but not limited to financial institutions). (iii) decrease from 5 percent to 1 percent the threshold above which NBM permission to acquire

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	shareholding in banks is needed.[30] The current mission supports this set of measures. In addition, the authorities (namely the MOF, the NBM) may wish to: • Put pressure on the NCFM about its duties and accountability vis-à-vis the national depository to ensure identification of the UBO. • Engage in discussions with the relevant counterparts (e.g., the MOJ) to ensure alignment between the LFI and other NBM regulation on significant holdings in banks' capital and the law governing market activities. There is no concept of acting in concert in significant shareholdings under this law. It seems that the NCFM does not pay particular attention to the fact that a natural person may hold numerous participations under the threshold of 5 percent through different companies. They only have the concept of acting in concert for takeover purposes (there is a compulsory takeover bid over the whole of the capital of the company when a person acquires more than 50 percent of the capital). • Increase penalties in case of fraudulent acquisition of shareholdings. The fines that the NBM can apply under Article 38 of the LFI do not appear to act as a significant deterrent. • Revisit the language of Article 15_6(4) of the LFI stipulating that a person who no longer meets the requirement for holding equity (e.g., when exercising an influence that might jeopardize bank's sound management), "*cannot further hold directly or indirectly new shares in <u>that</u> bank*". The authorities may wish to set a specific timeframe for that prohibition[31] and also consider banning the person from holding interest, directly or indirectly in other banks. • Perform due diligence to ensure that entities located in Non Cooperative Jurisdictions no longer hold directly or indirectly equity interest in the capital of a bank.[32] • explore the possibility to subject private registrars to systematic reporting obligations to NBM on shareholder transfers (and not only to the NCFS as planned). • Further, in order to better enforce the substantive purpose of CP6, the NBM may wish to (i) suspend voting and dividend rights of shares until their UBO provide full disclosure; and (ii) deduct from capital the excess of risk involved.
Principle 7	**Major acquisitions**. The supervisor has the power to approve or reject (or recommend to the responsible authority the approval or rejection of), and impose prudential conditions on, major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and to determine that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Essential criteria	

[30] This measure should be temporary while other more efficient options of controlling significant ownership and ultimate beneficial ownership are identified.

[31] The law does not indicate whether the prohibition will expire after a certain period of time.

[32] A company based in Liberia is still holding a direct equity (3 percent of total capital) in a Moldovan bank.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)

Supervisory Powers, Responsibilities and Functions	
EC1	Laws or regulations clearly define: (a) what types and amounts (absolute and/or in relation to a bank's capital) of acquisitions and investments need prior supervisory approval; and (b) cases for which notification after the acquisition or investment is sufficient. Such cases are primarily activities closely related to banking and where the investment is small relative to the bank's capital.
Description and findings re EC1	As per Article 28 (7) of the LFI, 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 15 percent of the bank's regulatory capital; and the total net current value of a bank's equity interests may not exceed 50 percent of the bank's regulatory capital. According to the Regulation on equity investments of banks in legal entities, if the aforementioned limits are exceeded, prior written authorization of the NBM is required. In order to receive clearance, the bank's Board is required to submit written application to the NBM detailing, among others: (i) name and residence of the targeted legal entity; (ii) the amount of its capital; (iii) equity interest (in MDL and in percent) to be purchased; (iv) in case of purchase of shares: (a) the total number of shares issued by the legal entity; (b) the number of voting shares issued by the legal entity; (c) the face value (fixed) of a share; (d) the number of shares to be purchased; (e) the purchase price of shares; and (f) the description of purchased shares (common or preferred, with or without a voting right, etc.). Other useful information are required such as (v) the ratio of total amount of equity interests in the capital of the legal entities held by the bank to the bank's Total Regulatory Capital; (vi) the purpose and reasoning of the investment; and (vii) a copy of the financial analysis (operations of the legal entity, overall return, profitability, solvency, etc.) conducted by the bank that served as a basis to purchase the equity interest in the capital of the legal entity. In case the bank has the intention to hold an equity interest in the capital of a legal entity, which represents the equivalent of 25 percent or more from its capital, the acquirer shall submit additional information, including, but not limited to the list of shareholders/associates holding significant equity interest in the capital of legal entities in which the bank has the intention to invest, with the specification of their equity interest ratio and annual financial reports of the legal entity for the last two years. When assessing the bank's application, the NBM determines whether the acquisition or proposed investment does not expose the bank to excessive risks. To that end, the NBM will assess the observance by the bank of the prudential indicators set by the authorities, such as: the share in the total regulatory capital of the total value of the bank's investments into tangible assets and the equity interests in the capital of economic entities (<100 percent); the share in the Tier I Capital of the individual book value (<15 percent) or total value (<50 percent) of the equity investments in legal entities, the net exposure of the bank (<15 percent); the total

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	exposure (less than 5 times of the total regulatory capital); the long-term liquidity (≤1) and current liquidity (≥20 percent); the risk-weighted capital adequacy ratio (≤ 16 percent), etc. If the proposed investment/acquisition exposes the bank to undue risks, the NBM will not grant permission to invest. In practice, the monitoring of the risk inherent in investments and assessment of the investment policy of banks is part of the on-site examination.
EC2	Laws or regulations provide criteria by which to judge individual proposals
Description and findings re EC2	The Regulation on equity investments of banks in legal entities, Chapter IV, article 2, provides criteria by which to judge individual proposals. In particular, NBM will assess whether the applicant has a satisfactory financial situation that can sustain the acquisition and whether such acquisition will not have negative consequences that may affect the financial condition of the bank, such as potential losses, liquidity shortage, substantial deviations from the business-plan, non-observance of prudential indicators' value limits.
EC3	Consistent with the licensing requirements, among the objective criteria that the supervisor uses is that any new acquisitions and investments do not expose the bank to undue risks or hinder effective supervision. The supervisor also determines, where appropriate, that these new acquisitions and investments will not hinder effective implementation of corrective measures in the future.[33] The supervisor can prohibit banks from making major acquisitions/investments (including the establishment of cross-border banking operations) in countries with laws or regulations prohibiting information flows deemed necessary for adequate consolidated supervision. The supervisor takes into consideration the effectiveness of supervision in the host country and its own ability to exercise supervision on a consolidated basis.
Description and findings re EC3	As discussed under EC 1 above, banks are required to seek approval for a major acquisition, and in the event of the acquisition of a non-bank financial institution, it must follow the criteria established in the licensing process. Restrictions on exposures to non-financial commercial companies are governed by the regulation on bank investments, which limits the risk relative to regulatory capital. Moreover, to approve such investments, the NBM would determine whether the expansion would not affect the financial condition of the bank, and that the organizational structure of the bank remains suitable after the investment transaction is realized. The NBM would also assess if the bank's capital adequacy levels remain at the required level and if the acquisition will not create obstacle to effective supervision. From the discussion, it is not clear if the NBM also evaluates whether investments or major acquisitions will not hinder effective implementation of corrective measures in the future, including the orderly resolution of the bank. Moldovan banks may acquire investments in foreign companies. Only one bank made an investment in a foreign company (in Macedonia).
EC4	The supervisor determines that the bank has, from the outset, adequate financial, managerial and organizational resources to handle the acquisition/investment.

[33] In the case of major acquisitions, this determination may take into account whether the acquisition or investment creates obstacles to the orderly resolution of the bank.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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Description and findings re EC4	According to regulation (in particular the regulation on investments of banks in property), the NBM determines that the bank has adequate financial, managerial and organizational resources to handle the acquisition/investment. In particular, banks are required to adopt appropriate policies and internal procedures to properly manage and monitor investments in property. According to the regulation on investments of banks in property, plant and equipment, banks have created a commission empowered to control all activities related to investments in property, plants and equipment. This function can be carried out by the commission that is responsible for management and control of equity investments in legal entities.
EC5	The supervisor is aware of the risks that non-banking activities can pose to a banking group and has the means to take action to mitigate those risks. The supervisor considers the ability of the bank to manage these risks prior to permitting investment in non-banking activities.
Description and findings re EC5	As indicated during the mission, the NBM pays attention to the risks that non-banking activities can pose to banking groups and to that end considers the ability of the bank to manage these risks prior to permitting investment in non-banking activities. According to section 10 of the Regulation on equity investments of banks in legal entities, the acquirer would submit twice a year to the NBM financial reports of entities in which the bank holds equity interests representing the equivalent of 25 percent or more. Also, pursuant to section 6 of the same Regulation, banks shall have in place monitoring mechanisms over the economic entities in which they hold significant interests. During on-site inspections, NBM inspectors would assess the equity investments in the capital of economic entities, as well as policies and internal procedures of the bank in relation to equity investments in the capital of economic entities, as well as their adequate management. If, after the issuance of the authorization, the NBM comes to the conclusion that the non-banking activities in which the bank has invested, are exposing the institution to excessive risks, the NBM can apply sanctions. In particular, it can prescribe the bank to divest or to liquidate any subsidiary in case the NBM determines that the subsidiary is becoming insolvent and poses a significant risk to the financial stability of to the bank itself.
Assessment of Principle 7	**C**
Comments	
Principle 8	**Supervisory approach**. An effective system of banking supervision requires the supervisor to develop and maintain a forward-looking assessment of the risk profile of individual banks and banking groups, proportionate to their systemic importance; identify, assess and address risks emanating from banks and the banking system as a whole; have a framework in place for early intervention; and have plans in place, in partnership with other relevant authorities, to take action to resolve banks in an orderly manner if they become non-viable.
Essential criteria	
EC1	The supervisor uses a methodology for determining and assessing on an ongoing basis the nature, impact and scope of the risks: (a) which banks or banking groups are exposed to, including risks posed by entities in the wider group; and

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	(b) which banks or banking groups present to the safety and soundness of the banking system; The methodology addresses, among other things, the business focus, group structure, risk profile, internal control environment and the resolvability of banks, and permits relevant comparisons between banks. The frequency and intensity of supervision of banks and banking groups reflect the outcome of this analysis.
Description and findings re EC1	NMB is empowered by the provisions of both the LNBM (Articles 44, 47, 75[1]) and the LFI (Articles 37 and 40) to carry out on-site inspections and off-site controls in order to assess the financial conditions of banks and the compliance of their activity with the current legislation. Article 25 (2) of LFI stipulates that financial institutions shall maintain at all times adequate capital and sufficient liquid resources, proportionate to the type of activity and shall diversify their financial assets according to the risk of loss. In this context, according to its supervision manuals, NBM uses two closely related methodologies to assess a bank's risk profile: a CAMELS (used for on-site supervision) and a CA(M)ELS based instrument (used by off-site supervision) that aims to identify risks and anticipate potential problems in banks. CAMELS addresses the following elements: capital adequacy (C), assets quality including credit risk management practices (A), management (M), earnings (E), liquidity (L), and sensitivity to market risks (S). CAELS addresses the same elements except management (M); NBM also assesses separately internal and external audit functions, information system management and anti-money laundering. Every individual CAMELS element is assessed via off-site analysis and on-site examinations according to a set of criteria stipulated in the Rating Matrix. Based on these assessments, a final rating is determined, reflecting the risk profile of a bank. NBM uses the following scale: CAMELS 1 (strong), CAMELS 2 (satisfactory), CAMELS 3 (unsatisfactory), CAMELS 4 (deficient), and CAMELS 5 (critical). The final CAMELS rating is only decided after the full scope on site examination of a bank. It should be mentioned that depending on the analysis of the financial statements submitted to NBM, CAELS ratings are updated monthly (for example in March, to „BANCA SOCIALA" S.A. was assigned a CAELS rating 3, but in April, after the analysis of the financial situation of this bank, the rating was lowered to 4). In this way the CAELS rating reflect monthly the current risks in the banks. The intensity of the supervision is based upon the ratings given and the results of previous on-site inspections. As a result, banks that have been assigned a CAMELS rating 4 or 5 are considered to be problematic and are subject to enhanced scrutiny by the Special and off-site supervision Division or placed under the special administration regime. In this respect, depending on problems, banks are required to submit, on a daily basis, either information related to their prudential ratio level or ad-hoc detailed information about some balance sheet positions, such as interbank placements. According to the Manual for on-site controls, each bank is subject to a full scope examination

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	every year. When establishing the "On-site inspection schedule", on a semi-annual basis, the systemic importance of each bank is not taken into consideration.[34] All banks are subject to the same inspection cycle despite the fact that NBM has established a methodology for identifying systemically important banks. The list of systemically relevant banks is prepared by the BRSD based on criteria such as market share, substitutability and interconnectedness (as set out in the BCBS paper on *Global systemically important banks: assessment methodology and the additional loss absorbency requirement*, November 2011). Banks are classified on a scale from 1 to 14 with the first 5 or 6 categories considered as systemically important. During the mission, a draft regulation which provides for clear and detailed criteria based on which, on a monthly basis, banks should be classified on their systemic relevance were presented to the assessors. This methodology was prepared with the TA of the U.S. Treasury. The on-site methodology is mostly compliance based and does not take the systemic relevance sufficiently into account and therefore the methodology is not proportionate. This means in practice that banks classified as systemically important according to the internal methodology are subject to the same supervisory approach in the on-site examination as non-systemic banks. However, the time allocated to the examination and the size of the team might be increased. During the mission, assessors were informed that the NMB is considering changing the inspection approach by putting more emphasis on risks as well as on the systemic importance of banks.
EC2	The supervisor has processes to understand the risk profile of banks and banking groups and employs a well defined methodology to establish a forward-looking view of the profile. The nature of the supervisory work on each bank is based on the results of this analysis.
Description and findings re EC2	In order to establish a forward looking view of the risk profile of a bank, a number of off-site activities are executed. A primary approach is to assess the performance and trends of banks within their peer groups. The analysis of the reports submitted by the banks is performed by NBM Special and off-site supervision division in accordance with the Manual on financial institutions analysis (internal methodological recommendations). Also, the NBM performs a dynamic analysis of prudential indicators, including their resilience in stressed conditions. Off-site supervisors (assigned to the "Special and off-site supervision" division) are responsible for conducting a quarterly macro stress test for each individual bank and for the whole banking system (based on macro scenarios). On the other hand, BRSD staff assigned to the "Banking control and monitoring" unit assess compliance with the regulation (on credit risk, interest rate risk, FX risk and liquidity risk) as well as the quality of stress test done by each bank during their full-scope examinations.
EC3	The supervisor assesses banks' and banking groups' compliance with prudential regulations and other legal requirements.

[34] Indeed during the mission a matrix was presented to the team the mention that the systemic importance of the bank is not taken into consideration had in view that for all banks are performed, annually, regular on-site inspections focused on the same topics irrespective of their risk profile and systemic importance.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
Description and findings re EC3	Compliance with prudential regulations and other legal requirements is an integrated part of the examination process. These assessments take place via off-site analysis and on-site examination. According to the BRSD Manual on on-site controls, the main scope of the on-site examination is to identify the risk level of a bank and to assess the Board members' capacity to control and manage such risk. Two modern computerized information systems called FAS Inventory and BOSS were implemented by the NBM in order to facilitate off-site supervision. These tools allow the NBM to monitor possible negative trends in banks activity on a real time basis. As noted above, the NBM performs dynamic analysis of prudential indicators. Thus, on a monthly basis, NBM examines the compliance with the regulatory capital, risk weighted capital adequacy, liquidity ratios and other indicators (large exposure, transactions with affiliated parties, participations, loan classification etc.) for each bank on a solo basis. The NBM also analyzes the existing trends in each bank and in the entire banking system and evaluates the risk profile of each bank (CAMELS rating). Based on the outcomes of these analyses, a report on the financial situation of the banking system is prepared describing the main trends and events that took place during the period, compared with the last year and the similar month of the last year. The report includes detailed information on the financial situation and latest developments of problematic banks and submitted, on a monthly basis, to the NBM Council of Administration. Despite the current language of the LFI, there is no requirement relating to consolidated prudential supervision. Albeit the LFI stipulates that accounts, records and financial statements of the financial institutions shall reflect the operations and financial situation of the bank, both on an individual and consolidated basis; however the NBM has only recently amended regulations to create the framework for supervision on a consolidated basis. Requirements related to consolidated prudential supervision are not yet in force.
EC4	The supervisor takes the macroeconomic environment into account in its risk assessment of banks and banking groups. The supervisor also takes into account cross-sectoral developments, for example in non-bank financial institutions, through frequent contact with their regulators.
Description and findings re EC4	According to Article 4 of the LFI, the primary objective of the NBM shall be to ensure and maintain the price stability. There is no explicit mandate of the NBM in the financial stability area. However, the NBM undertakes a number of tasks and participates in a range of groupings that ensures that it develops a view of the macroeconomic environment that can inform its supervisory activities. For example, an Agreement of Cooperation between the NBM and the NCFM was concluded on December 27, 2010, in order to promote financial stability and exchange information in the regulatory arena. According to this agreement, the NCFM is tasked to supervise the non-banking financial sector and to submit any requested information to the NBM, if necessary. Also, an internal Sub-committee on Financial Stability was established within the NBM and a new division within the BRSD was set up. The "Special and off-site supervision" division is responsible for incorporating macro-prudential analyses into the assessment of banks, group of banks and the banking system. Risk exposures, mainly credit and liquidity risk and developments in the banking system as a whole are monitored and assessed on the basis of supervisory reporting data. Thus, the impact of key macroeconomic indicators on the quality of the loan portfolio of banks is assessed through

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	macro prudential stress testing of credit risk. Another useful tool is the study of an early warning analysis of the evolution of macroeconomic indicators of real sector, external sector, fiscal and financial sector, which measure the level of risk presented by the dynamic changes of these indicators and emits warning signals based on the trends of macroeconomic indicators. Also, in view of economic and geographic considerations the impact on the financial stability of cross-sector developments in the euro area and the CIS are presented in the early warning study. The macro-economic environment is discussed by the NBM's Board (Council of administrations) and in the NMB Sub-committee on Financial Stability. Further, the macro-economic environment is also discussed by the NCFS.
EC5	The supervisor, in conjunction with other relevant authorities, identifies, monitors, and assesses the build-up of risks, trends, and concentrations within and across the banking system as a whole. This includes, among other things, banks' problem assets and sources of liquidity (such as domestic and foreign currency funding conditions, and costs). The supervisor incorporates this analysis into its assessment of banks and banking groups and addresses proactively any serious threat to the stability of the banking system. The supervisor communicates any significant trends or emerging risks identified to banks and to other relevant authorities with responsibilities for financial system stability.
Description and findings re EC5	The NBM (BRSD) identifies, assesses and monitors the build-up of risks, trends and concentration of risks within and across the banking system as a whole. As discussed above, the BSRD performs ongoing monitoring of individual and peer groups of banks and to that end uses three models of stress testing. The macro prudential stress test uses a wide range of factors (GDP, Inflation rate, credit interest rate, appreciation/depreciation of domestic currency) and determines their impact on credit risk and on the quality of portfolio, both under periods of stability and stress. Aggressive lending, expressed by an increase in the portfolio over the system average can therefore lead to higher probability of bearing losses. Liquidity stress tests examine the systemic impact of a crisis on banks' liquidity, based on inflows and outflows of liquid assets during a given month. When simulating the stress scenarios, the capital adequacy ratio of each bank is also taken into account. For this purpose, the NBM uses the capital adequacy ratio subject to the macro prudential stress test of credit risk. The stress testing performed on a monthly basis, estimates the impact of credit and liquidity risks of the banking activity, applying shock parameters that are based on the lowest and the highest values historically recorded by the domestic banking sector. Consequently, stressed ratios for non-performing loans, capital adequacy and liquid assets are calculated. Any serious threat to the stability of the banking system or any emergence of significant risks is reported to the NBM Board members through the issuance of the so-called "Report on the financial condition of the banking system". Also, information related to the activity of participants on financial non-banking market is reported to the NCFS and the NCFM, under the terms of the agreements.
EC6	Drawing on information provided by the bank and other national supervisors, the supervisor, in conjunction with the resolution authority, assesses the bank's resolvability where appropriate, having regard to the bank's risk profile and systemic importance. When bank-specific barriers to

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)

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	orderly resolution are identified, the supervisor requires, where necessary, banks to adopt appropriate measures, such as changes to business strategies, managerial, operational and ownership structures, and internal procedures. Any such measures take into account their effect on the soundness and stability of ongoing business.
Description and findings re EC6	According to the LFI, the NBM is the sole resolution authority. Thus, in case of problems, the NBM may apply certain measures; including placing the bank under the "special supervision" regime (see CP 11 for further details). For more severe situations, the NBM can place the bank under the special administration regime or resort to the liquidation in the most extreme scenario. Moreover, when a bank is in a distressed condition, pursuant to Article 38 of the LFI, the NBM may require direct and indirect holders of a significant interest in a bank to develop and implement recovery measures. These measures include: a) changing the structure of assets and liabilities of the bank; b) changing the organizational structure of the bank; c) additional financing from the bank's shareholders and others; d) increasing the bank's capital; and e) other measures used to address the financial situation of the bank, approved by the NBM. The NCFS, according to the provision of article 9 c) of the MoU on Maintenance of Financial Stability (February 28, 2011), should be kept informed by the NBM about the banks that need additional capital or which require special administration, liquidation or other urgent measures. In December 2011, NBM sent a letter to all banks requiring them to prepare and submit contingency plans, providing at the same time criteria for drawing up these plans. According to the NBM recommendations, the contingency plans should address capital, liquidity, profitability and asset management with the aim to ensure bank's business continuity in all circumstances, but only on an individual basis.
EC7	The supervisor has a clear framework or process for handling banks in times of stress, such that any decisions to require or undertake recovery or resolution actions are made in a timely manner.
Description and findings re EC7	NBM has a set of formal corrective tools at its disposal (see CP 11 for more details). The LFI, the 2011 MoU on the Maintenance of Financial Stability and the Regulation of the NBM Financial Stability sub-Committee provides the framework for bank resolution. Articles 37 and 38^1-38^{14} of the LFI provide for an extensive set of tools for special administration and liquidation. Also pursuant to Article 38 (2^1) of the same Law, the NBM may require direct and indirect holders of significant interest in a bank to develop and implement recovery measures, which include: a) change in the maturity term of assets to ensure execution of bank's obligations b) increase in equity capital; c) additional financing from the bank's shareholders and others. In addition, according to article 31 of Regulation on internal control systems within banks, banks should have in place contingency plans, approved by the banks' Board. Although the NBM has an extensive set of tools for special administration and liquidation, there is no clear framework or process for handling banks in times of stress (see also precondition Framework for crisis management, recovery and resolution).
EC8	Where the supervisor becomes aware of bank-like activities being performed fully or partially outside the regulatory perimeter, the supervisor takes appropriate steps to draw the matter to

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	the attention of the responsible authority. Where the supervisor becomes aware of banks restructuring their activities to avoid the regulatory perimeter, the supervisor takes appropriate steps to address this.
Description and findings re EC8	As noted above, the NBM is not yet practicing consolidated supervision and therefore does not have information on banks practices to restructure their activities to avoid the supervisory perimeter. During the mission assessors were informed that only few banks control other financial institutions (mainly leasing companies) and they do not contemplate disposing of their participation. The NBM provides information to the National Anticorruption Center relating to money laundering and other crimes in accordance with its agreement. When finding any legal infringement by a bank related to permissible activities under its license, the NBM notifies the relevant competent authorities.
Assessment of Principle 8	**LC**
Comments	In the 2008 FSAP it was recommended to introduce an early warning system to enhance NBM ability to respond in a timely and effective manner to potentially disruptive capital movements. It was also recommended that (i) all pertinent areas of the NBM contribute with information for the successful implementation of this system and (ii) that banks notify the BRSD promptly of substantive change in overall condition or any materially adverse change (including breach of legal or statutory requirements). While the first two recommendations were implemented, the last one was not transposed into legislation. During the mission, assessors were informed that the Regulation on internal control within the banks will be amended and banks will be required to promptly notify NBM of substantive change in overall condition or any materially adverse change. During on-site examinations, supervisors assess the risk profile of the banks to ensure appropriate focus on all risks activity. However, the NBM approach is still a mix between risks-based and compliance based focus, which appears to be excessively time consuming. Besides, too much attention is sometimes given to minor issues. The NBM may wish to shift its focus towards a full-fledged Risk-Based Approach. Information provided for off-site supervision is comprehensive and thorough. The current supervisory inspection planning does not take into consideration the risks profile of each bank nor their systemic importance.[35] All banks are subject to the same inspection cycle despite the fact that NBM has established a methodology for identifying systemically important banks. The human resources allocated to both on-site and off-site supervision does not appear adequate. Even though the staffing has been increased over the past few years, the new staff are very young and with limited or no previous professional experience. Moreover, there are still 4 vacant positions (3 staff have been on maternity leave for more than 3 years). Therefore,

[35] See explanation for EC 1 in footnote 56.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	banking supervision is under pressure and the situation may worsen even further with the migration to Basel II and the need to establish an adequate crisis management framework. The NBM may wish to consider the following: • Adopt a more risk-based approach. Further moves towards a more comprehensive system of risk-based supervision is needed in the short-term, especially as the Moldovan financial sector is exposed to very serious risks in the current global environment. • Explore the possibility to enhance off-site and on-site resources. • Implement the framework for crisis management.
Principle 9	**Supervisory techniques and tools**. The supervisor uses an appropriate range of techniques and tools to implement the supervisory approach and deploys supervisory resources on a proportionate basis, taking into account the risk profile and systemic importance of banks.
Essential criteria	
EC1	The supervisor employs an appropriate mix of on-site[36] and off-site[37] supervision to evaluate the condition of banks and banking groups, their risk profile, internal control environment and the corrective measures necessary to address supervisory concerns. The specific mix between on-site and off-site supervision may be determined by the particular conditions and circumstances of the country and the bank. The supervisor regularly assesses the quality, effectiveness and integration of its on-site and off-site functions, and amends its approach, as needed.
Description and findings re EC1	NBM employs a mix of on-site and off-site supervision as is stipulated in the Law on NBM and in the Manual on on-site controls. The NBM approach to the supervisory process is that off-site supervision is the main instrument for monitoring the activities and risks in the banking sector, with information being used to supervise the performance and the credit situation of the bank and determine the frequency and scope of on-site supervision, while the on-site analysis is used to verify the compliance with the regulations or further investigate off-site findings. Based on the data from the financial reports submitted regularly by banks, the NBM performs the analysis of current development trends in each bank and of the whole banking system. After the analysis is completed, a monthly report covering the financial position of the banking system is prepared for review by the Council of Administration of the NBM. In the event a negative trend in the bank's activity is detected, the Council of Administration approves a decision covering the enforcement measures to be taken in order to improve the financial

[36] On-site work is used as a tool to provide independent verification that adequate policies, procedures and controls exist at banks, determine that information reported by banks is reliable, obtain additional information on the bank and its related companies needed for the assessment of the condition of the bank, monitor the bank's follow-up on supervisory concerns, etc.

[37] Off-site work is used as a tool to regularly review and analyze the financial condition of banks, follow up on matters requiring further attention, identify and evaluate developing risks and help identify the priorities, scope of further off-site and on-site work, etc.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	position of the bank. The NBM performs a range of on-site inspections, from full scope on-site inspections, to targeted examinations. The quality, effectiveness and integration of its on-site and off-site functions are periodically reviewed by the NBM. The latest revision of the internal manual for on-site supervision took place in June 2012. Also, on-site and off-site evaluations are integrated in the Strategic Plan of the NBM of Republic of Moldova for 2013-2017. According to this Plan the NBM intends to identify optimal ways to implement the Basel II Capital Accord, by evaluating the qualitative and quantitative impact on the banking system. This goal will require amendments of the existing legal framework and the development of new legal rules for bank capital adequacy, which will be aligned with the EU requirements. Further, implementation of prudential reporting in accordance with COREP, consolidated supervision of all credit institutions, effective implementation of risk-based supervision by automating the generation of necessary reports, and the improvement of legal instruments for prudential supervision are envisaged for developing the banking supervision function. Moreover, in order to assess the quality and effectiveness of its supervisory framework the NBM employs internal audit to review and help revise its processes as needed. The annual internal audit report for 2012 identified 9 recommendations addressing banking supervision.
EC2	The supervisor has a coherent process for planning and executing on-site and off-site activities. There are policies and processes to ensure that such activities are conducted on a thorough and consistent basis with clear responsibilities, objectives and outputs, and that there is effective coordination and information sharing between the on-site and off-site functions.
Description and findings re EC2	The organizational structure of the BRSD provides an effective integration of on-site and off-site supervision with clear responsibilities set out. The on-site resources are located in the Division for banking control and monitoring of AML/CFT, which is organized into two separate units covering bank activity control (13), and AML/CFT (3). The off-site resources are located in the Special Supervision and Off-site Division where one unit deals with the regular monitoring of banks, risk assessment and financial reporting (6), another with special supervision (7) and the third with crisis management (4). Within the off-site supervision units, a supervisor is assigned to monitor overall developments in a number of banks, while the on-site inspectors are specialized and deployed as needed. There is effective coordination and information sharing between on-site and off-site functions, mostly because of the way the internal process is established, joint meetings being organized also before each on-site inspection with a scope to inform the on-site supervisors about the main existing problems in the bank to be inspected, the issues that need enhanced attention, relevant data about the activity and performance of the bank in general, the risk of the bank and compliance with the requirements of the legislation in force, etc. The off-site activities take place according to a fixed schedule set out in the Manual on off-site examinations. Thus every month, a detailed systemic analysis (containing main developments in financial sector and problematic banks situation) is produced together with analysis of every individual bank, a group of banks and the system as a whole based on a set of certain indicators. This report is made by Special Supervision and Off-site division and sent for review by the Council of Administration of the NBM. In the event a negative trend in the bank's activity is detected, the Council of Administration can approve a decision covering the enforcement

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)

Supervisory Powers, Responsibilities and Functions	
	measures to be taken in order to improve the financial position of the bank. The on-site activities are executed according to the semiannual plan, subject to amendment for targeted examinations if off-site surveillance identifies deficiencies requiring immediate action. Targeted examinations can also be used to verify the implementation of recommendations arising from previous on-site inspections and this is usually after 90 days from the date the recommendations were communicated to banks. When drafting the six-monthly plan, a range of information is taken into account, including the risk data matrix; the CAMELS rating from the last inspection; CA(M)ELS rating of the last off-site supervision report; whether the bank has breached any prudential indicators; the condition of the bank at the time the last off-site analysis was performed. Although the matrix presented the rank of the systemic importance of the bank as it was mentioned in CP 8, regular on-site inspections focused on the same topics are performed for all banks annually, irrespective of their risk profile and systemic importance. The planning process consists of the following steps: setting the on-site inspection plan; appointing a chief of the inspection; performing a preliminary analysis of the information submitted by the bank and the latest report prepared by the off-site teams; setting the preliminary objective of the inspection; identifying the tasks; setting the final objective of the inspection taking into account information received from other NBM Departments and from other sections of BRSD. Finally, the timetable for the inspection is agreed. The inspection plan aims to ensure that all banks are subject to a complex inspection at least once a year in addition to thematic inspections. According to the information presented to the assessors for the period 2011–13 the on-site examination plans were executed and targeted examinations performed as follows: **Period** | **Full Scope On-site Inspections** | **Targeted Inspections** 2011 | 14 | 2 2012 | 14 | 4 2013 | 13 | 1
EC3	The supervisor uses a variety of information to regularly review and assess the safety and soundness of banks, the evaluation of material risks, and the identification of necessary corrective actions and supervisory actions. This includes information, such as prudential reports, statistical returns, information on a bank's related entities, and publicly available information. The supervisor determines that information provided by banks is reliable[38] and obtains, as necessary, additional information on the banks and their related entities.
Description and findings re EC3	Off-site supervision is performed by the NBM based on the financial reports submitted by banks in accordance with FINREP on a solo basis. Thus, banks submit daily, monthly, quarterly, biannually 37 financial and prudential reports, which cover the main areas of banks' activity: management, credit operations and deposit acceptance, liquidity, solvency and profitability of

[38] Please refer to Principle 10.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	commercial banks. From December 31, 2013, banks are required to submit biannual FINREP financial statements at consolidated level. Other sources of information used by the NBM include bank annual reports and certified financial statements, other ad hoc reporting on certain issues, publicly available information. At the same time, banks shall submit quarterly and biannually financial reports of the legal entities where holds 25 percent or more of the share. In addition to the information submitted by banks, the off-site and on-site inspectors verify the accuracy of the data submitted by the banks by checking these through different data bases such as: the register of real estate ("Cadastru"); the register for the identify of resident individuals and legal entities ("Access"); and official websites of foreign banks and rating companies, as well as other credible mass-media sources. Additionally, the NBM requires correspondent banks to confirm all balances in respect of the bank subject to inspection; the existence of any accounts that are pledged as collateral, whether or not such collateral is subject to an official lawsuit or restrictions. The NBM requires banks to provide their statutory audit reports and limited audit reviews. According to recently introduced practices, the NBM inspectors now require administrators (see note below) of the bank to sign a statement by which they confirm that all assets, liabilities and off-balance articles (issued/received guarantees, conditional commitments etc.) are reflected in the balance sheet as of the inspection date, submitted to the NBM and that up to the date of the balance sheet submission, there are no other transactions or operations concluded/performed on behalf of the bank that are unrecorded. Please note that the term "administrator" has a specialized meaning under the LFI: it means a member of the Board, of the executive body, of the Censors Committee, the Chief accountant, manager of a branch, as well as any other person who alone or together with other has the legal or statutory authority to enter into commitments for the account of the bank.
EC4	The supervisor uses a variety of tools to regularly review and assess the safety and soundness of banks and the banking system, such as: (a) analysis of financial statements and accounts; (b) business model analysis; (c) horizontal peer reviews; (d) review of the outcome of stress tests undertaken by the bank; and (e) analysis of corporate governance, including risk management and internal control systems. The supervisor communicates its findings to the bank as appropriate and requires the bank to take action to mitigate any particular vulnerabilities that have the potential to affect its safety and soundness. The supervisor uses its analysis to determine follow-up work required, if any.
Description and findings re EC4	In order to regularly review and assess the safety and soundness of banks, NBM uses a variety of tools. The NMB has developed an early warning system which includes regular monitoring, on a quarterly basis, of six sectors—the real economy; the financial sector; external; fiscal; the EU and CSI, based on a set of indicators provided by the internal methodology.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	The analysis of prudential reports (financial statements, capital requirements) is conducted by both on-site and off-site functions. This analysis aims to evaluate banks' financial position via a set of financial indicators. Horizontal peer reviews are conducted by off-site supervision. For this purpose banks are classified, by size in three groups: small (total assets< Lei 1.5 billion), medium (total assets >Lei 1.5 billion lei<Lei 4.5 billion), and big (total assets > Lei 4.5 billion). A set of statistical indicators are calculated and averaged to facilitate a horizontal peer review. Corporate governance, risk management and internal controls are examined during on-site inspections according to the CAMELS methodology, while relevant developments related to these issues are also monitored off-site. The Manual on on-site controls provides guidance for the examiner in order to evaluate corporate governance and the internal control function, but not the risk management function. All full scope/thematic inspection results are discussed during on-site inspections with the bank management. Inter alia, this process allows a bank to take corrective actions immediately, even before the end of the inspection. Remedial measures to be imposed as a result of the inspection are determined by the Council of Administration of the NBM. The measures are proposed by the Director of the BRSD having consulted with the heads of the other supervisory and monitoring divisions within the NBM. Under the law (article 75 of the LNBM) and confirmed in the Manual, the bank receives a copy of the preliminary inspection results for comment and provision of further information, as relevant, prior to the finalization of the inspection report. A follow-up meeting with the bank addresses any final proposed objections, after which the final report is submitted and the NBM prescribes measures to be taken by the bank. Further communication between the bank and NBM ensures follow-up of the recommendations.
EC5	The supervisor, in conjunction with other relevant authorities, seeks to identify, assess and mitigate any emerging risks across banks and to the banking system as a whole, potentially including conducting supervisory stress tests (on individual banks or system-wide). The supervisor communicates its findings as appropriate to either banks or the industry and requires banks to take action to mitigate any particular vulnerabilities that have the potential to affect the stability of the banking system, where appropriate. The supervisor uses its analysis to determine follow-up work required, if any.
Description and findings re EC5	NBM conducts a number of stress tests to identify, assess and mitigate risks across banks and in the banking system. Such stress tests assess: credit risk, interest rate risk, currency risk and liquidity risk, as well as the combination of these risks. At the same time, when assessing credit risk, the macroeconomic situation is taken into consideration, and scenarios with different macroeconomic parameters are applied. NBM stress test results are neither shared with the industry nor published in the Annual report. The bank's internal policies related to stress testing are examined during on-site inspections, as well as the risks analyzed, shock parameters used and the results obtained. NBM issues proposals to improve the stress tests if the parameters are inadequate or risk coverage is insufficient. At the same time, the NBM checks whether the internal policies related to contingency plans are observed and whether the banks take appropriate actions to mitigate the vulnerabilities to risks identified by the stress tests.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	The Council of Administration of the NBM is informed through the monthly report on the banking system if the results of the stress tests show serious warning signs. The stress testing analysis is used also as a tool to identify necessary amendments to the NBM normative acts of the NBM, including prudential indicators. Thus, during 2010–11, the requirements for the minimum level of the equity and Tier I capital were modified. Amendments to the Regulation on large exposures were also recently approved, which are aimed to widen the scope of large exposures (to cover interbank placements of any duration and including NOSTRO accounts).
EC6	The supervisor evaluates the work of the bank's internal audit function, and determines whether, and to what extent, it may rely on the internal auditors' work to identify areas of potential risk.
Description and findings re EC6	Supervisors evaluate the internal control function of banks during on-site inspection, including internal audit functions. Specifically, the supervisors assess the internal audit approach, their structure and audit findings for the specific risk areas under review. Internal NBM procedures guide the inspection process. The inspection comments on the efficiency of the audit function, as well as providing suggestions to improve the function.
EC7	The supervisor maintains sufficiently frequent contacts as appropriate with the bank's Board, non-executive Board members and senior and middle management (including heads of individual business units and control functions) to develop an understanding of and assess matters such as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality, risk management systems and internal controls. Where necessary, the supervisor challenges the bank's Board and senior management on the assumptions made in setting strategies and business models.
Description and findings re EC7	According to the LFI all members of the Board and of the executive body shall meet criteria on the qualifications, experience and reputation. These criteria are assessed by the NBM in the approval process inclusive organizing interviews (see also CP5). The NBM Manual for on-site inspection also covers the assessment of the quality of bank's management. Thus, during on-site inspections the NBM inspectors assess Board and management performance, technical competence (including heads of business units and those with control functions) as well as checking whether preventive measures and prompt corrective actions were taken as necessary. On-site inspectors also analyze minutes of the Annul General Meeting and Extraordinary General Meeting of Shareholders (if applicable) as well as Board minutes, minutes of the executive body, and Censors Committee, as well as ALCO reports. The inspectors check the current organizational structure of the bank, the quality of the internal procedures, as well as whether they are updated; conformity with NBM limits, as well as the knowledge of the management regarding bank's performance and condition. The inspection report draws conclusions on the quality of the bank's management and is discussed with the bank management. The NBM Council of administration organizes meetings with members of the management of the bank to discuss key matters highlighted in the inspection report. Also the NBM management and representatives of the BRSD can organize ad-hoc meetings with the bank management on different topics generally related to off-site issues.
EC8	The supervisor communicates to the bank the findings of its on- and off-site supervisory analyses in a timely manner by means of written reports or through discussions or meetings

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	with the bank's management. The supervisor meets with the bank's senior management and the Board to discuss the results of supervisory examinations and the external audits, as appropriate. The supervisor also meets separately with the bank's independent Board members, as necessary.
Description and findings re EC8	The results of on-site analysis are submitted to the NBM management and are discussed with the bank management. Prior to issuing the examination report the inspection team has a formal exit meeting. In this meeting the on-site team communicates the final issues, and recommendations with the executive management in order to ensure correct and representative conclusions and to allow the bank to take immediate corrective actions. The exit meeting is followed by the inspection report, which is presented to heads of Divisions and Units from the BRSD for checking correctness, completeness and accuracy of information and is communicated subsequently to the bank management and the Board for allowing them to present their agreement or disagreement with the conclusion of the report. The final Report on on-site inspection results is approved by the Director of BRSD and is submitted to the NBM Council of Administration. The Board and president of the executive body of the bank are invited to participate in a meeting with the NBM Council of administration. Afterwards, the NBM Council of Administration adopts a decision that includes all measures necessary to be taken by bank in order to comply with shortcomings found and, where necessary, remedial actions or sanctions. The findings from off-site analysis are communicated to the bank in a Letter, in accordance with the article 75 of Law on NBM. Additionally, the NBM usually meets with the bank if any material issues have arisen. Issuing the final report, typically takes between two and four months. Nevertheless, the assessors noted instances of significant delay, where some final reports were not yet issued in respect of inspections that had taken place a year or more prior to the assessment.
EC9	The supervisor undertakes appropriate and timely follow-up to check that banks have addressed supervisory concerns or implemented requirements communicated to them. This includes early escalation to the appropriate level of the supervisory authority and to the bank's Board if action points are not addressed in an adequate or timely manner.
Description and findings re EC9	Banks are asked to submit an action plan addressing the recommendations in the inspection report. The action plan is reviewed by the Special supervision and off-site division together with On-site control division, before responding to the bank. If the action plan does not address supervisory concerns, thematic inspections may be planned. If during on-site inspection or off-site supervision, it is determined that bank has not acted to remedy previous issues, as agreed in its last action plan, then the Special and off-site supervision division develops proposals to rectify the situation. In practice, it is observed that problems in certain banks can continue for a long period of time.
EC10	The supervisor requires banks to notify it in advance of any substantive changes in their activities, structure and overall condition, or as soon as they become aware of any material adverse developments, including breach of legal or prudential requirements.
Description and findings re EC10	Banks are required to apply for supervisory approval in respect of a number of important changes in their activity and management structures, including performing new activities that require a license from the NBM, opening branches and representative offices, as well as

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	appointing administrators (See also CP 5). Banks are also required to apply for supervisor approval on intended distribution of dividends. Further, a bank is required to notify immediately the NBM when it is in default or over indebted, or there is a risk that the bank will enter into default (LFI article 38).
EC11	The supervisor may make use of independent third parties, such as auditors, provided there is a clear and detailed mandate for the work. However, the supervisor cannot outsource its prudential responsibilities to third parties. When using third parties, the supervisor assesses whether the output can be relied upon to the degree intended and takes into consideration the biases that may influence third parties.
Description and findings re EC11	The NBM may, on occasion, commission a special audit by external auditors. Thus, article 44 of LNBM allows NBM to delegate some supervisory tasks to qualified professionals i.e. auditors in order to perform on-site inspections of banks. According to article 37 paragraph 4 from LFI they have the right to: a) examine the accounts, records and other documents; b) require administrators, employees and agents of the bank or subsidiary to provide any information on their activity and operations. In such circumstances detailed terms of reference are drawn up and the NBM has particular regard to the track record of the company providing the audit.
EC12	The supervisor has an adequate information system which facilitates the processing, monitoring and analysis of prudential information. The system aids the identification of areas requiring follow-up action.
Description and findings re EC12	NBM uses a number of different information systems (e.g.,"Invoke FAS Regulatory," "BOSS" and"Statistica"), to collect financial and prudential information from banks that facilitate the off-site supervision process. An important feature of these systems is the ability of the NBM to monitor negative trends in banks' activity in a timely manner. Accordingly, a number of reports are generated each month, which facilitate assessment of the performance of banks and monitoring of compliance with prudential requirements. At the same time, the financial condition of each bank is analyzed monthly, and a CA (M) ELS rating is assigned to the bank. If a negative signal is identified, the Director of BRSD is expected to propose measures to the Council of Administration of the NBM, which shall adopt, where necessary, a decision regarding remedial measures to be taken.
Additional criteria	
AC1	The supervisor has a framework for periodic independent review, for example by an internal audit function or third party assessor, of the adequacy and effectiveness of the range of its available supervisory tools and their use, and makes changes as appropriate.
Description and findings re AC1	NBM processes are reviewed by the Internal Audit Department of NBM. These reviews are designed to examine the adequacy and effectiveness of available supervisory instruments and their use, as well as to provide proposals for their improvement.
Assessment of Principle 9	**LC**
Comments	The NBM uses a mix of on- and off-site supervision. There is regular and frequent contact between the NBM and banks' management.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	It takes sometimes between two to four months to issue an on-site inspection report, and several reports were issued after one year (during FY 2013). These delays may affect timely corrective measures. The NBM should explore ways to address this problem. Moving towards a more comprehensive Risk-based supervisory system will certainly be a major step forward in this regard. The frequency and intensity of supervision should depend more on the systemic relevance of the banks and the risks identified. Thus, systemically relevant banks should receive more resources to undertake off-site analysis, while the on-site examinations would be higher for these institutions. To address these issues, the NBM could apply the following recommendations: • Improve the examination process by shortening the delay between the end of the on-site visit and the official submission of the report to the bank; • Enhance on-site and off-site supervision for systemically important banks; • Improve supervisory methodologies to enable a timely intervention in banks; • Take a more active stance in influencing the quality of internal audit in banks and establishing a regular dialogue with the bank's internal auditors; • Engage more actively in a dialogue with external auditors.
Principle 10	**Supervisory reporting**. The supervisor collects, reviews, and analyzes prudential reports and statistical returns[39] from banks on both a solo and a consolidated basis, and independently verifies these reports through either on-site examinations or use of external experts.
Essential criteria	
EC1	The supervisor has the power[40] to require banks to submit information, on both a solo and a consolidated basis, on their financial condition, performance, and risks, on demand and at regular intervals. These reports provide information such as on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, risk concentrations (including by economic sector, geography and currency), asset quality, loan loss provisioning, related party transactions, interest rate risk, and market risk.
Description and findings re EC1	The NBM is empowered to collect supervisory information from banks in accordance with Article 44 of LNBM. When necessary, therefore, the NBM is empowered to require any necessary information to have an updated situation of the entity supervised especially with regard to the capital adequacy, liquidity, and exposure to the different type of the risk. Pursuant to articles 37 of the LFI banks shall prepare and submit to the NBM, according to its regulations, reports on its management, operations, liquidity, solvency, and profitability, as well as on its subsidiaries, both separately and on a consolidated basis for an assessment of the

[39] In the context of this Principle, "prudential reports and statistical returns" are distinct from and in addition to required accounting reports. The former are addressed by this Principle, and the latter are addressed in Principle 27.

[40] Please refer to Principle 2.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	financial situation of the bank and each of its subsidiaries. For the purpose of monitoring the compliance with the prudential requirements, banks submit reports on classification of assets, large exposures, exposures related to affiliated persons, bank deposits, calculation of total regulatory capital, risk weighted capital adequacy, liquidity, operative information (daily data on liquid assets, the balance of interbank deposits and loans), diverse information, bank's shareholders, equity investment of banks in legal entities, large deposits. These reports are submitted on a solo basis. The NBM's detailed reporting instructions stipulate that all banks are required to submit their prudential returns within 10 days of the end of the reporting period. Most reports are submitted on a monthly basis excepting reports on: large exposures, affiliated persons (both exposure and the list of affiliated persons), assets taken into possession/purchased for debt repayment, etc. Moreover, from the end of March 2014, more detailed information with respect to banks shareholders, shareholders which own more than 1 percent of the bank capital, disposed shares etc. will be reported to the NBM. All regulatory returns are filed on an electronic transmission system (SIRNBM,) There are no requirements for banks to submit prudential returns on a consolidated basis.
EC2	The supervisor provides reporting instructions that clearly describe the accounting standards to be used in preparing supervisory reports. Such standards are based on accounting principles and rules that are widely accepted internationally.
Description and findings re EC2	According to Article 33 of the LFI, banks accounts and financial reports must comply with accounting standards as set by the NBM, complying with the requirements for recording the accounts of financial institutions. These shall be also prepared in accordance with the generally accepted accounting practice. Accounts, records and financial statements of financial institutions shall reflect the operations and financial condition of subsidiaries and branches and shall be prepared both separately and on a consolidated basis. The NBM has established detailed reporting instructions for prudential reporting forms. In 2011 the NBM issued Instructions on FINREP (based on IFRS) individual financial statements applicable to banks. FINREP provides a set of reports containing basic information on assets, liabilities and equity of the bank, income and expenditure related to the bank's activity and additional information on disclosures for certain positions from the basic reports; financial assets classification, impaired and outstanding assets, financial liabilities, tangible and intangible assets, loan commitments and financial guarantees, interest rate risk, etc. According to these instructions, since January 1, 2012, banks have been required to submit financial reports in accordance with these new requirements. Consolidated FINREP requirements were approved in July 2013. This Instruction provides for a set of reports on the financial situation of the group of entities included in the consolidated group and shall be reported by banks on an annual basis.
EC3	The supervisor requires banks to have sound governance structures and control processes for methodologies that produce valuations. The measurement of fair values maximizes the use of relevant and reliable inputs and are consistently applied for risk management and reporting purposes. The valuation framework and control procedures are subject to adequate independent validation and verification, either internally or by an external expert. The supervisor assesses whether the valuation used for regulatory purposes is reliable and prudent. Where the

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	supervisor determines that valuations are not sufficiently prudent, the supervisor requires the bank to make adjustments to its reporting for capital adequacy or regulatory reporting purposes.
Description and findings re EC3	Article 25 of the LFI stipulates that banks shall 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. Meanwhile, according to the Regulation on Internal controls, banks' governing bodies must ensure complete, accurate and timely reporting, and have in place procedures to ensure truthful, accurate and timely bookkeeping. For assets and liabilities the applicable treatment for valuation are those provided by IFRS standards. External auditors are required to validate the accuracy of returns for reliability in accordance with IFRS requirements while the internal audit is responsible for verifying accounting records and other records, and analyzing transactions by comparing them with the financial statements. During on-site examinations, the accuracy of the reports for prudential purposes submitted to the NBM is reviewed and, if discrepancies are detected, the NBM may request their adjustments or, may apply remedial measures and/or sanctions in accordance with the provisions of Article 38 of the LFI. According to the information provided by NBM in one case the bank's external auditor required supplementary adjustments of the allowances for loan losses. Consequently all prudential reports have been adjusted and resubmitted to the NBM.
EC4	The supervisor collects and analyses information from banks at a frequency commensurate with the nature of the information requested, and the risk profile and systemic importance of the bank.
Description and findings re EC4	The NBM is empowered to collect supervisory information from banks in accordance with Article 37 of LFI. NBM collects information from all banks on monthly and quarterly basis. Individual FINREP data are required on a monthly, quarterly and semi-annual basis. From December 2013 NBM will collect annually consolidated financial information based on FINREP. Banks already prepared consolidated financial statements which were submitted annually to the NBM under the Regulation governing audit reports. Capital requirements data is collected, at solo level, on a monthly frequency. The NBM does not collect data on consolidated level for capital requirements or other prudential ratios. The NBM responsible subdivision identifies the systemic banks based on an internal methodology. Moreover the NBM develops monthly, quarterly and semiannually, stress tests based on information collected from banks. As noted above, monthly reports on the condition of the banking system and individual banks are submitted to the NBM's management and the Council of administration.
EC5	In order to make meaningful comparisons between banks and banking groups, the supervisor collects data from all banks and all relevant entities covered by consolidated supervision on a comparable basis and related to the same dates (stock data) and periods (flow data).
Description and findings re EC5	NBM collects data from all banks, on a solo level, based on standardized frameworks and with the same frequency. The reporting instructions of the above data are the same and are based

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	on IFRS rules, for financial data, and on supervisory rules, for capital requirements data and assets classification. The IT platform, standardized frameworks and the same frequency of reports allow the NBM to make comparisons between banks and their peer groups. As noted above, NBM will now collect financial data through FINREP on a consolidated basis for banks and their affiliates in accordance with Article 37 of the LFI. Few banks have such affiliates and their impact on the consolidated balance sheet of the group is negligible.
EC6	The supervisor has the power to request and receive any relevant information from banks, as well as any entities in the wider group, irrespective of their activities, where the supervisor believes that it is material to the condition of the bank or banking group, or to the assessment of the risks of the bank or banking group or is needed to support resolution planning. This includes internal management information.
Description and findings re EC6	NBM is empowered to request data and documents deemed relevant and necessary for supervisory purposes. Pursuant to Article 47 paragraph (1) of the LNBM, the NBM can require all information deemed material, including management information, for supervision and assessment of their exposure to risks. This may be used to support also a resolution process. Moreover, according to the Regulation on equity investments of banks in legal entities, for the purpose of consolidated supervision of the risks assumed by banks, banks submit financial statements (balance sheet and income statement) of the entities in which they hold shares, representing the equivalent of 25 percent or more of capital as well as information on large exposures of the above-mentioned economic units.
EC7	The supervisor has the power to access[41] all bank records for the furtherance of supervisory work. The supervisor also has similar access to the bank's Board, management and staff, when required.
Description and findings re EC7	According to article 37 paragraph 4, NBM inspectors during their on-site inspections of banks and subsidiaries shall have the right to: examine the accounts, records and other documents and to require administrators, employees and agents of the bank or subsidiary to provide any information on their activity and operations.
EC8	The supervisor has a means of enforcing compliance with the requirement that the information be submitted on a timely and accurate basis. The supervisor determines the appropriate level of the bank's senior management is responsible for the accuracy of supervisory returns, imposes sanctions for misreporting and persistent errors, and requires that inaccurate information be amended.
Description and findings re EC8	The competent bodies of the banks, according to their internal regulations, are responsible for the accuracy and fairness of the information delivered and for the adequacy of the procedures to develop and check financial and supervisory reporting. According to the reporting instructions banks are required to amend inaccurate information. The LFI (article 38) empowers the NBM to issue administrative sanctions to individuals with administration functions (according to article 21 of the LFI, for breaches mentioned in article 38 para.1 of the LFI). No specific requirements referring to the persons who sign prudential reports are provided by the

[41] Please refer to Principle 1, Essential Criterion 5.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	NBM Regulations.
EC9	The supervisor utilizes policies and procedures to determine the validity and integrity of supervisory information. This includes a program for the periodic verification of supervisory returns by means either of the supervisor's own staff or of external experts.[42]
Description and findings re EC9	NBM employs internal checks to determine the validity and integrity of supervisory data, including periodic analysis and checking against the annual accounts (financial statements). Reports are submitted through the reporting system SIRBNM, which is a means of ensuring the accuracy of information. Banks are required to resubmit their reports when differences, mistakes and/or significant errors are detected by the NBM compared with previous reports. Moreover, banks are required to correct both errors generated by the system, as well as any errors found later and resend the electronic report within the reporting deadlines set by the legislation in force. Banks are obliged to notify the NBM about the errors found in previously submitted reports for all reporting periods in which they were committed or which have had an impact and to explain the changes made. Supervisory returns are also verified during the annual full scope on-site inspections.
EC10	The supervisor clearly defines and documents the roles and responsibilities of external experts,[43] including the scope of the work, when they are appointed to conduct supervisory tasks. The supervisor assesses the suitability of experts for the designated task(s) and the quality of the work and takes into consideration conflicts of interest that could influence the output/recommendations by external experts. External experts may be utilized for routine validation or to examine specific aspects of banks' operations.
Description and findings re EC10	NBM is empowered according to Article 44 of LNBM to perform, through its staff or other qualified professionals involved for this purpose, inspections over all banks, and to examine these institutions' books, documents and accounts, conditions in which the business is carried out and financial institutions' compliance with the legislation. In cases when the NBM decided to commission a special audit by external auditors, detailed terms of reference are drawn up and the NBM has particular regard to the track record of the company providing the audit. During the mission the assessors were informed that the NBM employed an audit company to perform a special audit mission in one bank, all details being mentioned in the Terms of References.
EC11	The supervisor requires that external experts bring to its attention promptly any material shortcomings identified during the course of any work undertaken by them for supervisory purposes.

[42] May be external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

[43] May be external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions. External experts may conduct reviews used by the supervisor, yet it is ultimately the supervisor that must be satisfied with the results of the reviews conducted by such external experts.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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Description and findings re EC11	According to Article 34 of the LFI and Regulations on elaboration and submission of the annual audit results, the independent audit shall inform the NBM about any fraudulent act of the bank officials or its subsidiaries, as well as any irregularity in the management and operations that could lead to material losses for the bank or its subsidiary. Assessors noted that in one case NBM and the bank management were informed about fraudulent acts. Regularly meetings are organized with the auditors at the level of the NBM management with the presence of the bank management.
EC12	The supervisor has a process in place to periodically review the information collected to determine that it satisfies a supervisory need.
Description and findings re EC12	In accordance with the regulations on prudential reporting, the NBM reviews information submitted by banks, and determines whether improvements are needed for supervisory purposes. As a consequence in 2012-2013, the reporting framework was improved by requesting banks to submit additional information on loan portfolio and guarantees issued, tangible assets taken into possession of the bank in exchange for repayment of loans, large deposits, which will allow a better identification and monitoring of the risks to which banks are exposed.
Assessment of Principle 10	**LC**
Comments	The NBM receives and analyzes a wide range of information with different frequency: daily, monthly, quarterly, bi-annually and annually. It has also established a robust validation process. However, it was noted by the assessors that, in the absence of proper IT application, off-site function devotes significant time and human resources to performing manually several tasks (e.g., preparation of internal reports). Moreover, prudential returns are neither required nor provided on a consolidated basis. It is recommended to: • amend the relevant secondary regulations in order to require banks to submit on a regular basis their consolidated prudential ratios, such as: capital adequacy, large exposure, transactions with affiliated parties; • implement a new IT application for a better execution of the off-site function.
Principle 11	**Corrective and sanctioning powers of supervisors**. The supervisor acts at an early stage to address unsafe and unsound practices or activities that could pose risks to banks or to the banking system. The supervisor has at its disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability to revoke the banking license or to recommend its revocation.
Essential criteria	
EC1	The supervisor raises supervisory concerns with the bank's management or, where appropriate, the bank's Board, at an early stage, and requires that these concerns be addressed in a timely manner. Where the supervisor requires the bank to take significant corrective actions, these are addressed in a written document to the bank's Board. The supervisor requires the bank to submit regular written progress reports and checks that corrective actions are completed satisfactorily. The supervisor follows through conclusively and in a timely manner on matters that are identified.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
Description and findings re EC1	In Moldova, the NBM raises its supervisory concerns with the Bank's management at an early stage. This takes place usually at the end of the on-site visit. The outcomes of the on-site visit are discussed with the bank's management (usually with the heads of relevant divisions and departments, members of the executive Board and, sometimes, with bank's Board members). These meetings provide an opportunity to discuss major findings with bank's management and to determine remedial measures, even before the inspection is finalized. In practice, the preliminary inspection report is submitted to the bank for discussion. Within 5 business days from the submission of this document, the bank will express its opinion and possible objection to the findings. Whenever serious issues for rectification are revealed by the inspection, the issues are formally presented to the NBM's Council of Administration (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. It is noteworthy that both the presidents of the Board and the executive body of the bank are invited to attend the NBM's CA meeting. Where necessary, the CA of the NBM can prescribe extra remedial measures in addition to the ones already contemplated in the inspection report. Banks with a CAMEL rating 4 or 5 (four entities as of the current assessment) are placed under the ambit of the Special supervision section that performs intensive scrutiny, including the formulation of corrective measures. If the financial condition of these banks deteriorates further, or if the bank does not comply with any corrective measures, the NBM can subject these entities to the so-called "Special Supervision" regime as set forth in Article 37[1]. Under this regime, a Special Supervision Commission (SSC) made up of 3 to 5 examiners from different NBM' Banking Supervision Department is appointed for 3 months with the mandate to issue recommendations to the bank's Board and executive body. The Commission can also formulate recommendations to the NBM Board on implementing measures or sanctions if the bank does not conform with the Commission's recommendations. The SSC does not substitute for a bank's management; it provides recommendations only on the most rapid and cost effective way to remedy any violations or deficiencies (art LFI, Article37[3]); the NBM Board itself can request additional measures. Depending on the recommendations made by the Commission in its reports, the NBM may decide to stop the Special Supervision process or to extend it for a period not exceeding 3 months. Should serious deficiencies still persist beyond this timeframe, the NBM may decide to apply special administration regimes. Only one bank has been placed so far under this SSC system.[44] The NBM has set up a follow up mechanism to ensure bank's performance against corrective measures. This is particularly true when a bank is subject to a "special supervision regime" as described above. On-site visits can take place to verify the degree of implementation. In general, the monitoring of the fulfillment of remedial measures is ensured through regular reports from the banks and/or via on-site visits. As indicated to the assessors, if the bank does not comply with the corrective measures, more severe measures than those from the initial decision could be taken by the Board of the NBM, including sanctions.

[44] The bank was ultimately liquidated.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
EC2	The supervisor has available[45] an appropriate range of supervisory tools for use when, in the supervisor's judgment, a bank is not complying with laws, regulations or supervisory actions, is engaged in unsafe or unsound practices or in activities that could pose risks to the bank or the banking system, or when the interests of depositors are otherwise threatened.
Description and findings re EC2	The NBM has available a wide range of supervisory tools to address situations where banks do not comply with laws and regulations or where banks engage in unsound practices. The relevant provisions can be found in LFI Article 37 and 38 and in the NBM law, Article75. 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 for example (see LFI, Article 38(1)) the issuance of a warning to the licensee or the issuance of an order to the bank to undertake "remedial actions". In more serious scenarios, the NBM can (i) restrict or suspend any bank's activity, including lending activities or to prohibit certain transactions; (ii) force a bank to change its organizational structure or sell any subsidiary; (iii) instruct the bank to increase its capital or to maintain a higher level of liquid assets; (iv) prohibit payment of dividends to shareholders or benefits (e.g., bonuses) to employees; (v) replace one or more administrators, etc. When a bank displays signs of severe deficiencies (with CAMELS rating 4 or 5), it becomes a "problematic banks" according to NBM policies; as a result, the bank can be placed under "special supervision" regime (LFI, Article 37—see above EC 1) that is carried out by a special supervision commission that can recommend a series of remedial measures, including, but not limited to, suspension of certain bank's decisions, amending the bank's management framework, limiting or suspending bank's activities and suggesting NBM to take more forceful sanctions. Under the regime of special administration, the NBM would use other types of instruments, including replacing or restricting powers of Board members or senior manager and imposing temporary management. For the duration of this special administration, the rights and obligations of the bank's shareholders, Board, executive body, and administrators shall be suspended and exercised by the special administrator.[46] Last but not least, in the most extreme scenarios (when the bank is no longer viable), the NBM can withdraw a bank's license, as permitted under Article 38 of the LFI. In practice, sanctions are recommended by the NBM Special Supervision Unit, in consultation with other departments. Depending on the nature of the corrective measures or sanction to be taken, final determination is either made by the Governor, the Vice Governor or by the Special Supervision Unit with the approval of the Vice Governor. Over the past years, the NBM has used its dissuasive or coercive powers in several instances. According to the information provided to the BCP assessors, sanctions have consisted in

[45] Please refer to Principle 1.

[46] Such a suspension, however, is not absolute. In effect, art. 37^6 (4) of the LFI provides that the general assembly retains those functions that do not contradict the purposes of the Special administration regime. Moreover, for specific issues, such as the increase of bank's capital, the law prescribes that the shareholders' assembly should be convened and it is only upon a failure of the assembly to decide on the capital increase that the special administrator can take such a decision on his own (Article 37^{10}).

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	warnings (24 since 2009), including a warning directed to the deputy chairman of an executive Board, pecuniary sanctions (5 fines since 2009) including to the president and members of a Board. Bank licenses have also been withdrawn in 2 instances since 2008. It is noteworthy that NBM remedial measures and sanctions are constantly dragged into the justice system. The team was provided with a list of recent litigation cases in which banks, shareholders and administrators have challenged NBM's decisions, even in circumstances of flagrant violation of the law. An example of this is the case of bank A, in which a group of shareholders acquired in 2013 a significant ownership of the bank without asking permission of the NBM;[47] as a result, the voting rights 's of the group of shareholders were suspended by the NBM. The claimants (shareholders) successfully challenged this decision to the District Court (of first degree). Another example is bank B that was fined by the NBM for breaching AML law and reporting false information. A shareholder of the bank challenged NBM's decision in the court. The Court of Appeal ruled in favor of the plaintiff and not only overruled NBM's decision but also ordered restitution of the collected fine to bank B. Subsequently, NBM's appeal was rejected by the Court of appeal and the Supreme Court also ruled against the NBM[48].
EC3	The supervisor has the power to act where a bank falls below established regulatory threshold requirements, including prescribed regulatory ratios or measurements. The supervisor also has the power to intervene at an early stage to require a bank to take action to prevent it from reaching its regulatory threshold requirements. The supervisor has a range of options to address such scenarios.
Description and findings re EC3	The LFI (Article 38) require banks to comply with regulatory requirements including capital adequacy, asset quality and liquidity and empowers the NBM to take the necessary measures in cases where it is deemed that a bank is in a "precarious" financial situation. To that end, the NBM can (i) order an increase of the regulatory capital, even if the bank already maintains the capital adequacy ratio within the limits established by the NBM; or (ii) impose restriction on dividends; and (iii) limit lending activities. In addition, the same law grants the NBM the power to restrict a bank from granting loans or take other necessary measures in case the bank is engaged in unsound practices. The team was told that several of these measures have been taken over the past few years. In one case for example, a bank which tier I capital fell below the minimum regulatory threshsold was required to suspend any distribution of bonuses, reduce expenditures and was prohibited from opening any new deposit, accounts to individuals until its tier I capital reaches again the regulatory threshold.
EC4	The supervisor has available a broad range of possible measures to address, at an early stage, such scenarios as described in essential criterion 2 above. These measures include the ability to

[47] The transfer of shares of Bank A took place from two shareholders to four legal entities (claimants). Each of these entities has got a stake of equal size (each 4.62 percent).

[48] The Supreme Court explained its decision by saying that the NBM had mistakenly qualified some legal relations between the bank and its clients, which led to the formation of erroneous conclusions of infringement in the area of prevention and combating money laundering.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	require a bank to take timely corrective action or to impose sanctions expeditiously. In practice, the range of measures is applied in accordance with the gravity of a situation. The supervisor provides clear prudential objectives or sets out the actions to be taken, which may include restricting the current activities of the bank, imposing more stringent prudential limits and requirements, withholding approval of new activities or acquisitions, restricting or suspending payments to shareholders or share repurchases, restricting asset transfers, barring individuals from the banking sector, replacing or restricting the powers of managers, Board members or controlling owners, facilitating a takeover by or merger with a healthier institution, providing for the interim management of the bank, and revoking or recommending the revocation of the banking license.
Description and findings re EC4	The LFI and the LNBM provide the NBM with a broad range of possible measures to address situations where, for example, (i) a bank or its management or shareholders have breached the banking law or any normative acts from the NBM, (ii) the conditions for getting a license are no longer met, (iii) the bank fails to comply with its AML/CFT obligations, (iv) the bank jeopardizes depositors' interests, (v) the bank does not comply with its reporting obligations or reports erroneous data on banking prudential indicators, or (vi) the bank does not conform with remedial measures. The LFI prescribes general and specific actions the NBM may take in this regard. Broadly speaking, in accordance with Article 38 of the LFI, the NBM is empowered to impose corrective actions on a bank. Certain specific actions include restrictions on branch expansion, suspension of a banking activity and restricting dividends. The supervisor has employed some of these actions and others, including raising prudential limits on a bank and withdrawing bank licenses, as part of its supervisory strategy. The NBM has also applied pecuniary sanctions (fines) against banks, notably for breaching their AML/CFT obligations. The NBM can also facilitate a merger or a purchase and assumption transaction upon an undercapitalized bank. This can be carried out by the special administrator, under the special administration regime. The LFI and the LNBM do not stipulate explicitly the application of a particular remedial measure or sanction for a certain type of violation. Measures and sanctions that are deemed necessary by the NBM are determined by the Council of Administration of the NBM on the basis of the gravity of violations and deficiencies and their recurrence, at the recommendation of the director of the Department of Banking Regulation and Supervision and after consultation with the person in charge of the Special and off-site supervision division, the head of the AML/CFT Unit, and other relevant staff.
EC5	The supervisor applies sanctions not only to the bank but, when and if necessary, also to management and/or the Board, or individuals therein.
Description and findings re EC5	The NBM can impose sanctions and other types of remedial measures not only on a bank but also to its administrators (art 38 of the LFI). As discussed above, the concept of administrators is defined broadly and encompasses members of the Board, of the executive body as well as members of the Audit committee. Any other person who alone or together with other has the legal or statutory authority to enter into commitment on behalf of such entity is also subject to this provision. The grounds for applying sanctions to individuals are the same as those for legal entities. These includes violations of prudential measures, reporting false data, compromising interests of depositors, failure to comply with remedial actions instructed by the NBM, among others. In those cases, the NBM can use the tools available under Article 38 of the LFI and issue warning

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	against individuals or withdraw the confirmation issued to an administrator. This was the case in 2011 for example, when the NBM dismissed an administrator before liquidating the bank. In addition, the NBM can inflict pecuniary sanctions to direct or indirect holders of equity interests in the capital of the bank of up to 10 percent of the size of their shareholding calculated at face value and/or to the administrators in the amount between 1 to 10 average salaries on financial activities.
EC6	The supervisor has the power to take corrective actions, including ring-fencing of the bank from the actions of parent companies, subsidiaries, parallel-owned banking structures and other related entities in matters that could impair the safety and soundness of the bank or the banking system.
Description and findings re EC6	The application of a ring-fencing strategy is contemplated in the LFI. Article 38 entitles the NBM to apply supervisory and remedial measures with respect to commercial banks, if it determines that the activity of parent companies, subsidiaries, and other companies linked with the bank may negatively influence its financial situation. The strategy can be applied through either a warning or a more forceful measure if deemed appropriate where abusive practices by a parent organization and/or affiliates are detected. In practice, this has never been applied.
EC7	The supervisor cooperates and collaborates with relevant authorities in deciding when and how to effect the orderly resolution of a problem bank situation (which could include closure, or assisting in restructuring, or merger with a stronger institution).
Description and findings re EC7	The framework for crisis management and resolution is in its infancy stage; the NBM has track records in dealing with problem banks but the conditions for its intervention are not well established.
Additional criteria	
AC1	Laws or regulations guard against the supervisor unduly delaying appropriate corrective actions.
Description and findings re AC1	There are no specific laws or internal processes that provide time lines under which a prospective corrective action must be approved by NBM authorities and imposed on a bank. As a practical matter, the authorities strive to have the process completed as quickly as possible subsequent to the conclusion of an examination, provided the action stems from an examination report.
AC2	When taking formal corrective action in relation to a bank, the supervisor informs the supervisor of non-bank related financial entities of its actions and, where appropriate, coordinates its actions with them.
Description and findings re AC2	To date, no such notification has occurred and the opportunities for a coordinated effort in this regard are very limited.
Assessment of Principle 11	**MNC**
Comments	In the 2008 BCP assessment, this principle was assessed “compliant” due to the fact that the NBM was enjoying a wide range of corrective and enforcement powers. And in fact, the NBM

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	has used a variety of measures to correct deficiencies detected in the course of on-site visits. As discussed above, decisions on financial remediation measures and sanctions were adopted as a result of multiple infringements, particularly in relation to: (i) insufficient size of Tier I capital; (ii) assets quality; (iii) misreporting; (iv) deficiencies in internal control systems, (v) violations in preventing and combating ML/TF; and (vi) failure to notify the NBM in case of change in equity interests in banks' capital. That being said, there are several issues that raise concerns and explain why this principle has to be downgraded to MNC. **The enforcement powers of the NBM have been diminished**. The present mission raises concerns about NBM's capacity to enforce prudential measures and take preemptive action in the wake of recent developments in Moldova. In effect, on October 1, 2013, the Constitutional court declared "unconstitutional" Article 11 (4) of the NBM law stipulating that decisions taken by the Central Bank and challenged in courts cannot be suspended until the decision of the tribunal becomes final. The Court's ruling means that all acts and decisions of the NBM—including those relating to safeguard measures, resolution, assessments of shareholders—can be challenged in court, leading to the suspension of the decision under certain circumstances,[49] by the lowest court in the country (the suspension does not apply to NBM decisions relating to licensing-including withdrawal of the license and liquidation). As indicated by a recent WB/IMF report, "*this decision relegates the NBM to the category of most fragile central bank and bank regulator*". Moldovan authorities (mainly the MOJ in conjunction with the NBM) have worked with both the IMF and the WB to explore solutions aimed at mitigating the risks arising from the Constitutional Court's decision. In December 2013, the Government and the NBM prepared amendments to the NBM law with the purpose to strike a balance between the effectiveness of the NBM actions as a central bank, supervisor and resolution authority and its accountability through judicial review. These amendments were reviewed by the WB and IMF legal teams and it was believed that the draft legislation represents a step in the right direction, as it establishes a framework for filing complaints against the NBM.[50] Key provisions include: requiring evidence and proof of irreparable damage before seeking the suspension of NMB acts; establishing an internal appeal process within the NBM,[51] giving the defendant (the NBM) a chance to defend and not allowing decisions without letting the defendant know and finally, allowing for the suspension of NBM decisions only in extreme cases.

[49] As indicated above, till January 2014, the suspension of the actions by the NBM was immediate. In order to mitigate this problem, amendments were made to the Law and the NBML entered in force on January 24, 2014. Actions by the NBM can thus be suspended by the court, at the request of the plaintiff, with the compulsory summoning of the parties, and after the act has been challenged before the Council of Administration of the NBM (Article 11^1 of the revised NBML).

[50] Joint IMF/WB letter to the Governor of the NBM, dated December 9, 2013.

[51] The NBM Board has 30 days to review the claim of the plaintiff before it goes to the court. NBM will make a determination on the case and if the claimant is not satisfied, it will appeal the decision to the Court of first instance that can decide to suspend the NBM decision.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	Despite this notable progress, there are still several matters of concern. The text amending the NBM law still contains provisions that handicap the NBM's ability to take measures—e.g., remedial actions—in the most effective way. The most problematic provisions are: Article 11 (9) of the revised NBM law stipulates that when a plaintiff challenges an NMB decision, the act of the NBM (e.g., on special administration of a bank, assessment and supervision of banks' shareholder, measures under the special administrator regime) shall be judged within 3 months from the day of submission.[52] Besides, this delay could be longer if the plaintiff lodges an appeal against the court's decision at the end of this 3 month period (if the court rules in favor of the NBM) and in the case the lawsuit is brought up to the Supreme Court, this process would delay the NBM decision even further. This timeframe appears to be very long. Even if a court takes only 3 months to review NBM's decision, the lapse in time may compromise effectiveness of corrective measures, particularly when it comes to troubled banks. This is worrying as the NBM is constantly dragged into the court over its regulatory action (see above EC 2) and in practice, many matters languish in the courts longer than 3 months. Further, the new revised law does not clearly prescribe that NBM decisions are immediately enforceable unless suspended or annulled in accordance with the law. Along the same lines, the law is silent on the fact that the contested NBM decision stay in force until the decision on its suspension is made by the court.[53] In conclusion, even though this new regime has not yet been tested in practice, there are still concerns about the capacity of the NBM to take prompt corrective measures in the area of supervision. Article 38 of the LFI (7, a) stipulates that measures and penalties applied by the NMB may be appealed. In that case, if the (competent) court determines that the actions applied by the NBM towards the bank are illegal, the NBM "shall pay all material claims and the withdrawal of license remain valid". **Sanctions contemplated in relevant law (e.g., LFI, NBML and AML/CFT law) do not seem dissuasive enough.** This is particularly true when it comes to pecuniary sanctions. Pursuant to Article 38, the NBM can apply fines up to 0.5 percent of the capital of the bank and up to 10 percent of the size of the shareholding. However, since the entire shareholding for one individual or a company might to be well captured, the effect of this fine might not be optimal and dissuasive. As for administrators, the fine can be within a range of 1 to 10 average salaries. **The NBM does not have in-house methods that could provide management minimum guidance on how to apply criteria for sanctions as defined in the law.** This does not permit proportionate response. **The prescription regime applicable to sanctions diminishes the capacity of NBM to**

[52] The court of justice must review the appeal to suspend enforcement of the acts of the NBM within 5 days from the day of submitting it. This decision to suspend the NBM's action/decision is separate from the consideration of the substance of the case.

[53] This was a recommendation from the IMF/WB legal team.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)

Supervisory Powers, Responsibilities and Functions

enforce the law. According to the NBM law, sanctions taken by the NBM (Article $75^2(4)$) are subject to a legal prescription of 6 months after the violation has been detected by the NBM and the violation itself to a prescription of 3 years. After 6 months, it is understood that application of sanctions are not possible.

The NBM response is not increased in case of persistent breaches. In case of persistent deficiencies in the same institutions, the NBM should apply a gradual response and increase the intensity of the sanctions. This could be achieved through either a combination of sanctions (e.g., warning+fine) or through higher pecuniary fines.

The table below illustrates the lack of gradual response in case of recurrent violations of AML/CFT requirements by banks, between 2010 and 2013.

Bank	2010	2011	2012	2013
Bank A	warning			Warning
Bank B	warning		Warning	Warning
Bank C		warning		
Bank D				
Bank E	warning			
Bank F	warning	warning	warning	

The Special Supervision regime does not seem well designed. According to the NBM, this regime has been established to promote a gradual enforcement response to address situation of problematic banks. It also permits closer interaction between NBM examiners and bank's management during the SSC process. However, the assessors are of the view that issuing recommendations through this Special Supervision Regime may not be the most appropriate response to address situations that warrant urgent or immediate action. Instead, it could lead to additional delay if the bank is not responsive. This is particularly true in an environment where banks have a poor risk culture and inadequate corporate governance systems.

Moreover, the law does not specify the objective criteria to be used to place a bank under the ambit of the SSC. Article 37^1 refers to the concept of "precarious financial situation" but does not provide objective criteria. Further, neither the law nor NBM internal procedures assign to the bank any particular timeframe for adopting the recommendation; this is in fact determined on a case by case basis.

In conclusion, the NBM may wish to consider the following recommendations:

- Take more forceful action in case of persistent problems, and apply gradual response, including stricter remedial measures.
- Amend the law to increase the level of fines that can be applicable to the bank, its shareholders and administrators.
- Reconsider the prescription regime for sanctions by expanding the six months timeframe from the date a breach has been discovered by the NBM.
- Set internal guidelines to assist NBM management in determining the most adequate

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	response in case of breach or violation • Monitor the application of the new LNBM law by judges to assess whether the new legal amendments introduced to mitigate the consequences of the Constitutional Court ruling are having the desired effect and do not lead to major restrictions to NBM powers. • Distinguish between remedial measures/or corrective actions (that could apply when, in the NBM opinion, the risk exposure is too high) and sanctions that should apply if and only if a bank breached the law or a regulation. This will allow NBM to apply early corrective actions (already mentioned in previous FSAPs), that should not depend on infringement. • For the Special Supervision regime: • establish objective criteria for subjecting banks to the special supervision regime; • set a time frame for adopting the SSC recommendations by banks; and • apply this regime with discernment, e.g. when the financial condition of the bank is not compromised.
Principle 12	**Consolidated supervision**. An essential element of banking supervision is that the supervisor supervises the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential standards to all aspects of the business conducted by the banking group worldwide.[54]
Essential criteria	
EC1	The supervisor understands the overall structure of the banking group and is familiar with all the material activities (including non-banking activities) conducted by entities in the wider group, both domestic and cross-border. The supervisor understands and assesses how group-wide risks are managed and takes action when risks arising from the banking group and other entities in the wider group, in particular contagion and reputation risks, may jeopardize the safety and soundness of the bank and the banking system.
Description and findings re EC1	For 2012 only four financial groups prepared consolidated financial statement. Each consists of one banking institution and several types of NBFIs mainly leasing companies located in Moldova, with no cross border presence. Banks are the principal entity in these financial groups, representing the preponderance of total assets in all cases at present. To gain an understanding of the organizational and ownership structure, and the nature and types of activities in which the components of these banking groups engage, NBM is empowered by legislation (Article 37 of the LFI) to collect information on the balance sheet and nature of their activities on an annual basis. Banks are required to monitor the activity and administration of legal entities in which the bank holds a significant interest (25 percent). Additionally the bank must maintain data (including financial reports) as required by the NBM "Regulation on equity investments of banks in legal entities."

[54] Please refer to footnote 19 under Principle 1.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	The NBM takes the following actions to understand and assess the risks related to the banking group: • Receives and analyzes consolidated financial reports from banks. • Receives and analyzes a report on participation shares in the capital of the economic units. • Analyzes information reported by banks according to the "Regulation on equity investments of banks in legal entities" (financial statements and large exposures). • Analyzes during on-site inspections risks related to the equity investments in entities where the bank has a greater than 50 percent interest.
EC2	The supervisor imposes prudential standards and collects and analyses financial and other information on a consolidated basis for the banking group, covering areas such as capital adequacy, liquidity, large exposures, and exposures to related parties, lending limits and group structure.
Description and findings re EC2	At the time of the assessment, CARs and other prudential ratios (large exposures, exposures to related parties, etc.) were not required and not computed on a consolidated basis. However only four banks had subsidiaries. Also, some banks' in their annual consolidated financial statements published CARs calculated for both solo and consolidated basis under the Basel I methodology. The differences between the solo and consolidated ratios were insignificant, reflecting the insignificant levels of non-banking activity in these groups at the time.
EC3	The supervisor reviews whether the oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) is adequate having regard to their risk profile and systemic importance and there is no hindrance in host countries for the parent bank to have access to all the material information from their foreign branches and subsidiaries. The supervisor also determines that banks' policies and processes require the local management of any cross-border operations to have the necessary expertise to manage those operations in a safe and sound manner, and in compliance with supervisory and regulatory requirements. The home supervisor takes into account the effectiveness of supervision conducted in the host countries in which its banks have material operations.
Description and findings re EC3	According to the prevailing laws and regulations, the NBM has such rights but has not applied them in the absence of any cross border presences of the domestic banks.
EC4	The home supervisor visits the foreign offices periodically, the location and frequency being determined by the risk profile and systemic importance of the foreign operation. The supervisor meets the host supervisors during these visits. The supervisor has a policy for assessing whether it needs to conduct on-site examinations of a bank's foreign operations, or require additional reporting, and has the power and resources to take those steps as and when appropriate.
Description and findings re EC4	According to the law (article 37 of the LFI), the NBM has these rights but has not applied them in the absence of any cross border presences of the domestic banks.
EC5	The supervisor reviews the main activities of parent companies, and of companies affiliated with the parent companies, that have a material impact on the safety and soundness of the bank and the banking group, and takes appropriate supervisory action.
Description and	The NBM is not entitled to review the main activities of parent companies and companies

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)

Supervisory Powers, Responsibilities and Functions	
findings re EC5	affiliated with the parent companies. If during the supervision process, issues are identified, the NBM is entitled to request full information and explanation from the bank (i.e. the domestic bank). The NBM is also entitled to request information (based on collaboration agreement, if any, or through an official letter) from the supervision authority of the parent companies. At present no Memorandum of Understanding is signed with any of the home supervisory authorities (Austria (FMA), France (ACPR), Italy (BoI) and Germany (BAFIN)) of the four banking groups which have subsidiaries in Moldova (except National Bank of Romania which is the sub-consolidated supervisor of BCR SA, the parent bank of BCR Chisinau), despite the effort made by NBM to conclude such arrangements.
EC6	The supervisor limits the range of activities the consolidated group may conduct and the locations in which activities can be conducted (including the closing of foreign offices) if it determines that: (a) the safety and soundness of the bank and banking group is compromised because the activities expose the bank or banking group to excessive risk and/or are not properly managed; (b) the supervision by other supervisors is not adequate relative to the risks the activities present; and/or; (c) the exercise of effective supervision on a consolidated basis is hindered.
Description and findings re EC6	To operate cross-border in a non-domestic jurisdiction (Article 13 paragraph (4) LFI), a bank must seek the authorization of the NBM. Approval is carried out based on the requirements of "Regulation on equity investments of banks in legal entities" and "Regulation on branches, representative offices and secondary offices of banks" which also establish approaches and issues related to the risks of these entities. Meanwhile, the LFI (article 37) enables supervisors to conduct on-site inspections in each entity, including cross-border ones. Having in view that no Moldovan bank has a cross-border presence the NBM has not needed to evaluate the capacity of another supervisory authority and does not have a process with which to do so.
EC7	In addition to supervising on a consolidated basis, the responsible supervisor supervises individual banks in the group. The responsible supervisor supervises each bank on a stand-alone basis and understands its relationship with other members of the group.[55]
Description and findings re EC7	The NBM supervises each bank on a solo basis. Given that Moldovan banks do not have any branches, or subsidiaries abroad, only domestic banks and companies in which a bank holds over 25 percent of equity are subject to any form of consolidated supervision.
Additional criteria	
AC1	For countries which allow corporate ownership of banks, the supervisor has the power to establish and enforce fit and proper standards for owners and senior management of parent

[55] Please refer to Principle 16, Additional Criterion 2.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	companies.
Description and findings re AC1	Under the regulations governing the holding of equity interests in banks (Article 30), if the proposed acquirer of a bank is a legal entity, the NBM shall conduct an assessment of its integrity and professional competence covering the legal entity itself and the persons directing the activities of that legal entity.
Assessment of Principle 12	**MNC**
Comments	In the 2008 FSAP it was recommended to conduct consolidated supervision. Consequently the LFI was amended, requiring banks to prepare and submit reports on its management, operations, liquidity, solvency, and profitability, as well as on its subsidiaries, both separately and on a consolidated basis. The NBM's approach to consolidated supervision does not seem to be comprehensive and effective. While the LFI is clear on the NBM supervision mandate, the framework for consolidated supervision is only partially developed, mainly through the implementation of IFRS which require also consolidated financial statements. There are no requirements for consolidated prudential supervision and prudential returns submission at the consolidated level. In Moldova, there are four subsidiaries of foreign groups on which NBM has limited information from home supervisors. Subsidiaries of foreign banks are supervised by the NBM in the same manner as Moldovan banks but no arrangements with home supervisor of the banking groups with presence in Moldova have been signed (excepting the National Bank of Romania, which is the sub-consolidated supervisor of BCR SA, the parent bank of BCR Chisinau), despite the effort made by NBM to conclude such arrangements. The country has also four domestic groups with small non-bank financial activities (e.g., leasing and credit card processing). For these groups, NBM only gets consolidated financial statements (since 2012) as well as individual financial statements and LEL reporting for each entity within the group, but misses consolidated prudential returns. As it was mentioned in CP 6 the ownership structures of banks, including the largest 6 institutions, have been the target of dramatic shareholder changes over the past 2 years. Most of the recent changes in ownership of Moldovan banks have not been conducted in a transparent manner and there is a suspicion that at least three banks have a common UBO. Further to this, from a consolidated point of view these banks should be treated as a member of the same group and consequently to receive an adequate supplementary supervision in order to assess the associated upward risks (from a broader corporate group perspective). In conclusion, the NBM should develop consolidated prudential supervision rules for the domestic groups and pursue its efforts to conclude agreements with home supervisory authorities.
Principle 13	**Home-host relationships**. Home and host supervisors of cross-border banking groups share information and cooperate for effective supervision of the group and group entities, and effective handling of crisis situations. Supervisors require the local operations of foreign banks to be conducted to the same standards as those required of domestic banks.
Essential criteria	

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
EC1	The home supervisor establishes bank-specific supervisory colleges for banking groups with material cross-border operations to enhance its effective oversight, taking into account the risk profile and systemic importance of the banking group and the corresponding needs of its supervisors. In its broadest sense, the host supervisor who has a relevant subsidiary or a significant branch in its jurisdiction and who, therefore, has a shared interest in the effective supervisory oversight of the banking group, is included in the college. The structure of the college reflects the nature of the banking group and the needs of its supervisors.
Description and findings re EC1	According to the LFI (article 13), banks may open branches and representative offices in other states upon the preliminary approval of the NBM, and subject to inspections by the NBM or by auditors appointed by the NBM. At the time of the assessment there is no Moldovan bank with a cross-border presence.
EC2	Home and host supervisors share appropriate information on a timely basis in line with their respective roles and responsibilities, both bilaterally and through colleges. This includes information both on the material risks and risk management practices of the banking group[56] and on the supervisors' assessments of the safety and soundness of the relevant entity under their jurisdiction. Informal or formal arrangements (such as memoranda of understanding) are in place to enable the exchange of confidential information.
Description and findings re EC2	The LNBM (article 7) enables NBM to share information with other financial sector supervisors that pursue financial and economic stability. At present NBM have only host supervisor responsibilities. Draft agreements on cooperation in the field of banking supervision between NBM and supervisors of the four banking groups operating through subsidiaries in Moldova, respectively from Germany, Austria, France and Italy have been in the process of negotiation since 2008, but no agreements have been signed up to now. The level of communication does not appear to impede the exchange of information significantly in the cases in which there is no operating MoU inasmuch as NBM receives all required information. However, home supervisory authorities of banking groups with presence in Moldova didn't invite NBM to participate in the College of supervisors set up at the level of the banking group.
EC3	Home and host supervisors coordinate and plan supervisory activities or undertake collaborative work if common areas of interest are identified in order to improve the effectiveness and efficiency of supervision of cross-border banking groups.
Description and findings re EC3	In the absence of a MoU with any of the home supervisors of the four subsidiaries, no coordination and planning of supervisory activities is done between NBM and these home supervisors.
EC4	The home supervisor develops an agreed communication strategy with the relevant host supervisors. The scope and nature of the strategy reflects the risk profile and systemic importance of the cross-border operations of the bank or banking group. Home and host supervisors also agree on the communication of views and outcomes of joint activities and

[56] See Illustrative example of information exchange in colleges of the October 2010 BCBS Good practice principles on supervisory colleges for further information on the extent of information sharing expected.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	college meetings to banks, where appropriate, to ensure consistency of messages on group-wide issues.
Description and findings re EC4	According to the regulations, supervisors have these rights but have not applied them given the absence of cross border presences by the domestic banks. From the prudential point of view, subsidiaries of foreign banks are treated similarly to local banks, thus they must be financially strong enough on a stand-alone basis, without any support from the group. Home country supervisors have not invited the NBM to the College of Supervisors meetings.
EC5	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities, develops a framework for cross-border crisis cooperation and coordination among the relevant home and host authorities. The relevant authorities share information on crisis preparations from an early stage in a way that does not materially compromise the prospect of a successful resolution and subject to the application of rules on confidentiality.
Description and findings re EC5	To ensure cross-border cooperation and coordination, the NBM has concluded several agreements on the projects initiated by regulators and banking supervisors from abroad but no home-host relationship between them exists currently. As noted above under EC2, the NBM has been seeking to sign cooperation agreements with four home supervisors since 2008. While the authorities in France and Italy have thanked NBM for the initiative there has been no substantive response including any proposals or objections. The authorities in Austria have sent an official refusal to continue any negotiations on the draft agreement because of weaknesses in Moldovan legislation regarding banking secrecy. However, Austrian authorities expressed an interest in cooperative arrangements provided that confidential information was not exchanged. At the time of the assessment, no home country authority had shared information on crisis management with the NBM.
EC6	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities and relevant host authorities, develops a group resolution plan. The relevant authorities share any information necessary for the development and maintenance of a credible resolution plan. Supervisors also alert and consult relevant authorities and supervisors (both home and host) promptly when taking any recovery and resolution measures.
Description and findings re EC6	As mentioned above no MOU has been signed with any of the four home authorities of the foreign banks with subsidiaries in Moldova. Currently, the NBM is working with the Federal Financial Supervisory Authority in Germany in order to sign an agreement on cooperation in banking supervision field. Thus, the ability of NBM to develop a resolution plan to address evolving bank problems and possible resolution in a cross-border situation, especially for the existing four subsidiaries, has not been developed due to the inaction of the home supervisor.
EC7	The host supervisor's national laws or regulations require that the cross-border operations of foreign banks are subject to prudential, inspection and regulatory reporting requirements similar to those for domestic banks.
Description and findings re EC7	Foreign banks' subsidiaries are subject to the same licensing procedures, prudential regulations and NBM off-site and on-site supervision as domestic banks. According to Article 12 of the LFI, no foreign bank shall be permitted to engage directly in any

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	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. A foreign bank may open representative offices in the Republic of Moldova only after notifying the NBM in accordance with the normative acts of the NBM. Representative offices of foreign banks shall limit their activity to acts of information, connection or representation and shall not be engaged in any activity provided for in Article 26 of the LFI.
EC8	The home supervisor is given on-site access to local offices and subsidiaries of a banking group in order to facilitate their assessment of the group's safety and soundness and compliance with customer due diligence requirements. The home supervisor informs host supervisors of intended visits to local offices and subsidiaries of banking groups.
Description and findings re EC8	The LFI has no clear provisions related to the direct on-site access of home supervisory authorities to subsidiaries of banking groups under their supervision. In the absence of either legal provisions or MoUs signed with the four home authorities (Austria, France, Germany and Italy) of the subsidiaries of foreign banks (except National Bank of Romania which is the sub-consolidated supervisor of BCR SA, the parent bank of BCR Chisinau), it is not clear how on-site inspections could be performed by home supervisors and under which conditions. None of these home supervisors has performed on-site inspections at the level of Moldovan subsidiaries. Although, currently the NBM has neither home or host supervisory responsibilities vis-à-vis banks from Republic of Belarus, Russian Federation, Kazakhstan, there are bilateral agreements signed with them, which provide that inspections made by the home country shall be carried out with the participation of the host. In this context the home supervisor must write to inform NBM of the planned timing and scope of the examination. Also, on-site inspection can be conducted, in certain circumstances, by an international audit organization appointed by home supervisor. The home supervisor must share the key conclusions of the inspection with the host supervisor.
EC9	The host supervisor supervises booking offices in a manner consistent with internationally agreed standards. The supervisor does not permit shell banks or the continued operation of shell banks.
Description and findings re EC9	No foreign bank is 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 an authorization has been issued by the NBM. A foreign bank may open representative offices in the Republic of Moldova only after notifying the NBM as in accordance with the regulations of the NBM. Representative offices of foreign banks shall limit their activity to market research, representative and customer contact operations acts of information, connection or representation and shall not be engaged in any activity provided for in Article 26 of the LFI.
EC10	A supervisor that takes consequential action on the basis of information received from another supervisor consults with that supervisor, to the extent possible, before taking such action.
Description and findings re EC10	As mentioned above, currently the NBM has only host country supervisory responsibilities but no MoU has been signed in this respect. Consequently, the NBM does not consult home supervisors before taking action against the subsidiaries of the foreign groups.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
Assessment of Principle 13	**LC**
Comments	NBM's approach to sharing information with overseas supervisors, excepting those that represent professional secrecy which could be disclosed in the conditions provided by article 36 of LNBM, seems open and cooperative, even in the absence of a written agreement with home consolidated supervisory authorities. However, supervisors should further seek ways to strengthen the communications links with foreign bank supervisors of the subsidiaries present in Moldova. The ability of NBM to develop a resolution plan to address evolving bank problems and possible resolution in a cross-border situation, especially for the existing four subsidiaries, has not been developed due to the inaction of the home supervisor. The NBM is encouraged to pursue its efforts to conclude agreements with home supervisory authorities.
Prudential Regulations and Requirements	
Principle 14	**Corporate governance**. The supervisor determines that banks and banking groups have robust corporate governance policies and processes covering, for example, strategic direction, group and organizational structure, control environment, responsibilities of the banks' Board and senior management,[57] and compensation. These policies and processes are commensurate with the risk profile and systemic importance of the bank.
Essential criteria	
EC1	Laws, regulations or the supervisor establish the responsibilities of a bank's Board and senior management with respect to corporate governance to ensure there is effective control over the bank's entire business. The supervisor provides guidance to banks and banking groups on expectations for sound corporate governance.
Description and findings re EC1	The LFI (article 18–20) and the Regulation on internal controls within banks (chapter III) stipulate the main responsibilities of the different bodies that together form the corporate governance of a bank, to ensure there is effective control over the banks entire business. The main bodies of a bank are: General Shareholder Meeting, Board, executive body and Censor Committee. The bank is directed by the Board and managing body, two tier structures being applied similar to other commercial companies as is provided by the Law on Joint Stock Company (LJSC). The Board is comprised of an odd number of members, not less than three (LJSC stipulates that for state owned companies and other companies with more than 50 shareholders the number of Board members should be no less than five). The majority of the members of the Board should be independent persons with no affiliation to the bank. The General Shareholders meeting elects the chairman of the Board if it is not stipulated in the bank statute that the Board elects the chairman. Board members are appointed by the General Shareholders Meeting for a four year term with right to re-election for the same duration, without limitation. The

[57] Please refer to footnote 27 under Principle 5.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	members of the Board may also be dismissed at any time by the ordinary Shareholders Meeting. The assessors noted during the mission that in a few cases the number of the members of the Board does not comply with the minimum required number, measures to address this issue being imposed by NBM in these cases. The Censors Committee is comprised of an odd number of members but, again, not less than three who are appointed by the General Shareholders' Meeting for a four year period and has direct reporting line to the GSM. Members could be individuals or an audit company and could not be simultaneously a member of the Board. The Censors Committee is responsible for the adequacy of external and internal audit functions of the bank, including reviewing the scope and results of audits carried out in respect of the operations of the bank and the independence and objectivity of the bank's external auditors (Regulation on internal controls). Consequently this committee does not fully comply with the corporate governance principles for the Audit Committee which provides that their members are to be elected by the Board from its members and direct reporting line to it. In addition, an audit committee should recommend to the board or shareholders for their approval, the appointment, compensation and dismissal of external auditors, etc. Also, the Regulation on internal control requires banks to establish a corporate governance code which is to be published on their website. When drafting the corporate governance code, banks were guided by the recommendations elaborated for all joint stock companies. This code contains principles and concrete situations that the entities' involved persons (members of the executive bodies, the Board and shareholders) shall follow in their mutual relations and represent a set of governing standards that guide the management of the entities and shareholders when they apply general principles for an efficient management of the company. Instead of issuing binding regulation, NBM issued recommendation letters that instructed banks to implement best international practices in drafting this code. This practice implies a certain degree of expected compliance by banks with sound corporate governance principles. The Board of Directors is fully responsible for approving adequate and efficient internal controls with the aim of encouraging efficient and prudent activities. The executive body bears the general executive responsibility for the day-to-day conduct of business and affairs of the bank. According to the sound corporate governance principles the compliance with them can be achieved so long as several essential functions are in place. As noted in CP 15 and CP 26 the NBM regulations do not provide requirements for the establishment of independent risk management and compliance functions within banks.
EC2	The supervisor regularly assesses a bank's corporate governance policies and practices, and their implementation, and determines that the bank has robust corporate governance policies and processes commensurate with its risk profile and systemic importance. The supervisor requires banks and banking groups to correct deficiencies in a timely manner.
Description and findings re EC2	According to its internal manuals (e.g., Manual on on-site controls, other regulations related to licensing, requirements for banks' administrators, etc.) the NBM regularly assesses the quality of a bank's corporate governance through on-site inspections and off-site monitoring. The assessors noted that in the manual on on-site controls, Chapter 3 Management capacity, mentions that the assessment of M - CAMELS component, should be based on the provisions of BCP 5 and 14 (each EC being described) and also on the local legal framework (LFI, LJSC,

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	other regulations issued by NBM). During on-site inspections, performed at least annually within each bank, NBM supervisor's check the existence of policies and practices related to a bank's corporate governance, approved by the Board. Thus, the supervisor focus on: ownership structure; whether the relations between management bodies, including shareholders, are sufficiently disclosed; power, duties, responsibilities and independence of members of the Board; strategic planning and objectives; the way management runs the bank; compliance with all applicable rules and regulations; possible conflicts of interests; internal control systems and adequate auditing programs; and management information systems. During off-site monitoring the corporate governance is followed through such activities as notifications, prior approvals on shareholder changes, bank's statute, and banks' administrators (See also CP 5). According to the Manual on on-site controls during the on-site inspections supervisor should consider the following: bank's statute, financial statements, minutes of General Shareholders Meeting, Board, Censors Committee and other committees, agreements between shareholders, related parties transactions, findings of internal audit reports, organizational chart, distribution of staff, segregation of duties, sources of funds, internal regulations and policies, reporting, and interviews with main directors. For deficiencies noted in the bank's policies and practices, supervisors require the bank to take effective remedial actions on a timely basis.
EC3	The supervisor determines that governance structures and processes for nominating and appointing Board members are appropriate for the bank and across the banking group. Board membership includes experienced non-executive members, where appropriate. Commensurate with the risk profile and systemic importance, Board structures include audit, risk oversight and remuneration committees with experienced non-executive members
Description and findings re EC3	The LFI (Article 17) prescribes that each bank shall be governed by internal regulations, approved by its Board, which in compliance with its statute shall establish the charter and functions of the bank, the composition and competence of management and control bodies. Members of the Board are appointed by the General Shareholder Meeting (LFI article 19) which also establishes their remuneration and are always subject to prior approval by NBM (LFI article 21). An important responsibility of the General Shareholders Meeting is also to establish the Censors committee (LFI article 20). It was noted in practice that all banks' Boards of Directors have established a committee for collateral valuation and very few have established a risk management committee, a remuneration committee or a nomination committee. When they are established, the risk committee, remuneration committee or nomination committee are composed of members of the Board. There is no specific requirement in the law or regulation for such committees. According to the banks' governance code the Board sets conditions and standards for selection, remuneration, appraisal and removal of executive bodies of the bank. Under the LFI prior approval is required for the appointment of all members of the Board, members of the executive body, chief financial officer, and members of the Censor Committee and indeed any other employee of the bank that fall under the definition of administrator (See also CP 5). During the on-site examination the supervisors determine whether the Board composition is diverse enough to ensure fair and balanced debate in the decision-taking process, whether provision of Article 66 item (6) of the Law on joint stock companies, are observed (members of

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	executive body and Censors committee should not be member of the Board); and assesses if appropriate structures and processes are in place.
EC4	Board members are suitably qualified, effective and exercise their "duty of care" and "duty of loyalty."[58]
Description and findings re EC 4	The LFI (article 21) and Regulation on the requirements of banks' administrators, prescribes clear requirements for members of the Board regarding qualifications, work experience and reputation ("fit and proper test"). See also CP 5. NBM assesses compliance mentioned above through ongoing monitoring and on-site inspections. In its on-site supervision the NBM focuses on Board meetings minutes, member attendances, documents presented for their approval, subjects in discussions related to the business of the bank. As it was noted in CP 5, EC 7 there is no requirement for the individual Board members or the Board collectively to have a sound knowledge of the material activities that the bank intends to pursue, and the associated risks.
EC5	The supervisor determines that the bank's Board approves and oversees implementation of the bank's strategic direction, risk appetite[59] and strategy, and related policies, establishes and communicates corporate culture and values (e.g., through a code of conduct), and establishes conflicts of interest policies and a strong control environment.
Description and findings re EC5	According to the LFI (Article 18), the Board elaborates and ensures the implementation of the bank's policy. The Board is required to approve an adequate and efficient internal control system, having in place written internal regulations (policies, procedures, regulations instructions, etc.) and to ensure its periodic revision (at least annually) in all bank's activity domains, as well as in order to comply with the legislation in force. The bank should elaborate at least: a short document on bank's short and long-term policy and strategy objectives; a code of corporate governance; internal procedures to describe employees' functions and responsibilities, and reporting and communication channels; a code of employees' conduct and a regulation on interest conflict settlement policy within the bank; program of employees' training and supporting measures to ensure that employees have due knowledge of their responsibilities and authorities, and of all the modifications or performances within the bank.

[58] The OECD (OECD glossary of corporate governance-related terms in "Experiences from the Regional Corporate Governance Roundtables", 2003, www.oecd.org/dataoecd/19/26/23742340.pdf.) defines "duty of care" as "The duty of a Board member to act on an informed and prudent basis in decisions with respect to the company. Often interpreted as requiring the Board member to approach the affairs of the company in the same way that a "prudent man" would approach their own affairs. Liability under the duty of care is frequently mitigated by the business judgment rule." The OECD defines "duty of loyalty" as "The duty of the Board member to act in the interest of the company and shareholders. The duty of loyalty should prevent individual Board members from acting in their own interest, or the interest of another individual or group, at the expense of the company and all shareholders."

[59] "Risk appetite" reflects the level of aggregate risk that the bank's Board is willing to assume and manage in the pursuit of the bank's business objectives. Risk appetite may include both quantitative and qualitative elements, as appropriate, and encompass a range of measures. For the purposes of this document, the terms "risk appetite" and "risk tolerance" are treated synonymously.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	During on-site inspections the supervisor determines that banks have adequate policies and an overall business strategy and that these are updated and commensurate with the risk level to which the bank might be exposed. Supervisors assess the internal control environment and whether the Board approved and implemented a corporate governance code, as well as the compliance with policies and strategies, and their communication to bank's management through staff's code of conduct.
EC6	The supervisor determines that the bank's Board, except where required otherwise by laws or regulations, has established fit and proper standards in selecting senior management, maintains plans for succession, and actively and critically oversees senior management's execution of Board strategies, including monitoring senior management's performance against standards established for them.
Description and findings re EC6	The LFI and Regulation on the requirements of Bank's administrators prescribe fit and proper standards for administrators including members of the Board and the executive body. There is a requirement for prior approval (LFI article 21) as well as qualifying and disqualifying criteria (LFI article 19). It is the responsibility of the Board to set out long-term objectives for the bank and to monitor their realization (LFI article 18). The fit and proper test is assessed off-site by the Licensing Unit. This process could be vitiated by the lack of shareholder transparency in banks (see also CP 5). At the same time the Law on joint stock companies, stipulates that the general shareholders meeting should approve: the charter of the executive body, the election or termination of the administrators; remuneration and compensation; and the quarterly reporting by the company's executive body. The company's Board members represent the interests of the shareholders, and within their competence, exercise the general administration and control over the company activity, including the activity of executive body. According to the LFI, the bank is guided by the regulations approved by the Board that establish the limits of competence for the administrators, including the executive body. However, there is no specific requirement provided by NBM regulations for the Board to establish fit and proper standards in selecting senior management, or maintaining plans for succession. [60] During the on-site inspections supervisors verify the existence of the charter of the executive body and the decisions regarding its election. The inspection also checks whether the Board has approved and implemented a corporate governance code, compliance with these policies and strategies, as well as, the communication by the bank's management to the employees of the code of conduct.
EC7	The supervisor determines that the bank's Board actively oversees the design and operation of the bank's and banking group's compensation system, and that it has appropriate incentives, which are aligned with prudent risk taking. The compensation system, and related performance standards, are consistent with long-term objectives and financial soundness of the bank and is rectified if there are deficiencies.

[60] Not relevant for the assessment given that the LFI prescribes fit and proper standards for Board members.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
Description and findings re EC7	The Law on joint stock companies prescribes that the Board, according to bank statute, is responsible for approving the wage bill and the level of remuneration of the employees. The Regulation on Internal Controls, states that banks shall clearly document and the Board approve, short and long term objectives, policies and strategies, including remuneration. During the on-site inspection the supervisor assesses the compensation system of a bank by reviewing the procedures, salary, bonus, turnover, training, and recruitment to determine if they are compliant with requirements.
EC8	The supervisor determines that the bank's Board and senior management know and understand the bank's and banking group's operational structure and its risks, including those arising from the use of structures that impede transparency (e.g., special-purpose or related structures). The supervisor determines that risks are effectively managed and mitigated, where appropriate.
Description and findings re EC8	The Regulation on internal controls requires banks to have procedures for planning, approving, and introducing new types of activity, including a description of the relevant risks and evaluation of the degree of the risk, the acceptable limits of risk processes for keeping accounting records, a description of the methods used to determine the tariffs and prices or corresponding value, other registers and internal control systems. The Board is responsible for ensuring periodic reviews (at least once per year) of these procedures. The on-site inspectors determine if the Board and the executive bodies understand the bank, its operational structure and risk profile by focusing on whether the Board and management body have analyzed and approved the new activities and products before they are introduced. The assessment includes examining whether there has been a detailed analysis of risks, potential market, competition, profit/cost analysis, proposed volume and management experience; whether the bank has in place written policies and procedures and has implemented appropriate reporting and internal control systems before engaging in new activities. However, the assessors come to the conclusion that in the absence of specific requirements on an independent risk management function (see also CP 15) and specialized committees at the level of the Board the assessment made by NBM supervisors might not present in an accurate manner the degree in which the bank's Board and senior management know and understand the detailed analysis of risks to which the bank is exposed.
EC9	The supervisor has the power to require changes in the composition of the bank's Board if it believes that any individuals are not fulfilling their duties related to the satisfaction of these criteria.
Description and findings re EC9	The supervisor has the power to require changes in the composition of the Board if it believes that any individuals are not fulfilling their duties related to the satisfaction of these criteria. Thus according to Article 38 of the LFI, the NBM has the right to withdraw the confirmation issued to the administrator of the bank if the NBM determines that the administrators, including members of the Board, are guilty of an infraction consisting of: violation of legal requirements and NBM's normative acts, failure to comply with requirements for issuance the authorization, permission, approval, confirmation; fiduciary obligations; obligations stipulated by the legislation regarding the prevention and combating money laundering and terrorism financing, endangers the interests of the depositor or have engaged in risky or doubtful operations; failed to report or is late with reporting; reported erroneous data on banking prudential indicators or other requirements provided in the normative acts of the NBM; or has failed to comply with remedial measures established by the NBM.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	At the same time, according to the LFI, if the administrator, including the member of the Board, has not disclosed a conflict of interest, the NBM can suspend the administrator from office for a period of no more than one year or can approve a decision to dismiss him/her.
Additional criteria	
AC1	Laws, regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material and bona fide information that may negatively affect the fitness and propriety of a bank's Board member or a member of the senior management.
Description and findings re AC1	According to the LFI, the external auditor shall inform the NBM about any fraudulent act by an employee of the bank or its branch office and any irregularity or deficiency in its administration or operations that could result in a material loss for the bank or its branch office. There is no specific requirement in NBM regulations for banks to notify the supervisors as soon as they become aware of any material and bona fide information that may negatively affect the fitness and propriety of Bank's Board member or a member of the senior management.
Assessment of Principle 14	**MNC**
Comments	According to the regulation in force, banks are required to have strategies, policies, and procedures in place for CG purposes. In this regard, Board and the executive body at each bank have an obligation to pursue good governance, in addition to understanding the risk profile of their institution. However, in the absence of binding specific requirements such as: independent risk management and compliance functions; specialized committees at the level of the Board; individual Board members or the Board collectively to have a sound knowledge of the material activities and the associated risks, in practice, banks exhibit a poor level of compliance with CG regulation. Moreover the lack of shareholder transparency in banks could impede sound governance structure. From their interviews with banks, the NBM and other stakeholders, BCP assessors come to the conclusion that banks and banking groups do not have robust and effective corporate governance policies and processes (see also CP 5, 15, and 26). In this context, the NBM should be more intrusive by challenging the risk appetite for all risk categories of banks and their alignment with policy and procedures. The important forms of oversight that should be included in the organizational structure of any bank in order to ensure appropriate checks and balances include oversight by the Board; oversight by senior management; direct line supervision of different business areas; and independent risk management, compliance and audit functions. Currently, the NBM is planning to amend the Regulation on Internal controls, with the view to establish the mandatory role for bank's Board and promote the elaboration of a corporate governance code. At the same time, the regulation will incorporate key aspects such as (i) the relations between executive body, bank's Board, shareholders and other persons; (ii) structures through which the bank's objectives are established; (iii) the means necessary to achieve the objectives and to monitor performance; (iv) the responsibilities of the bank staff; (v) as well as, the way to manage the bank's activity by the Board. The regulation also plans to set the Board responsibility to define a code of conduct. The same regulation will require the internal audit

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	function to check independently compliance with conflict of interest policies. To achieve a greater level of compliance for this CP, the NBM should consider the following: • Foster the implementation of the amendments to the Regulation on internal control systems within banks as soon as possible to promote Corporate Governance.[61] • The LFI should also be amended in order to broaden the executive functions (e.g., key executives—categories of staff whose professional activities have a material impact on the credit institutions' risk profile; heads of internal control functions-risk management, compliance, internal audit), that need prior approval of the NBM based on fit and proper standards. • NBM to take more intrusive action by challenging the risk appetite and risk tolerance of a bank and evaluating the tone at the top. • Continue assessing the balance of power, the incentive system and the risk appetite of a bank using instruments such as assessing the leadership profile [62]of an administrator. Introduce a legal or regulatory obligation that calls for the banks to notify the supervisor as soon as they become aware of any material information that may negatively affect the fitness and propriety of a Board member or a member of senior management.
Principle 15	**Risk management process**. The supervisor determines that banks[63] have a comprehensive risk management process (including effective Board and senior management oversight) to identify, measure, evaluate, monitor, report and control or mitigate[64] all material risks on a timely basis and to assess the adequacy of their capital and liquidity in relation to their risk profile and market and macroeconomic conditions. This extends to development and review of contingency arrangements (including robust and credible recovery plans where warranted) that

[61] The recommendation is related to the amendments to the Regulation on internal control systems within banks (presented in a draft to the assessors) which prescribes detailed responsibilities for management bodies (Board and executive body).

[62] According to principle 44 of the BIS Corporate governance document the Chair of the Board has to provide leadership to the board and is responsible for the board's effective overall functioning, including maintaining a relationship of trust with board members.

[63] For the purposes of assessing risk management by banks in the context of Principles 15 to 25, a bank's risk management framework should take an integrated "bank-wide" perspective of the bank's risk exposure, encompassing the bank's individual business lines and business units. Where a bank is a member of a group of companies, the risk management framework should in addition cover the risk exposure across and within the "banking group" (see footnote 19 under Principle 1) and should also take account of risks posed to the bank or members of the banking group through other entities in the wider group.

[64] To some extent the precise requirements may vary from risk type to risk type (Principles 15 to 25) as reflected by the underlying reference documents.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	take into account the specific circumstances of the bank. The risk management process is commensurate with the risk profile and systemic importance of the bank.[65]
Essential criteria	
EC1	The supervisor determines that banks have appropriate risk management strategies that have been approved by the banks' Board and that the Board set a suitable risk appetite to define the level of risk the banks are willing to assume or tolerate. The supervisor also determines that the Board ensures that: (a) a sound risk management culture is established throughout the bank; (b) policies and processes are developed for risk-taking, that are consistent with the risk management strategy and the established risk appetite; (c) uncertainties attached to risk measurement are recognized; (d) appropriate limits are established that are consistent with the bank's risk appetite, risk profile and capital strength, and that are understood by, and regularly communicated to, relevant staff; and (e) senior management takes the steps necessary to monitor and control all material risks consistent with the approved strategies and risk appetite.
Description and findings re EC1	According to Article 18 of the LFI, the Board is responsible for preparing and ensuring the bank's internal policy application. In addition the Regulation on the internal controls, article 8 stipulates that the financial institutions shall prepare, organize and implement their own internal control systems, based on the NBM regulation and in line with the generally accepted practices in the field, including the documents of the Basel Committee and European Community Directives. It should be mentioned that, instead of issuing binding regulation, NBM periodically informed banks, by letters, about relevant Basel Committee Recommendations in the field of risk management, this practice implying a certain degree of compliance by banks with sound risk management principles. The Regulation on internal control systems within banks (article 30) stipulates that the internal control system shall be adapted to the specific banks financial activity and risks and must provide identification, assessment, monitoring and control of risk to which the bank is exposed. At the moment there are no specific requirements for banks, provided by NBM regulations, to have dedicated risk management department and risk specialists for each of the major banking risks. Thus, Boards does not receive useful monitoring information on the level and the nature of the risks the bank might be exposed from an independent function in order to take any needed remedial action. Such requirements are provided in the draft amendment of Regulation on internal control systems. However few banks have such departments. There is no a general good practice at the level of the banking system to set up a risk management committee at the Board level (one bank among 14 has a risk management committee at the Board level).

[65] It should be noted that while, in this and other Principles, the supervisor is required to determine that banks' risk management policies and processes are being adhered to, the responsibility for ensuring adherence remains with a bank's Board and senior management.

<table>
<tr><th colspan="2">Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)</th></tr>
<tr><th colspan="2">Supervisory Powers, Responsibilities and Functions</th></tr>
<tr><td></td><td>During the on-site inspections, the NBM supervisors review the decisions made by the Board and senior management with regard to all material risks taken by the bank. Also the supervisors verify whether there banks have in place:
• An organizational structure that contains a risk management function.
• Strategies and policies, in written internal rules and procedures, and codes of conducts communicated to all relevant staff throughout the credit institution at least to the level needed to carry out their particular duties.
• An adequate flow of information between senior management and the operational staff who is conducting risk assessments.
• Risk management policies and methodology governing limits and other control mechanisms, including Procedures to identify, report and liquidate violations and activity drawbacks
• Adequate information systems for measuring, assessing, and reporting on the size, composition and quality of exposures.</td></tr>
<tr><td>EC2</td><td>The supervisor requires banks to have comprehensive risk management policies and processes to identify, measure, evaluate, monitor, report and control or mitigate all material risks. The supervisor determines that these processes are adequate:
(a) to provide a comprehensive “bank-wide” view of risk across all material risk types;
(b) for the risk profile and systemic importance of the bank; and
(c) to assess risks arising from the macroeconomic environment affecting the markets in which the bank operates and to incorporate such assessments into the bank’s risk management process.</td></tr>
<tr><td>Description and findings re EC2</td><td>According to article 30 of Regulation on the internal control system, banks shall develop procedures to manage and control its business risks which must be adapted to the financial activity and risks involving the Bank and ensure the identification, assessment, monitoring and control of the risks to which it is exposed taking into consideration the complexity and bank specificities.

In this context, banks shall establish and maintain risk management and control procedures, for the risks to which they are exposed in their activity, including credit risk, currency, interest rate, liquidity, operational (including information technology), country, transfer, reputational and other risks.

The NBM has issued more specific regulations or recommendations that require banks to have management policies for specific types of risk: Regulation on lending activities which address credit risk management, Regulation on liquidity risk management, Recommendations on country and transfer risk management, Regulation on managing interest rate risk, Regulation on bank’s open foreign position, <u>Regulation on assets and conditional commitments classification</u>, Regulation on risk-weighted capital adequacy, etc.

These procedures are expected to address management of risk on a solo basis and must be drawn up in accordance with the complexity and specificity of the Bank's activity and to ensure:</td></tr>
</table>

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	• Implementation of the Bank's policies regarding the management and control of risks associated with its activity; • Assessment, management and monitoring of risks; • Identifying, measuring and monitoring on an ongoing basis of the Bank's position against risks; • Reporting to governing bodies of the Bank about exposures to risks in order to take decisions regarding the matters identified to significant risks assumed by the Bank. • Undertaking necessary measures to minimize and limit exposures to the risks affecting the achievement of the objectives of the Bank; • Identifying and monitoring risks associated with new products and activities, and significant changes in the characteristics of the existing products and activities as well as ongoing operational flow. The regulation states that the risk management process must be able to identify, measure, monitor, and control banking risks. Toward this end, appropriate corporate governance, and management and internal control mechanisms are required to control risks. The NBM checks during the on-site inspections whether the policies and strategies of the Bank's risk management are adjusted to fit the structure of the bank so that the risk management system, is understood by senior management and the staff, risk policies and limits are observed and appropriate measures are taken to monitor adverse effects arising from risks to which the bank might be exposed. All policies are assessed against the requirements of the corresponding regulation/ recommendations. This is done both during the licensing process and with subsequent submissions of policies.
EC3	The supervisor determines that risk management strategies, policies, processes and limits are: (a) properly documented; (b) regularly reviewed and appropriately adjusted to reflect changing risk appetites, risk profiles and market and macroeconomic conditions; and (c) communicated within the bank. The supervisor determines that exceptions to established policies, processes and limits receive the prompt attention of, and authorization by, the appropriate level of management and the bank's Board where necessary.
Description and findings re EC3	Banks are required to document their risk management policies and processes in accordance with the Regulation on internal control systems and subsequent regulations. The Board is responsible for ensuring periodic reviews (at least once per year). The entire risk management system also is required to be communicated to the bank staff and a training program for employees should be in place to make sure the employees are familiar with all changes or performances of the Bank. Board meeting minutes are reviewed to ensure that policies and procedures are regularly (at least annually) reviewed and updated. Compliance with internal policies and procedures is

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	verified through on-site inspections (including reviewing censors reports) and also verified through the receipt of external auditor's reports. The on-site inspectors also draw attention to the exceptions from risk management policies and whether those exceptions were presented to and approved by the Board.
EC4	The supervisor determines that the bank's Board and senior management obtain sufficient information on, and understand the nature and level of risk being taken by the bank and how this risk relates to adequate levels of capital and liquidity. The supervisor also determines that the Board and senior management regularly review and understand the implications and limitations (including the risk measurement uncertainties) of the risk management information that they receive.
Description and findings re EC4	The Board of the bank is responsible, according to Regulation on internal control systems within banks (article 13) and related specific risk management regulations, for periodic approval and review of an adequate internal control system related to risk management and for an adequate implementation of the risk management, inclusive risks evolution, and for the establishment of a management information system that will enable it to be informed of all significant risks in the bank. The system must provide timely, accurate and relevant information so that the Board can rely on it. The Board establishes the internal reporting flow necessary to ensure the Board and operating units have the information necessary to understand and govern risk factors, ensure that capital and liquidity positions are consistent with the prudential framework, and are sufficient for the level of risk undertaken by the bank. Through the on-site examination process, the supervisors assess the adequacy of bank processes relative to the requirements of the regulation and determines that the Board established policies, practices and procedures with respect to credit risk, interest rate, currency, liquidity, operational, country, transfer, and other risks to which the bank might be exposed, including carrying out stress-tests for these risks; whether reasonable parameters have been established for the risk profile, and whether the Bank operates within these parameters; whether the internal management reports provide to the Board adequate and regular information on the risks and management of these risks for making competent decision and for monitoring the implementation of those decisions; whether the Bank operates in accordance with the policies and rules and with the normative acts in force; whether the reports submitted to the NBM are accurate. The NBM also reviews the frequency of reports on operations made to senior management and confirms that senior management receives and reviews these reports. The Board and Board minutes are reviewed to determine the level of involvement and the process to be followed and documentation is described in the work programs to aid examiners in conducting the review.
EC5	The supervisor determines that banks have an appropriate internal process for assessing their overall capital and liquidity adequacy in relation to their risk appetite and risk profile. The supervisor reviews and evaluates banks' internal capital and liquidity adequacy assessments and strategies.
Description and findings re EC5	Both regulations on risk-weighted capital adequacy and bank liquidity require banks to have policies and procedures for management of capital and liquidity risk. The capital management policy shall include at least a capital planning process, procedures for future bank compliance with capital requirements, stress tests to identify the potential weaknesses and vulnerabilities on bank capital position as well as the internal reporting process.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	The liquidity management policy shall include at least appropriate information systems on the assessments, monitoring and reporting the level of the liquidity, stress test to identify the weaknesses and potential vulnerabilities, management plans for different stress test scenarios, as well as control of the liquidity management. In particular, procedures and internal instructions on information systems shall ensure that the bank's liquidity is duly assessed and examined by the Board to take appropriate decisions on liquidity management. Both policies shall provide for monitoring and evaluation in order to maintain an adequate level of capital that is consistent with their risk profile and for maintenance of a sufficient level of liquidity, but not less than the rate set by the NBM regulations. The risk profile of the bank is mainly considered relative to credit quality levels and other risk elements, but the prudential standard influences capital and liquidity adequacy significantly, in assessing whether a bank has a satisfactory level of capital or liquidity. The off-site supervisors regularly monitor capital adequacy and liquidity levels of banks through prudential reports submitted by bank. During on-site inspections, both bank's policies are assessed, in order to determine whether they are reliable and sufficient, taking into account the current and the forecasted financial condition of the bank. The banks policies must address the following factors: the current and expected growth, future profits, liquidity and resources management, risk weighted assets, asset quality, expected shares issuance, expected payment of dividends, general economic conditions in the Republic of Moldova, etc.
EC6	Where banks use models to measure components of risk, the supervisor determines that: (a) banks comply with supervisory standards on their use; (b) the banks' Board and senior management understand the limitations and uncertainties relating to the output of the models and the risk inherent in their use; and (c) banks perform regular and independent validation and testing of the models The supervisor assesses whether the model outputs appear reasonable as a reflection of the risks assumed.
Description and findings re EC6	In Moldova, banks are subject to the Basel I framework. Banks do not use modeling for purposes of estimating the amount of capital needed relative to their risk profile. Some of the foreign banks could employ these models internally and informally in connection with the requirements of the parent institution, but the results are not reviewed in the on-site examinations.
EC7	The supervisor determines that banks have information systems that are adequate (both under normal circumstances and in periods of stress) for measuring, assessing and reporting on the size, composition and quality of exposures on a bank-wide basis across all risk types, products and counterparties. The supervisor also determines that these reports reflect the bank's risk profile and capital and liquidity needs, and are provided on a timely basis to the bank's Board and senior management in a form suitable for their use.
Description and findings re EC7	For this purpose, the Bank shall establish and maintain procedures to ensure: regular and timely transmission of truthful information to the bank's management, reporting to executive bodies about errors and differences detected, reporting to management bodies about exposures to risks as to take decisions regarding the identified matters of significant risks assumed by the

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	bank. In turn, governing bodies must be able to ensure complete accurate and timely reporting, in accordance with the normative acts of the NBM. The NBM has issued requirements on information systems and reporting in the Regulation on internal control systems according with banks shall establish and maintain procedures to ensure: regular and timely transmission of truthful information to the bank's management, reporting to executive bodies about errors and differences detected, reporting to management bodies about exposures to risks as to take decisions regarding the identified matters of significant risks assumed by the Bank. During the on-site inspections Board documents are reviewed to assess the frequency of reporting to the Board as well as the adequacy and relevance of the content of the reports made by executive management and the timeliness of reports produced by the system, the thoroughness of limit and exception reporting.
EC8	The supervisor determines that banks have adequate policies and processes to ensure that the banks' Board and senior management understand the risks inherent in new products,[66] material modifications to existing products, and major management initiatives (such as changes in systems, processes, business model and major acquisitions). The supervisor determines that the Board and senior management are able to monitor and manage these risks on an ongoing basis. The supervisor also determines that the bank's policies and processes require the undertaking of any major activities of this nature to be approved by their Board or a specific committee of the Board.
Description and findings re EC8	Article 26 paragraph 3 of the LFI stipulates that no bank shall engage in financial activities that are not authorized under its license. Consequently activities which are not included in its license cannot be performed and permission must be sought for the license to be extended. According to the provisions of Regulation on internal control systems (Article 22 point 9) banks must have procedures for planning, approving, and initiating new types of activity, including a description of the relevant risks and evaluation of the degree of the risk, the acceptable limits of risk processes for keeping accounting records, a description of the methods used to determine the tariffs and prices or corresponding value, other registers and internal control systems, Board being responsible for approving and for ensuring periodic reviews (at least once per year). The Bank shall also have a training program for employees to make sure the employees are familiar with all changes or performances of the Bank. Credit institutions must develop thorough policies and procedures prior to implementing new products or initiatives which must be approved by the Board. Credit institutions must notify the NBM of new products and must request approval for new initiatives. The on-site inspectors check whether the Board and management have analyzed and approved the new activities and products before they are introduced by the Bank and provided a detailed analysis of risks, potential market, competition, profit/cost analysis, proposed volume and the management experience; whether the bank has in place written policies and procedures and

[66] New products include those developed by the bank or by a third party and purchased or distributed by the bank.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	implemented appropriate reporting and internal control systems before engaging in new activities; whether the Board is satisfied of the existence of sufficient capital to support all new activities and major management initiatives.
EC9	The supervisor determines that banks have risk management functions covering all material risks with sufficient resources, independence, authority and access to the banks' Board to perform their duties effectively. The supervisor determines that their duties are clearly segregated from risk-taking functions in the bank and that they report on risk exposures directly to the Board and senior management. The supervisor also determines that the risk management function is subject to regular review by the internal audit function.
Description and findings re EC9	The Regulation on internal control systems as well as risk management regulations issued by the NBM does not include a specific requirement for risk management functions nor the segregation from risk taking. However, from the information published by banks, it is apparent that few banks have risk management departments that report directly to the executive bodies. According to the Regulation on internal control systems the internal audit function is responsible for making an independent assessment of the adequacy and compliance of Bank's activity with its policies and procedures, as well as provisions of the legislation in force, and for communicating the results to the Board, Censors committee and the executive body. Moreover, internal audit shall inform the Board in due time, in accordance with internal regulations of the Bank, about significant risks and risks detected repeatedly and shall verify the continuous monitoring of risks that could affect the financial activities (credit risk, currency, interest rate, liquidity, country, operational risk, including information technologies, reputational, transfer, and other risks which may arise in the conduct of financial activities). Examiners determine during-on-site inspection if banks comply with the provisions of the Regulation on internal control.
EC10	The supervisor requires larger and more complex banks to have a dedicated risk management unit overseen by a Chief Risk Officer (CRO) or equivalent function. If the CRO of a bank is removed from his/her position for any reason, this should be done with the prior approval of the Board and generally should be disclosed publicly. The bank should also discuss the reasons for such removal with its supervisor.
Description and findings re EC10	Currently, only a few banks have established a department or units responsible for risk management. The on-site inspectors examine the activity of such units and their role in the risk management process. At the same time, in accordance with the planned amendments to the Regulation on the internal control systems within banks, the bank shall have an independent function of risk management, including monitoring of risk exposure, liquidity and capital position, under the direct responsibility of the Board. The Bank shall appoint a member of the Board who will be responsible for supervising the risk management function. Risk management function shall not have managerial responsibilities or financial responsibilities for generating profits, but shall have sufficient authority within the bank to influence the decisions relating to the bank's exposure to risk. This function must be actively involved in drawing up the bank's strategies in the decision-making process related to the activities of the Bank, as well as the approval of new products or significant changes of existing products. The Bank shall also ensure that there is an adequate separation of functions within the risk

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	management process, in order to avoid potential conflicts of interest. The risk management function must be able to communicate directly with members of the executive body on developments contrary to established risk tolerance and the Bank's strategy and policy. The head of the risk management function shall be able to report directly to the Board, where appropriate, to the auditing committee and/or risk management committee.
EC11	The supervisor issues standards related to, in particular, credit risk, market risk, liquidity risk, interest rate risk in the banking book and operational risk.
Description and findings re EC11	The NBM has issued specific regulations or recommendations that require banks to have management policies for specific types of risk: Regulation on lending activities and Regulation on classification of assets and conditional commitments which address credit risk management; Regulation on Liquidity of the bank; Recommendations on Country and Transfer Risk Management; Regulation on managing Interest Rate Risk, Regulation on bank's open foreign position; Regulation on large exposures and Regulation on bank transactions with its affiliated persons, Regulation on risk-weighted capital adequacy, etc. The contents of the standards vary, but most have requirements for managing the risk system, the organizational structure, internal reporting process, responsibilities of the Board and executive body as well as stress testing standards and requirements,
EC12	The supervisor requires banks to have appropriate contingency arrangements, as an integral part of their risk management process, to address risks that may materialize and actions to be taken in stress conditions (including those that will pose a serious risk to their viability). If warranted by its risk profile and systemic importance, the contingency arrangements include robust and credible recovery plans that take into account the specific circumstances of the bank. The supervisor, working with resolution authorities as appropriate, assesses the adequacy of banks' contingency arrangements in the light of their risk profile and systemic importance (including reviewing any recovery plans) and their likely feasibility during periods of stress. The supervisor seeks improvements if deficiencies are identified.
Description and findings re EC12	Stress test are required by the Regulation on internal control systems that stipulates that banks shall have in place procedures developed in accordance with the complexity and specificity of their activity, which would ensure the conduct of crisis stress tests for each type of risk, depending on the level of risk assumed and the specifics of the activity of the bank, including the size, sophistication and the diversification of operations, more detailed provisions, but still at the level of principles, being incorporated in specific risk management regulations. Stress tests should be used by banks as a diagnostic tool for understanding their risk profile, internal audit functions being responsible for carrying on analysis of the scenarios used and evaluate their effectiveness, by taking into account the possible events or changes in market conditions that can affect the activity of the bank. During on-site inspection the NBM supervisors determine whether the Board established policies, practices and procedures with respect to carrying out stress-tests on various risks and whether reasonable parameters have been established for the risk profile. Supervisors verify also whether bank performs stress tests and whether these are appropriate and sufficient compared to the complexity and specificity of the banks, whether the results are reported to executive management and to the Board, and determines that the bank integrates the results

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	into its decision-making and risk management processes. Supervisor requires corrective action such revisions and amendments if they determine that policies, practices and/or processes for carrying out stress tests are insufficient or unsuitable. In December 2011, the NBM sent a letter to all banks requiring them to prepare and submit contingency plans, providing at the same time criteria for drawing up these plans. According to the NBM recommendations, the contingency plans should address capital, liquidity, profitability and asset management with the aim to ensure bank's business continuity in any circumstances, including crisis situations and all activity. In February 2012, contingency plans were submitted by banks to the NBM. According to the information provided to assessors, plans submitted by seven banks comply with the NBM requirements, 6 are partially compliant and one is noncompliant. These plans have been reviewed by NBM and several banks were requested to make some amendments to their plans. At the same time, during the on-site inspections, the NBM verifies the quality of contingency plans and their adjustment to the changes on the financial market. This NBM review did not translate into concrete action meaning to impose measures in order to improve banks ability to foster emergency situations.
EC13	The supervisor requires banks to have forward-looking stress testing programs, commensurate with their risk profile and systemic importance, as an integral part of their risk management process. The supervisor regularly assesses a bank's stress testing program and determines that it captures material sources of risk and adopts plausible adverse scenarios. The supervisor also determines that the bank integrates the results into its decision-making, risk management processes (including contingency arrangements) and the assessment of its capital and liquidity levels. Where appropriate, the scope of the supervisor's assessment includes the extent to which the stress testing program: (a) promotes risk identification and control, on a bank-wide basis; (b) adopts suitably severe assumptions and seeks to address feedback effects and system-wide interaction between risks; (c) benefits from the active involvement of the Board and senior management; and (d) is appropriately documented and regularly maintained and updated. The supervisor requires corrective action if material deficiencies are identified in a bank's stress testing program or if the results of stress tests are not adequately taken into consideration in the bank's decision-making process
Description and findings re EC13	Stress test are required by the Regulation on internal control systems that stipulates that banks shall have in place procedures developed in accordance with the complexity and specificity of their activity, which would ensure the conduct of crisis stress tests for each type of risk, depending on the level of risk assumed and the specifics of the activity of the bank, including the size, sophistication and the diversification of operations, more detailed provisions, but still at the level of principles, being incorporated in specific risk management regulations. Stress tests should be used by banks as a diagnostic tool for understanding their risk profile, internal audit functions being responsible for carrying on analysis of the scenarios used and evaluate their effectiveness, by taking into account the possible events or changes in market conditions that can affect the activity of the bank. During on-site inspection the NBM supervisors determine whether the Board has established policies, practices and procedures with respect to carrying out stress-tests on various risks and

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	whether reasonable parameters have been established for the risk profile. Supervisors verify also whether bank performs stress tests and whether these are appropriate and sufficient compared to the complexity and specificity of the banks, whether the results are reported to executive management and to the Board, and determines that the bank integrates the results into its decision-making and risk management processes. Supervisors require revisions and amendments if they determine that policies, practices and/or processes for carrying out stress tests are insufficient or unsuitable.
EC14	The supervisor assesses whether banks appropriately account for risks (including liquidity impacts) in their internal pricing, performance measurement and new product approval process for all significant business activities.
Description and findings re EC14	The supervisor determines during on-site examinations (based on the Manual on on-site controls) whether banks have proper mechanisms in place for their internal pricing and performance measurement and also whether the Board and management have reviewed and approved the new activities and products before they are introduced by the bank and provided a detailed analysis of risks, potential market, competition, profit/cost analysis, expected volume and management experience; whether the bank developed written policies and procedures and implemented appropriate reporting and internal control systems before engaging in new activities.
Additional criteria	
AC1	The supervisor requires banks to have appropriate policies and processes for assessing other material risks not directly addressed in the subsequent Principles, such as reputational and strategic risks.
Description and findings re AC1	The supervisor assesses on-site during the full-scope examination if banks have policies and procedures regarding reputational risk. This is part of assessing Management (under the CAMELS methodology). Under the new supervisory methodology this risk will be assessed as a separate category. There is no specific requirement for identifying and assessing strategic risk.
Assessment of Principle 15	**MNC**
Comments	In the absence of binding requirements for banks to establish an independent risk management function, each bank has developed its own way of assessing risks depending on its internal operational differences and volume of transactions. Currently, there is no explicit legal requirement for the appointment of a dedicated risk officer. However, the Regulation on internal controls stipulate a clear functional separation between front office and/ back office functions. The legal and regulatory frameworks assign responsibility to the executive body for the effective management of the major types of risks (credit risk, liquidity risk, interest rate risk, country/transfer risk, image risk, FX risk, operational risk); however, certain types of risks difficult to measure are not covered. Assessors noted that the NBM is in the process of amending Regulation on internal control systems within banks so that the risk-management requirements and dedicated risk management function become more explicit and comprehensive. This new regulation will

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	(i) capture the main features of RM functions; (ii) include obligations on stress tests and the role of the management bodies in this regard; and (iii) require banks to have in place, within the risk management process, a contingency plan approved by the Board. The NBM approach to evaluating risk management in banks is heavily reliant on the on-site monitoring process, which is not deemed sufficiently robust to capture efficiently all qualitative aspects of risk management. It is therefore recommended to increase oversight intensity in banks where risk-management processes are poor. • The NBM should ensure that all banks continue to develop their risk management policies and processes. • The NBM should introduce a legal or regulatory obligation for banks to draw up annually a report about the conditions on which internal control is performed, with a distinct presentation of the aspects related to the risk management function, compliance function and internal audit function. • The NMB should speed up the approval process of the new Regulation on internal control systems within banks and include also strategic risks.
Principle 16	**Capital adequacy.**[67] The supervisor sets prudent and appropriate capital adequacy requirements for banks that reflect the risks undertaken by, and presented by, a bank in the context of the markets and macroeconomic conditions in which it operates. The supervisor defines the components of capital, bearing in mind their ability to absorb losses. At least for internationally active banks, capital requirements are not less than the applicable Basel standards.
Essential criteria	
EC 1	Laws, regulations or the supervisor require banks to calculate and consistently observe prescribed capital requirements, including thresholds by reference to which a bank might be subject to supervisory action. Laws, regulations or the supervisor define the qualifying components of capital, ensuring that emphasis is given to those elements of capital permanently available to absorb losses on a going concern basis.
Description and findings re EC1	The capital adequacy regime in Moldova is still governed by the Basel I rules. However, the NBM is planning to implement Basel II and some elements of the Basel III requirements with the assistance of the EU. The purpose of this project is to support the NBM in the gradual harmonization with the EU directive on capital requirements (CRD). NBM lays down its definitions for capital and its calculation in its "Regulation on Risk-Weighted Capital Adequacy" (approved by Decision no. 269 of NBM's Council of Administration on October 17, 2001, last amended on December, 20 2012) [RWA Reg].

[67] The Core Principles do not require a jurisdiction to comply with the capital adequacy regimes of Basel I, Basel II and/or Basel III. The Committee does not consider implementation of the Basel-based framework a prerequisite for compliance with the Core Principles, and compliance with one of the regimes is only required of those jurisdictions that have declared that they have voluntarily implemented it.

<table>
<tr><th colspan="2">Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)</th></tr>
<tr><th colspan="2">Supervisory Powers, Responsibilities and Functions</th></tr>
<tr><td></td><td>It defines Tier I Capital as including the total amount of the ordinary shares; preferred shares; capital surplus from the sale of these shares; undistributed profit and reserves obtained or increased as a result of profit distribution. The Tier II Capital includes the total amount of the cumulative and partially cumulative preferred shares with unfixed maturity; surplus of capital related to these shares; subordinated debts with unfixed maturity, etc. The regulation provides that the amount of Tier II Capital shall not exceed the amount of Tier I Capital.

RWA Reg paragraph 9–11 prescribe thresholds for requirements on minimum capital to be maintained by banks. RWA Reg paragraph 11(i) to 11(ii) require bank policies designed to maintain its capital adequacy ratio, capital planning, stress testing and internal reporting requirements to safeguard the minimum capital adequacy ratio. Article 37 and 38 of the LFI give the NBM broad powers for supervisory action in case the requirements are not met.

Moldovan banks are required to maintain a Ratio of Tier 1 Capital to RWA of 16 percent. When calculating this ratio, assets and off-balance sheet items are taken into account, which are classified into categories with specific risks weights (0 percent, 20 percent, 50 percent and 100 percent).

Assets at no risk are weighted with 0 percent weighting rate:
• Cash and cash equivalents; and
• Claims on central banks and government of Moldova (denominated in LEI).

Assets at low risk are weighted at a 20 percent weighting ratio:
• Claims on banks in Moldova; and
• Claims on banks in third countries (except OECD countries (only up to 1 year).

Assets at medium risk are weighted at a 50 percent weighting ratio:
• Credits secured by first residential mortgage; and
• Credits granted to the public sector except the central Government and guaranteed credits or secured with securities issued by the government.

Assets at high risk are weighted at a 100 percent weighting ratio:
• Lands, premises, and equipment, and
• Other credits.</td></tr>
<tr><td>EC2</td><td>At least for internationally active banks,[68] the definition of capital, the risk coverage, the method of calculation and thresholds for the prescribed requirements are not lower than those established in the applicable Basel standards.</td></tr>
</table>

[68] The Basel Capital Accord was designed to apply to internationally active banks, which must calculate and apply capital adequacy ratios on a consolidated basis, including subsidiaries undertaking banking and financial business. Jurisdictions adopting the Basel II and Basel III capital adequacy frameworks would apply such ratios on a fully consolidated basis to all internationally active banks and their holding companies; in addition, supervisors must test that banks are adequately capitalized on a stand-alone basis.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
Description and findings re EC2	The banks that operate in Moldova are mainly domestically licensed banks, with a few subsidiaries of foreign banks, and one branch of an internationally active bank. NBM does not differentiate between foreign and domestic banks, which mean that the definition of capital, the risk coverage, the method of calculation and the thresholds are the same for both. NBM requires banks to comply with Basel 1. These requirements are implemented in the Moldova law, regulation and guidelines. Currently Moldovan banks are required to have capital for credit risk (on- and off balance sheet) but not for market risks and operational risks.
EC3	The supervisor has the power to impose a specific capital charge and/or limits on all material risk exposures, if warranted, including in respect of risks that the supervisor considers not to have been adequately transferred or mitigated through transactions (e.g. securitization transactions)[69] entered into by the bank. Both on-balance sheet and off-balance sheet risks are included in the calculation of prescribed capital requirements.
Description and findings re EC3	The NBM has broad powers to impose financial recovery measures in the case of a bank failing to observe the (inter alia) capital adequacy requirements laid down in any of its regulations (Article 38 3) k) in connection with Article 37(9) of the Financial Institutions Law). Specifically, NBM can require a bank: • to increase reserves to cover the possible losses on loans and other assets; • to prohibit the payment of dividends or other distribution of capital; and • to implement measures of financial recovery referred to in Article 37 (9). According to Article39(9) of the LFI, in order to remedy the financial situation of the bank, one or more of the following measures could be taken: (a) changing the structure of assets and liabilities of the bank; (b) changing the organizational structure of the bank; (c) additional financing on behalf of bank's shareholders and other persons; (d) increasing bank's capital; (e) other measures that allow for remediation of financial situation of the bank and are acceptable for the NBM. RWA Regulation paragraph 7 expressly includes off-balance-sheet items "representing a risk for the bank" in its calculation of Risk Weighted Assets, which are the basis for its calculation of capital requirements. However, NBM considers neither market risk nor operational risk in its calculations of RWA as indicated above.
EC4	The prescribed capital requirements reflect the risk profile and systemic importance of banks[70] in the context of the markets and macroeconomic conditions in which they operate and

[69] Reference documents: Enhancements to the Basel II framework, July 2009 and: International convergence of capital measurement and capital standards: a revised framework, comprehensive version, June 2006.

[70] In assessing the adequacy of a bank's capital levels in light of its risk profile, the supervisor critically focuses, among other things, on (a) the potential loss absorbency of the instruments included in the bank's capital base, (b)

(continued)

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	constrain the build-up of leverage in banks and the banking sector. Laws and regulations in a particular jurisdiction may set higher overall capital adequacy standards than the applicable Basel requirements.
Description and findings re EC4	RWA Regulation 11(i) to 11(ii) requires banks to adopt internal policies in line with their risk profile. The capital adequacy requirements imposed on banks by the NBM do not vary by risk profile or systemic risk. However, RWA Reg. sets for all banks a higher overall capital adequacy standard, than the applicable Basel requirements (16 percent).
EC5	The use of banks' internal assessments of risk as inputs to the calculation of regulatory capital is approved by the supervisor. If the supervisor approves such use: (a) such assessments adhere to rigorous qualifying standards; (b) any cessation of such use, or any material modification of the bank's processes and models for producing such internal assessments, are subject to the approval of the supervisor; (c) the supervisor has the capacity to evaluate a bank's internal assessment process in order to determine that the relevant qualifying standards are met and that the bank's internal assessments can be relied upon as a reasonable reflection of the risks undertaken; (d) the supervisor has the power to impose conditions on its approvals if the supervisor considers it prudent to do so; and (e) if a bank does not continue to meet the qualifying standards or the conditions imposed by the supervisor on an ongoing basis, the supervisor has the power to revoke its approval.
Description and findings re EC5	Moldovan banks are under Basel 1 requirement; as a result, banks do not use internal-rating based approach for the calculation of regulatory capital. According to the RWA Reg. banks shall have in place internal policies and procedures on capital management, including, but not limited to, capital planning process, stress testing and internal reporting mechanisms to ensure proper management information on capital position, structure and quality. Going forward, Moldova is planning to migrate towards Basel II with the view to subject banks to a standardized approach for capital adequacy computation.
EC6	The supervisor has the power to require banks to adopt a forward-looking approach to capital management (including the conduct of appropriate stress testing).[71] The supervisor has the power to require banks: (a) to set capital levels and manage available capital in anticipation of possible events or

the appropriateness of risk weights as a proxy for the risk profile of its exposures, (c) the adequacy of provisions and reserves to cover loss expected on its exposures and (d) the quality of its risk management and controls. Consequently, capital requirements may vary from bank to bank to ensure that each bank is operating with the appropriate level of capital to support the risks it is running and the risks it poses.

[71] "Stress testing" comprises a range of activities from simple sensitivity analysis to more complex scenario analyses and reverses stress testing.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	changes in market conditions that could have an adverse effect; and (b) to have in place feasible contingency arrangements to maintain or strengthen capital positions in times of stress, as appropriate in the light of the risk profile and systemic importance of the bank.
Description and findings re EC6	The NBM, in its RWA Reg. (paragraph 11(i) and 11(ii)), requires banks to adopt policies and procedures to manage their own risk and to establish a capital management policy, including: (a) "capital planning process, taking into account the forecasts of the risks' level assumed by the bank, sources that can be used for capital policy, the dividend policy, etc.; (b) procedures for future bank compliance with capital requirements to mitigate the risks related to banking activity; (c) stress tests to identify the potential weaknesses and vulnerabilities on bank capital positions in the unpredictable conditions that will include credit risk, FX risk, interest rate risk, etc. and capital management plans, taking into account different stress scenarios on capital for unforeseen scenarios; and (d) internal reporting process to ensure the bank management with adequate information for measurement, estimation and reporting of the amount, structure and quality of capital." In practice, the NBM assesses during its on-site visits if banks comply with these requirements and in particular whether banks have conducted stress-tests. In addition, NBM inspectors conduct their own stress-test with their own scenarios. In a recent NBM stress-test exercise, banks ended up with very low CARs.
AC1	For non-internationally active banks, capital requirements, including the definition of capital, the risk coverage, the method of calculation, the scope of application and the capital required, are broadly consistent with the principles of the applicable Basel standards relevant to internationally active banks.
Description and findings re AC1	The NBM's regime does not differentiate between internationally active banks and non-internationally active banks.
AC2	The supervisor requires adequate distribution of capital within different entities of a banking group according to the allocation of risks.[72]
Description and findings re AC2	Moldova does not have local banking groups. The same regulatory requirements for capital are applied in the same way for both branches of foreign banks and domestic banks.
Assessment of Principle 16	**LC**
Comments	The Moldovan regime for capital adequacy is largely compliant with BCP 16. The initial (share) capital must be not less than MDL 100 million, the regulatory capital (Tier I Capital)—not less than MDL 200 million—approx. EUR 12.3 million—since December 2012. Also, the amount of Tier II Capital is limited to 100 percent of Tier I Capital and the minimum risk -weighted capital

[72] Please refer to Principle 12, Essential Criterion 7.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	adequacy is 16 percent (it was set at 12 percent in 2011). In practice, the average RW capital adequacy in the banking system is maintained at around 23 percent. However, a few issues have been observed: **Exposures secured by real estate mortgages do not receive a proper capital charge**. In the NBM instruction on RWA computation, no connection is made between borrowers and the collateral. A 50 percent capital charge is assigned to mortgages irrespective of whether the borrower occupies or will occupy the residential property. **There is no capital charge for FX exposures (open positions).** **The risk-weighted capital ratio might be inflated.** The average of risk-weighted capital adequacy in the banking system is maintained at about 23 percent. However, it is unclear whether there is a deduction of risk excess from eligible capital (for example on large exposures and related parties from undisclosed UBO).
Principle 17	**Credit risk.**[73] The supervisor determines that banks have an adequate credit risk management process that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify measure, evaluate, monitor, report and control or mitigate credit risk[74] (including counterparty credit risk)[75] on a timely basis. The full credit lifecycle is covered including credit underwriting, credit evaluation, and the ongoing management of the bank's loan and investment portfolios.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have appropriate credit risk management processes that provide a comprehensive bank-wide view of credit risk exposures. The supervisor determines that the processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank, take into account market and macroeconomic conditions and result in prudent standards of credit underwriting, evaluation, administration and monitoring.
Description and findings re EC1	Laws and regulations have set explicit requirements for credit risk management. The general framework is covered by article 30 of the Regulation on internal controls, according to which banks shall develop procedures to manage and control its business risks and which must be adapted to the financial activity and risks involving the Bank and ensure the identification, assessment, monitoring and control of the risks (including credit risk) to which it is exposed taking into consideration the complexity and bank specificities. Moreover the Regulation lays out the responsibility of the Board to ensure that effective risk management is in place and is adequate for the bank but no specific requirements are prescribed for an independent risk

[73] Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

[74] Credit risk may result from the following: on-balance sheet and off-balance sheet exposures, including loans and advances, investments, inter-bank lending, derivative transactions, securities financing transactions and trading activities.

[75] Counterparty credit risk includes credit risk exposures arising from OTC derivative and other financial instruments.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	management function. Thus, Boards does not receive useful monitoring information on the level and the nature of the credit risk from an independent function in order to take any needed remedial action. Further, the LFI (article 28, 32) specifies a set of requirements for credit risk management, including internal regulations for granting loans, observing limits and requirements regarding risk concentration limits (exposures), decision making process, asset classification, monitoring of collateral, and maintenance of documentation. The Regulation on banks' lending activity and the Regulation on classification of assets and conditional commitments also sets requirements on credit risk management. Therefore banks must establish and maintain organizational structures, internal policies and procedures of credit risk management providing for identification, monitoring and its evaluation depending on bank's risk profile in order to permanently uphold an appropriate and controlled credit risk environment. Decision making processes are also clearly stipulated and refer to the different hierarchies (special credit committee at the level of the bank's headquarters and similar credit committees at the branch level) depending on the size of the loan. Decisions on large exposures are to be taken by the majority of members of the Board before the conclusion of the respective transaction. The NBM has also issued a number of regulations on aspects of credit risk, including: on equity investments by banks, large exposures, transactions with affiliated parties, and foreign currency loans to residents. Supervisors review, during on-site examinations, the credit risk management of a bank (both CAMELS components Asset quality and Management). This covers all aspects of the credit lifecycle of a bank (credit underwriting, evaluation, administration and monitoring) assessing if banks act in accordance with their internal policy and procedures. The on-site process includes a significant level of sampling individual files, respectively 50 to 80 percent for loans granted to non-bank clients and higher for other types of assets. Credit risk management across the banking system is driven mainly by the lending departments, as few banks having separate risk management functions. Credit risk management is also monitored monthly by off-site functions, based on "Report on portfolio of granted credits and undertaken credit commitments". The conclusion of the off-site monitoring is presented to on-site inspectors before commencing on-site examinations in order to support their work.
EC2	The supervisor determines that a bank's Board approves, and regularly reviews, the credit risk management strategy and significant policies and processes for assuming,[76] identifying, measuring, evaluating, monitoring, reporting and controlling or mitigating credit risk (including counterparty credit risk and associated potential future exposure) and that these are consistent with the risk appetite set by the Board. The supervisor also determines that senior management implements the credit risk strategy approved by the Board and develops the aforementioned policies and processes.

[76] "Assuming" includes the assumption of all types of risk that give rise to credit risk, including credit risk or counterparty risk associated with various financial instruments.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
Description and findings re EC2	The Board is responsible for approving the strategies and policies for credit risk, monitoring their implementation, reviewing the implemented strategies and policies at least annually or more frequent in case of an important development (Regulation on internal controls, article 13), as well as for supervising the observance of the legislation in force, including of relevant NBM requirements on submission of information on the activity of the bank. The executive body of the bank (Regulation on internal controls article 14) is responsible for developing and implementing internal control systems as approved by the Board. Further, in order to ensure adequate internal control system management bodies of the bank (Regulation on internal controls article 15) are responsible for managing, reviewing and controlling the implementing internal control systems. During on-site examinations (full scope or thematic) supervisors determine according to provisions of the Manual on on-site controls, if the Board approves and regularly reviews strategies and policies. Typically, this involves a review of material going to the Board and review of Board minutes (date of approval, discussion, and documents presented). Further, the supervisor determines that the strategy and policies are correctly implemented by executive body, reviewing information used by executive body, analyzing credit approval process, credit administration, collateral management, problem recognition, credit policies and procedures, asset classification and provisioning procedures, inspecting loan files and verifying accuracy of reports submitted to the NBM as well as analyzing internal audit reports. In addition, the NBM supervisors review the decisions of credit extensions to ensure they are free from conflicts of interest and comply with the LFI. Any deficiencies detected in the credit area during an on-site examination are reflected in the report of examination that is submitted to the Board. The Board is advised that early remedial action of all regulatory and prudential violations is required. The off-site department also performs analytical reviews of the prudential return, assessing banks within their respective peer groups and identifying unusual trends or exposures. Detailed loan information submitted to the NBM on a monthly basis facilitates also the review of loan portfolio, especially in the sampling process. Consequently, the effectiveness of policies in this area is checked by both off-site and on-site supervision. Compliance with NBM regulations and internal policies is checked during on-site inspections (full scope and thematic) and more intensive by off-site supervision based on reports submitted on large exposures, and credits and commitments which are submitted monthly. The reports provide complete information for each loan granted by the bank including: name and type of the debtor, type of the loan, maturity, nominal interest rate, currency, name of the branch, type of the industry, type and value of the collateral, date of the last extension, reschedules, classification category, installment amount, number of days delays to disbursement or interest paid, consent of the debtor for checks in credit bureau information, credit history, etc.
EC3	The supervisor requires, and regularly determines, that such policies and processes establish an appropriate and properly controlled credit risk environment, including: (a) a well documented and effectively implemented strategy and sound policies and processes for assuming credit risk, without undue reliance on external credit assessments; (b) well defined criteria and policies and processes for approving new exposures (including prudent underwriting standards) as well as for renewing and refinancing existing

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	exposures, and identifying the appropriate approval authority for the size and complexity of the exposures; (c) effective credit administration policies and processes, including continued analysis of a borrower's ability and willingness to repay under the terms of the debt (including review of the performance of underlying assets in the case of securitization exposures); monitoring of documentation, legal covenants, contractual requirements, collateral and other forms of credit risk mitigation; and an appropriate asset grading or classification system; (d) effective information systems for accurate and timely identification, aggregation and reporting of credit risk exposures to the bank's Board and senior management on an ongoing basis; (e) prudent and appropriate credit limits, consistent with the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff; (f) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or Board where necessary; and (g) effective controls (including in respect of the quality, reliability and relevancy of data and in respect of validation procedures) around the use of models to identify and measure credit risk and set limits.
Description and findings re EC3	Policies and processes relating to credit risk are required by the LFI or NBM regulations respectively. According to the LFI provisions banks shall: • Issue internal regulations, which shall include at least the conditions of granting loans to applicants (clients, administrators, and bank employees), powers, duties and structure of the internal subdivision responsible for the management of operations related to loans, the decision making process with regard to the loans to be granted, and loan guarantee (LFI article 32, paragraph 1) • Maintain for each loan application, a copy of the decision of the person who authorized the credit on the approval of the transaction or a copy of the minutes of the Board meeting of the bank (where the decision was taken by the Board), contract documents, and other documentation of credit (LFI article 32, paragraph 9) • Monitor the borrower's activity and the amount of collateral (LFI article 32 paragraph 6) • Assess and classify assets/conditional commitments and allowances for assets losses/conditional commitments concerned (LFI article 28, paragraph 2). The Regulation on bank lending activity (Decision no.153 of 25.12.97) stipulates that the bank general policy shall at least: • define all types of credits granted by the bank and shall provide concise and comprehensive description of credits, including information on credit purpose, term and reimbursement structure, price, required collateral or other type of guarantee, etc.; • include a general guidance with regard to the share of each credit type in total credit portfolio, reflecting the bank's commercial strategy and consideration of separate risks; • reflect legal and regulatory credit limits, i.e., limits on large credit extension to a debtor or a

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	group of debtors in interconnection, affiliated persons and bank employees; • establish requirements with regard to credit securing, as well as forms of collateral to be established depending on credit type; • provide all possible procedures of credit extension and reimbursement; • include daily guidelines with regard to interest rates applied on different credit types, margin establishment at managerial and branch levels. Prices for special credit types shall be decided by the management body; • establish optimal proportions of credit types in total credit portfolio, giving due consideration to the risk implied within each credit risk; • provide relevant rules of systemic revision of credit portfolio, allowing an objective portfolio classification. • explicitly stipulate the responsibilities of banks and branches and rules of internal control procedures and data reporting. Also, the credit extension procedure may be subject to double control conducted by an independent unit, which shall report directly to the special credit committee or to the bank management. However, there are no specific requirements for banks, excepting those for repossessed assets, to have in place procedures for assessing collateral, especially tangible collateral, by certified evaluators, based on International Valuation Standards. On-site inspection as well as off-site monitoring verifies internal policies and procedures' compliance with the LFI, as well as compliance with the Regulation on internal control systems within banks, Regulation on classification of assets and Regulation on bank lending. The "Report on portfolio of granted credits and undertaken credit commitments" is checked by off-site examiners.
EC4	The supervisor determines that banks have policies and processes to monitor the total indebtedness of entities to which they extend credit and any risk factors that may result in default including significant unhedged FX risk.
Description and findings re EC4	A number of laws and regulations establish requirements for addressing the financial conditions of the borrower. These include the LFI, the Regulation on lending activity, and the Regulation on large exposure. The total indebtedness of the credit applicant should also be determined based on all available information including credit bureau records where debtors have consented to such disclosure. Banks may grant credits to residents in any foreign currency according to the provisions of the Regulation foreign currency loans to residents. However, such credits must be non-cash or could be used abroad via credit cards (chapter II of Regulation on foreign currency loans to residents).At the same time the Regulation on large exposures states that the net exposure of the bank's exposure in foreign currency credit to individuals, when converted to Moldovan lei shall not exceed 30 percent of the regulatory capital, 10 percent of total regulatory capital if mortgages are not included. Loans granted in FX or indexed to FX to unhedged debtors (debtor income in the loan currency is insufficient for servicing and repayment the debt) must be classified in a lower category than the bank would ordinarily classify the exposure unless there are mitigating factors such as the borrower having a lower level of indebtedness.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	However, the existing legal and regulatory framework does not prescribe specific standards for assessing the creditworthiness of unhedged retail clients (LTV ratios, maximum indebtedness ratios, types of eligible incomes, etc., credit scoring systems implementation). There is no requirement to apply more strict lending criteria for an unhedged borrower that is a legal entity.
EC5	The supervisor requires that banks make credit decisions free of conflicts of interest and on an arm's length basis.
Description and findings re EC5	The LFI stipulates that banks should not grant loans to related parties in more favorable conditions and terms than regular customers (article 31). There are also regulations that refer to making decisions free of conflicts and on an arm's length basis. For instance, it is the responsibility of the Board to make sure that there is no conflict of interest within the bank. Therefore a related person that has a material interest in a transaction (including granting of loans), shall leave any meeting where this transaction is discussed ("Regulation on bank transactions with its affiliated persons"). Moreover, the regulation stipulates the need for a clear approval procedure. Prudential reports are scrutinized to ensure there are no breaches and transactions with related parties are done on arms-length basis (Reports on loans to related parties are required on a quarterly basis), as part of ongoing monitoring. A more thorough review is undertaken during the on-site inspection when reviews of lending activities targeted all related party transactions. Reviews of the Board' minutes also provide information on related party activities.
EC6	The supervisor requires that the credit policy prescribes that major credit risk exposures exceeding a certain amount or percentage of the bank's capital are to be decided by the bank's Board or senior management. The same applies to credit risk exposures that are especially risky or otherwise not in line with the mainstream of the bank's activities.
Description and findings re EC6	According to the "Regulation on large exposures", the decision on the conclusion of any transaction, which would result in a "large" exposure (Net Exposure of the bank to any person or to a group of interrelated persons, constituting ten percent (10 percent) or more of the bank's Total Regulatory Capital) shall be taken by the majority of members of the Board before the conclusion of the respective transaction. Also, any transaction with an affiliated person shall be approved in advance by the majority of members of the Board according to the Regulation on bank transactions with its affiliated persons.
EC7	The supervisor has full access to information in the credit and investment portfolios and to the bank officers involved in assuming, managing, controlling and reporting on credit risk.
Description and findings re EC7	Article 37 paragraphs 6 and 7 from LFI stipulates that Banks and each of the subsidiaries are required to provide access in the bank to the NBM inspectors. In their inspections of banks and subsidiaries, the NBM inspectors shall have the right to examine the accounts, records and other documents and to require administrators, employees and agents of the bank or subsidiary to provide any information on their activity and operations.
EC8	The supervisor requires banks to include their credit risk exposures into their stress testing

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	programs for risk management purposes.
Description and findings re EC8	The Regulation on internal controls as well as the Regulation on classification of assets stipulates that banks should have procedures to manage and control the activity-related risks, including credit risk. These procedures shall ensure that stress tests for each type of risk are performed, and take into account the complexity and specifics of the bank activity. The banks shall carry out stress tests as a means of diagnostic control to identify and understand weaknesses or vulnerabilities on credit risk positions, respectively the bank risk profile. During the on-site inspection, the examiners also conduct stress tests using the NBM methodology, recording their results in the final inspection report.
Assessment of Principle 17	**MNC**
Comment	Based on the information presented to BCP assessors, either from on-site reports or in the monthly analysis made by off-site department, it was observed that in several reports submitted by banks, information on related parties was missing due to the lack of due diligence in identifying groups of debtors and single debtor exposures. Moreover according to the information provided to the mission, violations of regulations related to lending activity and credit risk management are by far the most frequent ones. The LFI and NBM regulations require banks to have adequate credit risk management policies, procedures and practices but no independent risk management function is required. Anyway credit risk management across the banking system is driven mainly by the lending departments, as few banks having separate risk management functions. Thus, Boards do not receive useful monitoring information on the level and the nature of the credit risk from an independent function in order to take any needed remedial action. In practice, the NBM determines if policies and procedures comply with the rules and regulations, including classification and provisioning rules, and underwriting standards. The LFI (article 32) stipulates that repayment of the loan can be secured by the pledge of movable and immovable property, by a bank guarantee and other assets specified in the law. Banks have the right to grant loans without collateral (blank loan) in certain conditions but in practice, banks heavily rely on the volume and the quality of the collateral instead of the borrowers' ability to repay the loan. There are no specific requirements for banks, excepting those for repossessed assets, to have in place procedures for assessing collaterals, especially tangible collateral, by certified evaluators, based on International Valuation Standards. For managing indirect FX risk arising from the credit activity with unhedged borrowers, banks shall have in place appropriate policies and procedures. However, in the regulation issued by NBM, this risk is not clearly stipulated and measured, excepted only at the aggregate portfolio level. The NBM may wish to consider the following: • Enhance supervisory scrutiny of financial analysis and valuation of collateral through loan reviews; • Focus more on determining if banks credit underwriting policies are prudent; • Introduce in the Regulation on lending activity provisions requiring : • banks to have in place procedures for assessing collateral, especially tangible collateral,

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	by certified evaluators, based on International Valuation Standards ; • banks to identify, assess and frequently monitor indirect FX risk as part of the credit underwriting and monitoring process; • Consider stricter collateral requirements (LTV ratios), different indebtedness ratio for individual loans, more restrictive lending criteria for legal entities and lower limits on concentration of large borrowers subject to FX risk. • In the new regulation on internal controls, define and distinguish between FX risk arising at the level of the borrower and the risk arising from the banking activity.
Principle 18	**Problem assets, provisions and reserves.**[77] The supervisor determines that banks have adequate policies and processes for the early identification and management of problem assets, and the maintenance of adequate provisions and reserves.[78]
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to formulate policies and processes for identifying and managing problem assets. In addition, laws, regulations or the supervisor require regular review by banks of their problem assets (at an individual level or at a portfolio level for assets with homogenous characteristics) and asset classification, provisioning and write-offs.
Description and findings re EC1	The LNBM and regulations provide that the accounting principles applicable to reports or statements required to be filed are in accordance with International Accounting Standards. Also banks are required to formulate policies and processes to identify and manage credit risk according to article 28 of the Regulation on internal controls. Moreover, the NBM requires banks to have internal policies and procedures on credit risk management covering identification, monitoring and evaluation (article 28 Regulation on classification of assets). Additionally banks must have policies and procedures to identify, value, and manage non-performing exposure (assets and conditional commitments) and quarterly assess and adjust provisions. The NBM uses a five-tier rating system, from standard to loss (compromised), and stipulates gradually provisioning allocations, from two percent to 100 percent (article 27, Regulation on classification of assets). Non-performing loans are those in categories sub-standard, doubtful and loss. Banks are required to classify the loans according to days of arrears, and financial condition of the borrower. According to the accountancy rules, respectively IAS 39, paragraph 58, an assessment of financial assets or group of financial assets is required at the end of each reporting period in order to identify impairments. In such cases, banks have to calculate the impairment loss. The

[77] Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

[78] Reserves for the purposes of this Principle are "below the line" non-distributable appropriations of profit required by a supervisor in addition to provisions ("above the line" charges to profit).

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	loss is considered as being "incurred" if there is objective evidence of impairment due to one or more events occurred after the initial recognition of the assets (IAS 39, paragraph 59). Indicators of impairment are according to the standard: significant financial difficulty of the issuer or obligor, a breach of contract, any concession made by the lender to the obligor in financial difficulties that the lender would not otherwise consider bankruptcy or other financial reorganization of the borrower becomes probable, the disappearance of an active market for the financial asset because of financial difficulties. The Regulation on lending activity of banks establishes the requirements with respect to the banks' lending policy and procedures, which will include, but are not limited to instructions on the bank's general lending policy (organizational charter, business and marketing strategy, collateral considered as acceptable and sufficient, the way of grating and repayment of loans, the review and control of the loan portfolio, etc.) and specific detailed instructions on the policy and procedures for each type of loan (including internal procedures for assessing the borrowers credibility, the management and examination of the risk, necessary collateral, problematic loans and their collection). To fulfill this responsibility, each bank is expected to ensure that controls are in place to consistently determine the allowances for loan losses in accordance with Regulation on assets and conditional commitments classification, stated policies and procedures, management's best judgment, and relevant supervisory guidance.
EC2	The supervisor determines the adequacy of a bank's policies and processes for grading and classifying its assets and establishing appropriate and robust provisioning levels. The reviews supporting the supervisor's opinion may be conducted by external experts, with the supervisor reviewing the work of the external experts to determine the adequacy of the bank's policies and processes
Description and findings re EC2	The NBM reviews the adequacy of a bank's loan classification, loss provisioning process, and overall capital adequacy during each on-site full scope examination. In assigning a component rating for assets, supervisors consider the adequacy of the bank's allowances for loan losses and other asset valuation reserves as well as the adequacy of its credit administration practices. Supervisors review the policies, procedures, and internal controls for classification of, and provisioning for, credit risk as well as compliance with laws and regulations while the reviews of bank classifications and valuations based on accountancy standards, respectively IFRS, is carried out by the independent auditors that audit the annual accounts. To support their assessment, supervisors generally assess the effectiveness of these internal control processes by reviewing a significant sample of loans (50 percent to 80 percent), assign them to categories (standard, supervised, sub-standard, doubtful and loss), and compare to the bank's classification. This always results in supervisory recommendations for additional provisions. Supervisors also review the internal and external audit reports, internal management reports, to determine that classifications and provisioning provide Board of directors and senior management an accurate and timely picture of the bank's credit risks. The Manual for on-site controls contains detailed procedures that supervisors should follow in conducting their reviews. It should be mentioned that the provisions of Article 37 of the LFI and of Article 44 of the LNBM entitle the NBM to appoint qualified specialists, authorized accountants in order to carry out inspections on the banks' activity. So far, the NBM has not used this right in the past. See also

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	CP 10 EC 10.
EC3	The supervisor determines that the bank's system for classification and provisioning takes into account off-balance sheet exposures.[79]
Description and findings re EC3	The Regulation on classification of assets makes clear that systems for classification and provisioning should take into account off-balance-sheet exposures. The regulation requires the recognition of credit losses in off-balance sheet exposures, including loan commitments, standby letters of credit, guarantees, and recourse liabilities on loan transfers.
EC4	The supervisor determines that banks have appropriate policies and processes to ensure that provisions and write-offs are timely and reflect realistic repayment and recovery expectations, taking into account market and macroeconomic conditions.
Description and findings re EC4	Banks are required to follow the fixed reserve rates per classification category stipulated in the regulation and to assess the classification at least quarterly or in cases of new loan at the time of occurrence. There is no requirement to classify assets, between reporting dates even if the quality of the asset is deteriorating. According to the accounting standards compliant with IFRS write-off must not be reported until the whole of the entity's rights have been extinguished (by expiry of the statute of limitations period, forgiveness or other causes) or until recovery. Write-offs include both reductions in the carrying value of impaired financial assets recognized directly in profit or loss and reductions in the amounts of the allowance accounts charged against the impaired financial assets. The supervisor determines during on-site examinations if the classification, provisioning and write-off practices are compliant with the above mentioned regulation. The most important criteria for asset classification are the financial condition of the borrower and the days past due. When the asset classification, defined in the regulation, is determined, the provisioning is also determined based on the fixed system of provisioning.
EC5	The supervisor determines that banks have appropriate policies and processes, and organizational resources for the early identification of deteriorating assets, for ongoing oversight of problem assets, and for collecting on past due obligations. For portfolios of credit exposures with homogeneous characteristics, the exposures are classified when payments are contractually in arrears for a minimum number of days (e.g., 30, 60, and 90 days). The supervisor tests banks' treatment of assets with a view to identifying any material circumvention of the classification and provisioning standards (e.g., rescheduling, refinancing, or reclassification of loans).
Description and findings re EC5	According to the Regulation on assets and conditionality commitments classification, banks are expected to have appropriate policies and processes, and organizational resources for the early identification of deteriorating assets, for ongoing oversight of problem assets, and for collecting on past-due obligations. Based on a combination of on-site examinations and off-site monitoring, NBM assesses the

[79] It is recognized that there are two different types of off-balance sheet exposures: those that can be unilaterally cancelled by the bank (based on contractual arrangements and therefore may not be subject to provisioning), and those that cannot be unilaterally cancelled.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	quality and timeliness of the bank's classification process, and credit workout processes to determine if they are appropriate. Supervisors also assess the trend in credit classification migration and may direct a bank to reclassify any credit where the classification category does not reflect the credit's actual condition. Examples reviewed by the assessors demonstrated the authorities' willingness to use enforcement tools as necessary when provisioning processes and practices are inappropriate and safety and soundness is threatened. Loan extension or renegotiation does not qualify the loan for a better category. However, the loan is maintained for 3 months in the same category and after these 3 months, the loan is reclassified, if the debtor has proven his payment capacity on a monthly basis (see also EC 9).
EC6	The supervisor obtains information on a regular basis, and in relevant detail, or has full access to information concerning the classification of assets and provisioning. The supervisor requires banks to have adequate documentation to support their classification and provisioning levels.
Description and findings re EC6	Banks are required to maintain complete and clear documentation in connection with each stage of credit granting, credit monitoring and credit control (LFI, article 32). Banks are required to report the classification and provisioning of loans, on a monthly basis, accordingly to the requirements set out in the reporting instructions (Decision No. 279 of December 1, 2011). Banks provide the following documents to the NBM on a monthly basis: FINREP reports; capital adequacy reports; and a report on restricted information related to loan portfolio (classifications are presented in details for each loan). A report on the full portfolio of loans and commitments (classifications are presented in details for each loan, including restructured ones) is provided quarterly. NBM supervisors may review all the books maintained by a bank and thus have full access to all records during an on-site examination. This includes access to individual loan files, risk-management reports, internal and external audit reports and other material (such as Board or committee minutes and reports). Banks failing to supply requested information or access to premises and personnel are subject to supervisory sanctions and prosecution. The authorities indicated that access to information on credit classification and provisioning is not an issue.
EC7	The supervisor assesses whether the classification of the assets and the provisioning is adequate for prudential purposes. If asset classifications are inaccurate or provisions are deemed to be inadequate for prudential purposes (e.g., if the supervisor considers existing or anticipated deterioration in asset quality to be of concern or if the provisions do not fully reflect losses expected to be incurred), the supervisor has the power to require the bank to adjust its classifications of individual assets, increase its levels of provisioning, reserves or capital and, if necessary, impose other remedial measures.
Description and findings re EC7	The NBM has the authority to require additional provisions or to impose other remedial measures. Assessment of the loan classification system and the adequacy of provisions is part of every full scope examination. Thus, the inspectors carry out a selective classification of the assets and conditional commitments according to the NBM's regulation, and determine the amount of allowances related to the bank's reclassified assets (regularly 50 percent of the portfolio is reviewed). If the supervisor concludes that the reported allowances for loan losses level is not appropriate or determines that the allowances for loan losses evaluation process is based on the results of an unreliable loan review system or is otherwise deficient, supervisors will require the bank to adjust the allowances for loan losses and address the process

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	deficiencies Banks must take into consideration the inspection results when preparing the reports submitted for the next reporting date after examination of the reports on the inspection by the Council of Administration of the NBM. Along with the reports submitted electronically, banks must send a written letter, explaining the changes made towards eliminating the deficiencies determined within the on-site inspections. Also, if the off-site supervision function, based on the analysis of the various reports submitted by the banks, determines that the loan classification by the bank was inadequate, letters are sent to the bank to alert its management. Reclassification of the loan portfolio, pursuant to the regulation is requested. At least one external audit report mentioned that auditors were unable to obtain sufficient audit evidence that repossessed assets are stated at the lower of cost and fair value at the audited date.
EC8	The supervisor requires banks to have appropriate mechanisms in place for regularly assessing the value of risk mitigants, including guarantees, credit derivatives and collateral. The valuation of collateral reflects the net realizable value, taking into account prevailing market conditions.
Description and findings re EC8	According to the NBM's Regulation on lending activity, banks' lending policies shall include sufficient requirements with respect to collateral and other types of guarantees for the loans. The policies must describe what collateral is considered to be acceptable and sufficient. The collateral and other types of guarantees must cover the whole loan (principal and interest). The bank's policy must also reflect measures for collecting and procedures on outstanding loans. The bank's policy shall also stipulate procedures in case the bank will be foreclosed. In case of mortgages, the evaluation of real estate by an independent appraiser prior to closing the mortgage contract is mandatory (Article 8 of the Law on Mortgage). The collateral value does not diminish the bank's exposure to risks for allowance loan losses purpose, with exception of pledged cash. The supervisor evaluates during on-site examinations whether the banks set up a procedure for collateral evaluation, if collateral evaluation is performed, if the value of collateral reflects the market value of collateral, and if collateral is revalued with sufficient frequency. However, as it was mentioned in CP 17, EC 3 there are no specific requirements for banks, excepting those for repossessed assets, to have in place procedures for assessing collaterals, especially tangible collateral, by certified evaluators, based on International Valuation Standards.
EC9	Laws, regulations or the supervisor establish criteria for assets to be: (a) identified as a problem asset (e.g., a loan is identified as a problem asset when there is reason to believe that all amounts due, including principal and interest, will not be collected in accordance with the contractual terms of the loan agreement); and (b) reclassified as performing (e.g., a loan is reclassified as performing when all arrears have been cleared and the loan has been brought fully current, repayments have been made in a timely manner over a continuous repayment period and continued collection, in accordance with the contractual terms, is expected).
Description and findings re EC9	Pursuant to the IFRS accounting standards, respectively IAS 39, banks should classify impaired assets in individual loans and loans assessed collectively.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	Banks have the discretion to determine which loans are to be considered as individual loans with respect to evaluation for impairment. The amount of impairments for a pool of loans is based on a bank's ongoing loan review process and analysis of loan performance. According to the Regulation on assets and conditional commitments a loan is identified as non-performing if it has met the criteria of the last three categories of credit classification: loss, doubtful and sub-standard. Their gross amount (principal and interest) is the total of non-performing loans. The following criteria are used: days in arrears on loan repayment and financial condition of borrower. The Regulation on classification of assets defines the notion of past-due asset (assets which payment for reimbursement / settlement has been made more than 30 days after payment due under the contract). If an asset is expired and its balance is considered past-due the loan is classified. If payments on a past-due asset have been made and the asset becomes due, then such an asset may be classified as standard or under supervision depending on the circumstances. In the event that no payment has been made on such asset for another 30 days, it shall be classified above the "substandard" category, depending on the circumstances. According to article 19 of the Regulation on classification of assets, the extension and the renegotiation of an asset cannot classify the exposure into a better category than it was on the extension or renegotiation date; the asset is maintained for 3 months in the same or in a worst category depending on restructuring type (extension or renegotiation); after this period of time the asset could be reclassified. Clear conditions in which these assets could be reclassified are stipulated in the regulation (article 30), respectively: • In case of extension—for assets classified as "supervised", if the interest and the principal is paid regularly (at least monthly) and the financial performance shows a high capacity of the debtor to fulfill its commitments, these assets could be classified more favorably, while for those classified as "substandard" or "doubtful", if the interest and the principal will be paid regularly (at least monthly), these could be classified more favorably, depending on the circumstances, but not above the "supervised" category. Otherwise, a tougher classification shall be made. • In case of renegotiation - for assets classified in "substandard" or "doubtful" category, if the interest and the principal is paid regularly (at least monthly), these may be classified more favorable depending on the circumstances, but not above the "supervised" category. Otherwise, a more severe classification shall be made.
EC10	The supervisor determines that the bank's Board obtains timely and appropriate information on the condition of the bank's asset portfolio, including classification of assets, the level of provisions and reserves and major problem assets. The information includes, at a minimum, summary results of the latest asset review process, comparative trends in the overall quality of problem assets, and measurements of existing or anticipated deterioration in asset quality and losses expected to be incurred.
Description and findings re EC10	According to the Regulation on internal controls, banks should have policies and procedures in place to ensure that the Board of a bank receives timely and appropriate information on the condition of the bank's asset portfolio, including classification of credits, the level of provisioning, and non-performing loans.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	On-site supervisors determine whether bank management provides clear, concise, and timely information about the loan portfolio and its associated risks to the Board of bank, and whether the reports' descriptions of loan portfolio risks are sufficient to enable the Board to exercise its supervisory responsibilities.
EC11	The supervisor requires that valuation, classification and provisioning, at least for significant exposures, are conducted on an individual item basis. For this purpose, supervisors require banks to set an appropriate threshold for the purpose of identifying significant exposures and to regularly review the level of the threshold.
Description and findings re EC11	Pursuant to the Regulation on classification of assets, banks are expected to value, classify, and allocate, on a quarterly basis, allowances for loan losses for each exposure on an individual basis. There is no specific threshold for significant loans. Individual or related groups of individuals, for which more than one exposure is recorded, are classified into one category, based on the lowest classification amongst the individual classifications. Moreover, according to IAS 39 banks are required to determine specific adjustments for impairment identified at individual level. The threshold for assessing whether objective evidence of impairment exists individually for financial assets that are individually significant is set up by each bank according to their methodology.
EC12	The supervisor regularly assesses any trends and concentrations in risk and risk build-up across the banking sector in relation to banks' problem assets and takes into account any observed concentration in the risk mitigation strategies adopted by banks and the potential effect on the efficacy of the mitigant in reducing loss. The supervisor considers the adequacy of provisions and reserves at the bank and banking system level in the light of this assessment.
Description and findings re EC12	Within the off-site function the NBM regularly assesses trends and concentrations in risk and risk build-up across the banking sector in relation to banks' NPLs and also in impaired loans. First, the BRSD prepares on monthly basis a report on the performance of the banking system. The report describes the concentration of non-performing loans by type of customer, economic sector, currency and type of loan. A comparison of the result with the previous month, and same period of the previous year is performed. Second, BRSD prepares a monthly report (CAELS) which describes the most important changes that happened in the banking system and individual banks. Much of this report is dedicated to NPLs. Where a negative trend is identified in a bank, the Director of BRSD informs the Council of Administration of the NBM, which if applicable, decides on the necessary measures to be taken. Assessors observed during the mission that there is a large gap between IFRS allowances for impairments and allowances for debts on loans calculated for prudential purpose. Thus, IFRS allowances for impairments represented at the end of December 2013 around 46 percent from allowances for debts on loans. Moreover, at the same date, the coverage ratio at the level of total loan portfolio was very low in both cases, either based on IFRS (allowance for impairments/debt on credit -4,7 percent) or based on prudential provisions (allowances for debt on credits/debt on credits -9,7 percent) and seemed not to reflect the real quality of the portfolio. This GAP appeared due to the differences between methodologies applied by banks,

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	respectively the prudential approach based on specific standards and the accountancy methodology which provide for a more expert judgment approach. At least one audit report for 2012 mentioned that it was not possible to determine whether any adjustments in respect of the value of allowances for impairment losses on loans were necessary. From the assessors discussions with banks, it was noted a very high threshold (in a particular case around 5 million euro), compared to the market and the bank portfolio, for assessing whether an exposure could be considered as individually significant from the impairment perspective. This practice has also been confirmed by the audit companies. Moreover, the audit company interviewed by the assessors informed that, in practice, the calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure minus costs for obtaining and selling the collateral, whether or not foreclosure is probable. Also, based on banks accounting policies, future cash flows in a group of financial assets (with similar credit risk characteristics), that are collectively assessed for impairment, are estimated on the basis of the contractual cash flows of the assets and the experience of management in respect of the extent to which amounts will become overdue as a result of past loss events and the success of recovery of overdue amounts.
Assessment of Principle 18	**MNC**
Comments	Starting January 1, 2012, new IFRS accountancy framework was introduced. Impairments for loan losses are calculated based on banks internal methodologies which are expert based. The impairments level is certified by the external auditor on a bi-annual basis, while NBM supervisors examined only the accuracy of the provisions for assets and conditional commitments. According to IAS 39, impairment losses should be recognized when they are incurred, rather than as expected. An impairment loss should be regarded as incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after initial recognition. Under this standard, collateral is valued taking into account costs for obtaining and selling the collateral. At least in one audit report for 2012 it was mentioned that while the allowances for impairment losses on loans were estimated based on the expected future cash flows from the sale of pledged assets, evaluated both by independent and by internal experts, the auditor was unable to obtain sufficient audit evidence about the estimated values of sales of pledged assets. However, the NBM does not require banks to estimate a discounted or liquidation value for collateral when determining provisions. Given the declining value of real estate and the low volume of transactions on which to base current market value, it is important that NBM considers the possible impact of underestimated losses due to real estate value estimates. Another problem that banks could face, having in view that IFRS standards were recently introduced, is ensuring timely provisioning under the current accounting model which looks to identify losses that have been "incurred" but not reported in the portfolio. According to the accounting standard, write off must be reported until the whole of the entity's rights have been extinguished (by expiry of the statute of limitations period, forgiveness or other causes) or until recovery. Write-offs include reductions in the carrying value of impaired

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	financial assets recognized directly in profit or loss. According to the information presented to the assessors the volume of reported write off is still high (2.3 billion lei at the end of 2013 compared to 1.1 billion lei in 2012). According to IFRS, assets taken into possession and held for sale should be valued at lower of cost and fair value. At least in one external audit report it was mentioned that auditors were unable to obtain sufficient audit evidence that these assets are stated at the lower of cost and fair value at the audited date. The mission identified several flaws under this CP. **There are multiple cases of misclassification**. The Regulation on assets and conditional commitments classification requires banks to provision according to a fixed percentage. Loans classified as standard, supervised, sub-standard, doubtful and loss are provisioned respectively at 2 percent, 5 percent, 30 percent, 60 percent, or 100. Despite a very clear classification regime, in practice, the NBM has observed multiple cases of misclassifications. While the NBM is expecting banks to solve their problem assets by restructuring process based on economic grounds and borrowers ability and willingness to repay under the new terms of the debt, banks restructuring practices scope seems to be mainly the delay in losses recognition and consequently in foreclosure or collateral execution. **The periodicity for classification is too long.** The regulation stipulates that banks shall classify the assets and conditional commitments at least on a quarterly basis. There is no requirement to classify assets, between reporting date, in case that the quality of the asset is deteriorating. Having in view that loans are classified based on borrower financial condition and debt service, quarterly classification will not capture the downgrade from one category to another during the month within the quarter and will not properly reflect the necessary provisions. As a result, prudential ratios might be inflated. **There is a large gap between IFRS allowances for impairments loans and allowances for debts on loans calculated for prudential purpose**. Thus, IFRS allowances for impairments represents at the end of December 2013 around 46 percent from allowances for debts on loans. Moreover, at the same date, the coverage ratio at the level of total loan portfolio is very low in both cases, either based on IFRS (allowance for impairments/debt on credit - 4,7 percent) or based on prudential provisions (allowances for debt on credits/debt on credits -9,7 percent) percent) while for NPLs the coverage ratio is around 84 based on prudential provisions and 48 based on IFRS provisions. This does not reflect the real quality of the portfolio.[80] At least in one audit report for 2012, the auditor mentioned that it was unable to determine whether any adjustments in respect of the value of allowances for impairment losses on loans were necessary. Also it is worst to be mentioned that, during interviews, the mission was told by a prominent external audit company that banks pay little consideration to qualified opinions;

[80] From the assessors discussions with banks, it was noted that the threshold for assessing whether an exposure could be considered as individually significant is very high (in that particular case around Euro 5 million) compared to the market and the bank portfolio. This practice has also been confirmed by the audit companies. This could explain the big difference between the allowances for impairments and allowances for assets and conditional commitments.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	instead, banks prefer to get a qualified opinion rather than making the appropriate provisions. It is recommended to: • Amend the provisions of the regulation on assets and conditional commitments classification to require a more frequent classification at least monthly and to increase the monitoring period from three to six months in case of extended or renegotiated assets and conditional commitments. • Revise banks' accounting policy on impairments of financial assets. • Perform more oversight over compliance with IFRS, particularly for impairments.
Principle 19	Concentration risk and large exposure limits. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate concentrations of risk on a timely basis. Supervisors set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties.[81]
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have policies and processes that provide a comprehensive bank-wide view of significant sources of concentration risk.[82] Exposures arising from off-balance sheet as well as on-balance sheet items and from contingent liabilities are captured.
Description and findings re EC1	The Regulation 3/09 issued in 1995 and amended multiples times (The revised Regulation from 12/19/2013, in force from 1/24.2014) governs the large exposures limits. The regulation defines an "exposure" as an exposure arising from on and off-balance sheets that may expose the bank to credit risk. The same regulation provides further indications on "net exposure", "large exposure" and "group of inter-related persons". Besides, the NBM conducted a series of amendments to the Regulation on large exposures, which are aimed to broaden the notion of exposure, in the context of qualification of interbank assets as exposure, regardless of their maturity date, including "Nostro" accounts.
EC2	The supervisor determines that a bank's information systems identify and aggregate on a timely basis, and facilitate active management of, exposures creating risk concentrations and large exposure[83] to single counterparties or groups of connected counterparties.

[81] Connected counterparties may include natural persons as well as a group of companies related financially or by common ownership, management or any combination thereof.

[82] This includes credit concentrations through exposure to: single counterparties and groups of connected counterparties both direct and indirect (such as through exposure to collateral or to credit protection provided by a single counterparty), counterparties in the same industry, economic sector or geographic region and counterparties whose financial performance is dependent on the same activity or commodity as well as off-balance sheet exposures (including guarantees and other commitments) and also market and other risk concentrations where a bank is overly exposed to particular asset classes, products, collateral, or currencies.

[83] The measure of credit exposure, in the context of large exposures to single counterparties and groups of connected counterparties, should reflect the maximum possible loss from their failure (i.e. it should encompass actual claims and potential claims as well as contingent liabilities). The risk weighting concept adopted in the Basel capital standards should not be used in measuring credit exposure for this purpose as the relevant risk weights were devised

(continued)

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
Description and findings re EC2	According to the Regulation on "large" exposures, banks are required to have in place internal policies and procedures to identify, assess, monitor and verify the exposure portfolio concentrations. The decisions on conducting any transaction that will lead to the formation of "large" exposures are subject to management approval taken by the majority of the Bank's Board members. According to the Regulation on internal controls, the governing bodies shall identify, assess on a regular basis and determine the risk of losses in the process of carrying out transactions and constitute adequate reserves for possible losses. Banks are obligated to comply with the limits imposed by the NBM at all-time. In case banks fail to conform to the limits, the NBM can require them to take corrective measures and, where appropriate, to submit to the NBM an action plan. In case the bank does not undertake measures to comply with the limits imposed, NBM shall apply sanctions or remedial measures in accordance with Article 38 of LFI.
EC3	The supervisor determines that a bank's risk management policies and processes establish thresholds for acceptable concentrations of risk, reflecting the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff. The supervisor also determines that the bank's policies and processes require all material concentrations to be regularly reviewed and reported to the bank's Board.
Description and findings re EC3	NBM exercises both off-site and on-site monitoring of compliance with LEL. The NBM monitors the information on the concentrations of credit risk on different sectors of the economy, depending on the type of collateral, based on information obtained from banks on the credit portfolio. Also, this information is used to perform various stress test scenarios. During the on-site supervision, the NBM inspectors verify whether the banks have in place policies and procedures in this area and whether the bank complies with these. In case the bank is found to be engaged in excessive risks, the NBM requires the bank to take necessary measures to minimize them. This was evidenced through the analysis, by the BCP assessors, of a collection of inspection files.
EC4	The supervisor regularly obtains information that enables concentrations within a bank's portfolio, including sectoral, geographical and currency exposures, to be reviewed.
Description and findings re EC4	To monitor banks exposures and their concentrations, the NBM requires banks to submit quarterly the report on "large" exposures, which contains identification data of the debtor/counterparty (including group of persons acting in concert), type of guarantee, classification of the asset/conditional commitment category, total exposure, net exposure, the number of loans extensions, etc., as well as information on the compliance with the maximum limits set for exposures. At the same time, NBM obtains information on the credit portfolio and lending commitments of the bank, based on which it examines the lending activity of the bank from different aspects: types of loans granted, their concentrations in different sectors of the economy, delays associated with the collection of payments etc.

as a measure of credit risk on a basket basis and their use for measuring credit concentrations could significantly underestimate potential losses (see "*Measuring and controlling large credit exposures*, January 1991).

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
EC5	In respect of credit exposure to single counterparties or groups of connected counterparties, laws or regulations explicitly define, or the supervisor has the power to define, a "group of connected counterparties" to reflect actual risk exposure. The supervisor may exercise discretion in applying this definition on a case by case basis.
Description and findings re EC5	The Regulation on LEL contains a definition of "Group of inter-related persons": • two or more natural or legal persons who constitute a single risk because one of them, directly or indirectly, has control over the other one or other ones; and • two or more natural or legal persons between whom there is no relationship of control but who are to be regarded as constituting a single risk because they are related. For the determination of relationship between persons exposed to the same risk, the bank will take into account the following criteria, inter alia: persons in family relationship of I and II degree, the joint property ownership, the existence of common managers, the issuance of guarantees; an interdependent business relationship that can not be substituted in the short term, the fact that most businesses rely on relationships with certain people, direct or indirect holding of at least 25 percent of the voting rights or capital of the legal person. During on-site inspections, the NBM determines the concentrations within the Bank's exposures to those persons.
EC6	Laws, regulations or the supervisor set prudent and appropriate[84] requirements to control and constrain large credit exposures to a single counterparty or a group of connected counterparties. "Exposures" for this purpose include all claims and transactions (including those giving rise to counterparty credit risk exposure), on-balance sheet as well as off-balance sheet. The supervisor determines that senior management monitors these limits and that they are not exceeded on a solo or consolidated basis.
Description and findings re EC6	The NBM regulation on LEL defines the concept of "Exposures" and "large Exposure" and includes all claims and transactions "Exposures" for this purpose include all claims and transactions (only those giving rise to counterparty credit risk exposure), on-balance sheet as well as off-balance sheet., on-balance sheet as well as off-balance sheet. The set of limits for large exposures as defined by the NBM regulation are: (1) Net Exposure of the bank to a person or group of inter-related persons shall not exceed fifteen percent (15 percent) of the bank's Total Regulatory Capital. (2) The sum of the net credit exposure to the 10 biggest debtors, including groups of interrelated persons, shall not exceed 30 percent of the bank's total credit portfolio. (3) The sum of all Large Exposures shall not exceed five (5) times the bank's Total Regulatory

[84] Such requirements should, at least for internationally active banks, reflect the applicable Basel standards. As of September 2012, a new Basel standard on large exposures is still under consideration.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	Capital. There is no clear indication however, as to whether banks are required to assess measure and control credit risk concentration by sector[85] or by location. There is however a limit on currency that stipulates that the total amount of the net exposure of the bank in Moldovan Lei linked to foreign currency rate to individuals, including those practicing the entrepreneurial activity or other type of activity shall not exceed 30 percent of the total regulatory capital. Since Moldova plans to migrate to Basel II, it will be necessary to expand the scope of risks captured under the LEL regulation, including operational risks, and market risks.
EC7	The supervisor requires banks to include the impact of significant risk concentrations into their stress testing programs for risk management purposes.
Description and findings re EC7	The NBM requires banks to include the impact of significant risk concentrations into their stress testing programs for risk management purposes. According to the Regulation on internal control systems, banks must establish and maintain procedures for risk management and control, including Large Exposure Limits. Stress-test exercises include the impact of significant risk concentrations.
Additional criteria	
AC1	In respect of credit exposure to single counterparties or groups of connected counterparties, banks are required to adhere to the following: (a) ten per cent or more of a bank's capital is defined as a large exposure; and (b) twenty-five per cent of a bank's capital is the limit for an individual large exposure to a private sector non-bank counterparty or a group of connected counterparties. Minor deviations from these limits may be acceptable, especially if explicitly temporary or related to very small or specialized banks.
Description and findings re AC1	The limits in Moldova are respectively 10 percent and 15 percent. Banks must observe at all times the limits set by the NBM Regulation on large exposures.
Assessment of Principle 19	**MNC**
Comments	The NBM has established the necessary requirements, including limits for individual customers, groups of connected customers and aggregated large exposures. Moreover, the National bank has reporting arrangements to monitor bank's compliance with concentration limits. Further, during on-site inspection, NBM assessors pay due consideration to the matter and have, in several occasions, detected situations where the bank was breaching its large exposure limits. In practice however, several problems were observed that led the assessors to maintain MNC for CP 19.

[85] Assessors were told that on the basis of information gathered from banks, the NBM can see exposure concentration in different sectors in the loan portfolio and if necessary banks are notified to decrease the concentration.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	Observance by banks of the risk concentration limits is questionable. While, in the NBM's opinion, the total aggregated value of LEL is about 1.2 times the capital (far below the maximum of 500 percent), several banks in the market are using several strategies to circumvent the LEL regulation and exceed the limit of risk concentration. In the case of a domestic systemically important bank for example, the NBM detected significant problems in relation to LEL. For several credits, the bank breached the LEL far above the regulatory limit of 15 percent (84 percent for two lines of credit). Moreover, major lines of credit were extended to different companies that were inter-dependent in one way or another. NBM asked the bank to consider these companies as forming a group. Despite a thorough analysis of the inter-linkages established by the NBM, the bank (supported by the MOF) objected and refused to consider these entities as a group of inter-related persons and did not follow the LEL. Due to the poor quality of assets, the bank suffered a major loss of LEI 300 million (approx. US$ 22 million) as a result of its risk concentration on these entities. In the wake of this unfortunate event, the NBM applied a series of remedial measures (e.g., increase of capital, additional collateral, reduction of cost). The mission was told that the NBM has identified other outliers that are taking excessive risks concentration to a group of connected clients, which raises concerns on the magnitude of the problem across the system. The problem is aggravated by the fact that, at the time of the mission, a court in Chisinau had suspended some of the provisions of the LEL.[86] **Lack of transparency in ownership structure of certain banks undermines the understanding of connected lending and as a result concentration risks**. The problem mentioned above is aggravated by the fact that, for a few banks, the ownership structure is not completely established. As discussed under CP 11, most of the recent changes in ownership of Moldovan banks have not been conducted in a transparent manner and did not receive NBM clearance. **The current regulation on LEL does not contain a specific definition of risk concentration.** The NBM regulation is relatively general on the definition of what constitutes a credit concentration. It defines the notion of "exposure", "net exposure", "and large exposure" but does not precisely address the concept of "risk concentration". The latter should encompass the sub-types of credit concentrations being addressed, including exposures to same counterparties, groups of connected counterparties, and counterparties in the same economic sector, geographic region or from the same activity or commodity (these limits are however applied in practice and the NBM monitors them). The NBM may wish to review its regulation or provide further guidance to the banking industry, using as a possible reference the 2010 CEBS Guidelines on the management of concentration risk under the supervisory review process. It is noteworthy that NBM has elaborated a draft amending and supplementing the Regulation on internal control system within banks that will include requirements on risk concentration management. To improve level of compliance with CP 19, the NBM may wish to:

[86] The BCP assessors were informed that after the mission, on March 13, 2014, the requirement related to interbanks exposure, previously suspended, was restored.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	• Increase level of knowledge on banks' ownership structure. • Enforce, through greater sanctions, observance of risks concentration limits. • Improve language in the regulation on LEL by defining in more detail the concept of risk concentration.
Principle 20	**Transactions with related parties**. In order to prevent abuses arising in transactions with related parties[87] and to address the risk of conflict of interest, the supervisor requires banks to enter into any transactions with related parties[88] on an arm's length basis; to monitor these transactions; to take appropriate steps to control or mitigate the risks; and to write off exposures to related parties in accordance with standard policies and processes.
Essential criteria	
EC1	Laws or regulations provide, or the supervisor has the power to prescribe, a comprehensive definition of "related parties". This considers the parties identified in the footnote to the Principle. The supervisor may exercise discretion in applying this definition on a case by case basis.
Description and findings re EC1	Article 31 (1) of the LFI defines "related persons" including "administrators" of a bank, their spouses and relatives till 2nd degree of consanguinity, shareholders with a "substantial interest", as well as "affiliated persons". Article 3 defines "administrators" including members of the Board, of the executive body, of the audit committee, the chief accountant, managers of branches, and any other person who alone or together with other person has the legal authority to enter into commitments for account of such entity. The same Article 3 of the LFI defines "affiliated persons" as those who: a) hold control over a legal entity (*such as a bank*); b) which are under control by the legal person; c) which are under common control with the legal entity, by another legal entity; d) which are member of the Board, of the executive body, and of the Audit Committee of the legal person; e) which according to the civil legislation are related to the individual-member of the Board, of the executive body, of the Audit Committee of the legal entity- by marriage or consanguinity of first and second degrees; or f) whose affiliation is determined by the NBM in normative acts that comply with generally accepted principles on efficient banking supervision. In addition, among other relevant definitions (control, parent subsidiary, person, and, inter-alia, beneficiary owner) Article 3 of the LFI describes "significant interest" at the 5 percent threshold of equity or voting powers, including direct and indirect participation in a legal entity, or that

[87] Related parties can include, among other things, the bank's subsidiaries, affiliates, and any party (including their subsidiaries, affiliates and special purpose entities) that the bank exerts control over or that exerts control over the bank, the bank's major shareholders, Board members, senior management and key staff, their direct and related interests, and their close family members as well as corresponding persons in affiliated companies.

[88] Related party transactions include on-balance sheet and off-balance sheet credit exposures and claims, as well as, dealings such as service contracts, asset purchases and sales, construction contracts, lease agreements, derivative transactions, borrowings, and write-offs. The term transaction should be interpreted broadly to incorporate not only transactions that are entered into with related parties but also situations in which an unrelated party (with whom a bank has an existing exposure) subsequently becomes a related party.

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	makes it possible to exercise a significant influence over the management or policies of that entity. To the shares owned or controlled by a person, the shares owned or controlled by a spouse or first degree relative are to be added. Regulation 127/2013 on equity holdings provides additional definitions that are applicable such as dominant influence, close links, and acting in concert. Moreover, Regulation on large exposures provides the criteria to identify and integrate a 'group of inter-related persons. Moreover, the definition of related parties transaction includes not only credit operations but all type of on-balance and off-balance sheet exposures and claims as well as dealings such as service contracts, asset purchases and sales, construction contracts, lease agreement, borrowing and write-offs. The provisions of LFI Article 31 provide sufficient powers to the NBM to establish concentration limits and applicable conditions with related parties by regulation. These powers have been implemented by NBM enacting regulations which detail credit limits and conditions for employees and for affiliated persons, respectively (see below EC3 to EC5). In conclusion, the definition of "related parties" appears complete and the NBM has discretion in applying the definition.
EC2	Laws, regulations or the supervisor require that transactions with related parties are not undertaken on more favorable terms (e.g. in credit assessment, tenor, interest rates, fees, amortization schedules, requirement for collateral) than corresponding transactions with non-related counterparties.[89]
Description and findings re EC2	Article 31 (1) of the LFI prohibits banks to extend credit to or for the benefit of a person related to the bank on less favorable terms and conditions than those offered to unrelated persons. During on-site examinations, NMB examiners pay due attention to this prohibition by looking at the conditions under which transactions with related parties are undertaken. The mission was told that all credit granted to affiliated counterparts are subject to 100 percent scrutiny of on-site inspectors in every single inspection. For deposits exceeding 1 million LEI (approximately US$ 73K), examiners also check the applicable terms and conditions. For loan operations, the NBM also verifies the conditions under which the credit is implemented (restructuring, write-off).
EC3	The supervisor requires that transactions with related parties and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the bank's Board. The supervisor requires that Board members with conflicts of interest are excluded from the approval process of granting and managing related party transactions.

[89] An exception may be appropriate for beneficial terms that are part of overall remuneration packages (e.g. staff receiving credit at favorable rates).

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Description and findings re EC3	Moldovan regime requires banks and their Board of Directors behavioral standards that are comparable to those advocated by this EC. Boards are required to review at least once per year the transactions with affiliated persons to assess the risks involved and to eliminate any favorable conditions granted to them. The NBM told the mission that these aspects are monitored during on-site inspections.
EC4	The supervisor determines that banks have policies and processes to prevent persons benefiting from the transaction and/or persons related to such a person from being part of the process of granting and managing the transaction.
Description and findings re EC4	Such policies are formally required by NBM. The NBM informed the mission that its supervisory staff performs this determination by means of a mix of supervisory tools and activities, including the review of periodic reports prepared by the banks, and through on-site target examinations (at least once per cycle) according to the risk profile of each institution. Occasionally, the online supervisors monitor the work program and the reports issued by internal and external auditors on the subject. They also review (once per year) the minutes of the Board and the reports presented to the Board by senior management on related parties and related transactions. The assessors have been told that the off-site and on-site supervision policies and procedures include appropriate guidance to perform the reviews and activities indicated. Moreover, examination and off-site reports reviewed by the assessors contain reference to findings relating to related party transactions, including violation in certain cases that lead to enforcement measures including fines.
EC5	Laws or regulations set, or the supervisor has the power to set on a general or case by case basis, limits for exposures to related parties, to deduct such exposures from capital when assessing capital adequacy, or to require collateralization of such exposures. When limits are set on aggregate exposures to related parties, those are at least as strict as those for single counterparties or groups of connected counterparties.
Description and findings re EC5	The provisions of LFI Article 31 grant sufficient powers to the NBM to establish concentration limits and applicable conditions with related parties by regulation. These powers have been implemented by NBM enacting regulations which detail the credit limits and conditions for employees and for affiliated persons, respectively. Current regulation limits to 10 percent of total regulatory capital the total credit exposure of a bank to its employees according to a limited number of uses (personal needs and for acquisition of a residence) and a maximum amount per use. For such purposes, banks' Board are required to adopt policies and procedures, including keeping a register to record affiliated persons to the bank and a second register to record transactions with the former. On the other hand, NBM regulation No. 240 limits to 10 percent of a bank's total regulatory capital its total exposure to any affiliated person or "group of persons" acting in concert. In addition, the regulation limits the total exposures to these affiliated persons and groups of persons acting in concert to 20 percent of a bank's tier one capital. The NBM does not have explicit powers to require the deduction of risk excess with related parties from capital for capital adequacy purposes.
EC6	The supervisor determines that banks have policies and processes to identify individual exposures to and transactions with related parties as well as the total amount of exposures, and to monitor and report on them through an independent credit review or audit process. The

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	supervisor determines that exceptions to policies, processes and limits are reported to the appropriate level of the bank's senior management and, if necessary, to the Board, for timely action. The supervisor also determines that senior management monitors related party transactions on an ongoing basis, and that the Board also provides oversight of these transactions.
Description and findings re EC6	Supervisors determine via on-site examinations if banks have policies and procedures to identify, monitor and report to the board and senior management (including exceptions) exposures to related-parties and reviews the exception reports.
EC7	The supervisor obtains and reviews information on aggregate exposures to related parties.
Description and findings re EC7	Based on the information recorded in the two Registers for "affiliated persons" and for the transactions with these parties, banks are required to report periodically (quarterly) information on both transactions and parties. The report on affiliated persons includes a detailed description on each person (name, identification number), if necessary, the degree of relationship, the shares size and the functions held by an administrator, or persons at all levels of affiliation (i.e., the indirect control or the person who is under the control of another third party) and any other data that can lead to the determination of affiliated relationships between the persons specified in the list and/or others and to the identification of inter-related activities. The report on transactions with affiliated persons also includes detailed information about transaction type (loan, loan commitment, placement, security, etc.), asset/engagement classification category, date of exposure, interest rate, etc. Simultaneously, based on the information from bank's loan and loan commitment portfolio, the NBM examines bank exposure to affiliated persons. Also, during on-site inspections, NBM's inspectors verify if banks keep and update the necessary information.
Assessment of Principle 20	**MNC**
Comments	In 2008, this principle was rated MNC due to the fact that the NBM did not receive all the necessary information to assess banks' monitoring concerning lending to related parties. Over the past few years, NBM has made progress in amending the regulation applying to related parties, by transposing the EU directive through two recent regulations (#240 of December 9, 2013). Definition of related or affiliated parties, "group of persons acting in concert" and related parties transactions have been enhanced. In addition, the NBM gives due consideration to related parties' risks during its in-situ visits and on-going monitoring. As part of their prudential reporting obligations, banks are also required to submit the list of related parties and transactions associated to them on a quarterly basis and inform the NBM of any change that have occurred since the last report. The assessors are of the view that credit should be given to the authorities for improving NBM's process and due diligence in monitoring risks arising from related parties transactions. **However, there are still concerns about the effectiveness of the current supervisory**

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	regime for related parties, due in large part to the recent developments in the market. In effect, most of the recent changes in ownership of Moldovan banks have been conducted in a complete opaque manner[90] and did not receive previous NBM clearance or disapproval. As a result, undisclosed "raiders" acting in concert have been able to acquire or accumulate significant controlling stakes in banks which can impact the nature of the bank's business and potentially, their safety and soundness.[91] The issue of transparency in bank's ownership is a widespread problem; according to a prominent external audit company, only 2 banks out of 10 (excluding the foreign ones) "*have more or less a clear, transparent shareholder structure*". **The lack of information on the ultimate beneficial owner of these stakes is directly affecting the surveillance of related parties[92] and large exposure limits alike (as discussed under CP 19).** The mission was also told by a reputable External audit company that 3 banks will receive a qualified opinion in 2013 due to imprudent transactions with affiliated parties (apparently loans granted to people with no clear background). As a result, the authorities could consider the following recommendations: • The NBM should pursue its effort to identify shareholders and UBO who own controlling interest in banks. This is of particular importance considering the volume of Banks' exposures to affiliates. According to the NBM 2012 Annual Report, exposures to related parties recorded significant shares in total credits - 2.6 percent (average per sector). The ratio of exposures to affiliates and Tier I capital amounted to 13.1 percent on December 31, 2012 (maximum limit -20.0 percent of Tier I capital); • enforce the regulation more forcefully in case of grave deviations from the rules; • increase NBM monitoring on the terms and conditions applied to deposits of related parties. Currently, this monitoring applies to deposit exceeding 1 million LEI (approx. US$ 73K), which seems to be very high and may not capture all potential conflicts of interest arising from transactions with affiliated parties.
Principle 21	**Country and transfer risks**. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate country risk[93] and transfer risk[94] in their international lending and investment activities on a timely basis.

[90] In many cases, ownership was acquired piecemeal through stock market operations, in transactions just under 5 percent of the subject bank's capital, in order to intentionally circumvent the law and escape NBM vetting.

[91] See the Corporate Governance Review of the Moldovan Banking System, 2014.

[92] BCP assessors were told during their interviews with an external audit company that three banks will receive for 2013 a qualified opinion for not complying with the regulation on exposure to affiliated and connected parties.

[93] Country risk is the risk of exposure to loss caused by events in a foreign country. The concept is broader than sovereign risk as all forms of lending or investment activity whether to/with individuals, corporates, banks or governments are covered.

[94] Transfer risk is the risk that a borrower will not be able to convert local currency into foreign exchange and so will be unable to make debt service payments in foreign currency. The risk normally arises from exchange restrictions

(continued)

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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Essential criteria	
EC1	The supervisor determines that a bank's policies and processes give due regard to the identification, measurement, evaluation, monitoring, reporting and control or mitigation of country risk and transfer risk. The supervisor also determines that the processes are consistent with the risk profile, systemic importance and risk appetite of the bank, take into account market and macroeconomic conditions and provide a comprehensive bank-wide view of country and transfer risk exposure. Exposures (including, where relevant, intra-group exposures) are identified, monitored and managed on a regional and an individual country basis (in addition to the end-borrower/end-counterparty basis). Banks are required to monitor and evaluate developments in country risk and in transfer risk and apply appropriate countermeasures.
Description and findings re EC1	The need for banks to have policies and processes to identify, measure, evaluate, monitor and report country and transfer risks are stipulated in the Regulation on internal controls and Recommendations on country/transfer risk. This latter document provides guidance to banks on their obligations as it relates to the management of country/transfer risk. According to this recommendation, banks should have in place a comprehensive country/transfer risk management program comprising at least: • Supervisory policies by the Board; • Risk management policies and procedures. • Risk assessment and reporting procedures. • Processes of country risk analysis and rating of individual countries. • Procedures for determination of exposure limits for countries, currencies and entities within countries. • Regular evaluation of conditions in individual countries. • Adequate internal control mechanisms. The level of detail and sophistication must be sufficient to identify all significant exposures of the bank and bank's consolidated group to a particular country/region or currency and shall provide sufficient information to enable performance of a risk analysis and monitoring exposures. During the on-site inspections (full scope) the level of compliance with the requirements for country/transfer risk is determined. If any deviations from these requirements have been detected or the bank has engaged in excessive risk, NBM, according to stipulations of the LFI, could impose a number of measures to remedy the detected deficiencies.
EC2	The supervisor determines that banks' strategies, policies and processes for the management of country and transfer risks have been approved by the banks' Board and that the Board oversee

imposed by the government in the borrower's country. (Reference document: *IMF paper on External Debt Statistics – Guide for compilers and users*, 2003).

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.
Description and findings re EC2	The bank's Board is responsible for developing and enforcing policies that include clearly defined procedures for managing country/transfer risk (Regulation on internal controls and Recommendations on country/transfer risk) and for periodic approval, review, and implementation of an adequate internal control system related to the risk. Such policies shall define the roles and responsibilities of persons and committees within the organizational structure for country/transfer risk management. The bank's country/transfer risk management system shall provide that the exposure limits shall be submitted by the executive body to the Board for approval and further shall be communicated to the subdivisions and personnel involved. The limits shall be reviewed regularly by management. The Board and the executive body shall be informed on exceptions and reasons thereof. It is general practice for banks in Moldova to monitor country risk on an individual country basis. During the on-site inspections (full scope) it is determined that country/transfer risk is adequately monitored and managed by the Board. Any detected deviations from these requirements or bank engagement in excessive risk, could be penalized by NBM, by imposing a number of measures to address the detected deficiencies.
EC3	The supervisor determines that banks have information systems, risk management systems and internal control systems that accurately aggregate, monitor and report country exposures on a timely basis; and ensure adherence to established country exposure limits.
Description and findings re EC3	According to the Recommendations on country/transfer risk, banks shall ensure that an internal control system is in place to determine compliance with the requirements of the bank's country/transfer risk management policies and procedures, as well as to provide an evaluation of its effectiveness. Also, according to the Regulation on internal controls, banks shall have in place procedures to manage and control its activity risks, including country/transfer risk and shall ensure: adequate evaluation, management and monitoring of risks; monitoring, based on a set frequency (regularly, daily, weekly and/or monthly) the volume of risk exposures, comparing such volumes with the limits set; elaboration of reports on such monitoring, indicating the risk positions that exceeded the limits set; identification, reporting and liquidation of violations, with written explanations on actions approved vis-à-vis the exceptions to the limits; ensuring regular and due transmission of accurate and complete information to management. During the on-site inspections, the NBM determines whether banks have information systems, risk management systems and internal control systems to ensure effective monitoring and timely reporting of country risk exposures, as well as to ensure compliance with country exposure limits.
EC4	There is supervisory oversight of the setting of appropriate provisions against country risk and transfer risk. There are different international practices that are all acceptable as long as they lead to risk-based results. These include: (a) The supervisor (or some other official authority) decides on appropriate minimum provisioning by regularly setting fixed percentages for exposures to each country taking into account prevailing conditions. The supervisor reviews minimum provisioning levels where appropriate.

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	(b) The supervisor (or some other official authority) regularly sets percentage ranges for each country, taking into account prevailing conditions and the banks may decide, within these ranges, which provisioning to apply for the individual exposures. The supervisor reviews percentage ranges for provisioning purposes where appropriate. (c) The bank itself (or some other body such as the national bankers association) sets percentages or guidelines or even decides for each individual loan on the appropriate provisioning. The adequacy of the provisioning will then be judged by the external auditor and/or by the supervisor.
Description and findings re EC4	Banks are required to continuously evaluate their risks and maintain reserve funds for their coverage. The country/transfer risk exposure is mitigated by provisions of Regulation on classification of assets which states that bank exposures influenced by the circumstances and conditions in a foreign country, based on the assessment of the respective assets/conditional commitments should be provisioned as follows: (1) 2 percent—for countries that are assigned by one of the international rating agencies Standard & Poor's, Moody's or Fitch-IBCA a rating varying from AAA/Aaa to A-/A3 inclusively. (2) 5 percent—for countries that are assigned by one of the international rating agencies Standard & Poor's, Moody's or Fitch-IBCA a rating varying from BBB+/Baa1 to BBB-/Baa3 inclusively. (3) 30 percent—for countries that are assigned by one of the international rating agencies Standard & Poor's, Moody's or Fitch-IBCA a rating varying from BB+/Ba1 to BB-/Ba3 inclusively. (4) 60 percent—for countries that are assigned by one of the international rating agencies Standard & Poor's, Moody's or Fitch-IBCA a rating varying from B+/B1 to CCC- /Caa3/C inclusively. (5) 100 percent—for countries that are assigned by one of the international rating agencies Standard & Poor's, Moody's or Fitch-IBCA a rating varying from CC/Ca/ DDD to R/C/D inclusively. The lowest rating provided by one agency among others shall be taken into consideration. Countries not assessed by one of the agencies mentioned above are evaluated by the bank itself based upon its internal policies and procedures. According to the Recommendations on country/transfer risk management by the banks, the assessment of country/transfer risk must include the following aspects: (a) Examination of political risk indicators, to assess the stability (political stability; social and economic conditions; investment environment; internal and external conflicts of the country). (b) Economic Risk Indicators to assess overall economic strength (GDP per capita; GDP growth; Inflation rate; State budgeted deficit; The ration of balance of payments current account to GDP). (c) Financial Risk Indicators, to assess the ability to repay external obligations (External debt

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	to GDP ratio; Debt service to annual exports ratio; Balance of payments current account to annual exports ratio; FX reserves to cover imports (in months); Exchange rate stability). Regular analysis of a particular country must be performed (at least once per year) or more frequently if events or conditions that might influence an adverse change in the country/transfer risk profile are disclosed. The analysis must be sufficiently documented, and its conclusions sent to appropriate units within the bank in order to adjust limits if necessary. The result of the country risk analysis is to assign a sovereign rating that reflects the perceived risk profile of the country.
EC5	The supervisor requires banks to include appropriate scenarios into their stress testing programs to reflect country and transfer risk analysis for risk management purposes.
Description and findings re EC5	According to the Regulation on internal controls, the bank shall have in place procedures to manage and control its activity risks, including country risk and transfer risk. These procedures shall take into account the complexity and specifics of bank's activity. Stress tests in crisis situations for every risk type, depending on the level of assumed risk and the specifics of bank's activity, which shall include the size, complexity and diversification of bank's operations, should be conducted as a means of diagnostic tool to understand the bank risk profile.
EC6	The supervisor regularly obtains and reviews sufficient information on a timely basis on the country risk and transfer risk of banks. The supervisor also has the power to obtain additional information, as needed (e.g. in crisis situations).
Description and findings re EC6	The NBM obtains the country exposure reports for individual banks on daily, monthly and/or quarterly basis according to the instructions for reporting FX operations. These reports contain detailed information for on and off-balance sheet exposure by type of obligor (government, banking, other), currency, etc. These reports are: (1) Report on foreign currency purchase and sale operations performed by the licensed bank; (2) Report on "FX loans and credits of the licensed bank"; (3) Report on FX guarantees of the licensed bank; (4) Report on licensed bank's operations with cash in foreign currency and traveler's checks in foreign currency; (5) Report on "Loans/credits related to direct investments in the Republic of Moldova received by the licensed bank"; (6) Report on "Operations according to the loan/credit contracts related to direct investments in the Republic of Moldova received by the licensed bank"; (7) Report on "Foreign securities of the licensed bank"; (8) Report on "Correspondent accounts and other placements of the licensed bank". The NBM regularly checks the accuracy and analyze these reports for levels of significant variations and trends. These analyses are supplemented by a more thorough review of country/transfer risk exposure during on-site examinations. The NBM is entitled (Articles 44 and 47 of the LNBM) to require also any information necessary for the purpose of supervision and regulation of bank's activity, including the verification and

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	monitoring of banks' country/transfer risk exposure. For example, in March 2013, the NBM requested information in respect to exposures and obligations to residents of Cyprus or parties related to them.
Assessment of Principle 21	**LC**
Comments	In the 2008 FSAP it was recommended to ensure accurate implementation of the new NBM recommendation covering off-balance sheet exposure in foreign currency. The NBM stipulates clear provisions within the Regulation on internal control and in the Recommendation on country/transfer risk management that banks should have in place internal procedures for managing such risk and shall perform regular analysis of a particular country or more frequently if events or conditions that might influence an adverse change in the country/transfer risk profile are disclosed. The mission learned that since 2012-2013, several banks have been excessively exposed through inter-bank placements to banks from one neighboring country. It seems that these banks either breached the internal counterpart limits or these limits were set up without any sound internal assessment of the related risks. Although excessive country risk exposure was identified at the level of a number of banks, no measures were imposed by NBM to address this issue. The NBM should : • continue to promote adequate policies and practices for country/transfer risk management; and • implement and require more stringent limits in terms of individual exposure lower than those related to large exposure.[95]
Principle 22	**Market risk**. The supervisor determines that banks have an adequate market risk management process that takes into account their risk appetite, risk profile, and market and macroeconomic conditions and the risk of a significant deterioration in market liquidity. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate market risks on a timely basis.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have appropriate market risk management processes that provide a comprehensive bank-wide view of market risk exposure. The supervisor determines that these processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank; take into account market and macroeconomic conditions and the risk of a significant deterioration in market liquidity; and clearly articulate the roles and responsibilities for identification, measuring, monitoring and control of market risk.

[95] The requirement envisaged the current excessive country risk exposure identified at the level of a number of banks that imply more stringent limits where is the case (especially for exposure against Russian banks) than those established by Regulation on large exposure. The good practices on risk management said that when setting counterparty limits banks should have in view the level of the risk exhibited by each counterpart.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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Description and findings re EC1	All requirements regarding risk management stem from the Regulation on Internal controls (article 30), where banks are required to have procedures to manage and control all risks, and review these regularly. In addition, there are regulations on bank's open FX position and on managing interest rate risk. There are no requirements for identifying, monitoring and managing market risk in the trading book. However, Moldova has not yet adopted the Market Risk Amendment and therefore banks do not have trading books. Banks are mainly exposed to interest rate and FX risk. The Regulation on FX positions require limits for open positions by currency and in total and provides the method for calculating banks' open FX positions. The Regulation on interest rate risk, states that banks must have a policy of interest rate risk management tailored to its individual requirements, including setting limits on interest rate risk, taking into consideration the size of bank capital. This policy shall be periodically reviewed (at least annually) in order to determine whether the limits for bank's exposure to interest rate risk correspond to the current situation, taking into account the total regulatory capital. During the on-site examination, the supervisor evaluates the bank's system for identifying risk, reviews the strategy, policy and procedures and assesses if the bank is compliant with the regulation.
EC2	The supervisor determines that banks' strategies, policies and processes for the management of market risk have been approved by the banks' Board and that the Board oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.
Description and findings re EC2	The Regulation on internal controls stipulate in general that the Board approve the banks' strategy, policies and procedures and oversees management of all risks, including interest rate risk, FX risk (article 30). During the on-site examination the supervisor reviews the minutes of the Board and all other committees of the bank to make sure that policies and procedures are reviewed regularly by these bodies and they receive periodic information regarding the management of these risks. Specific work programs and procedures in this respect are included in the on-site supervision manual. Approval of specific limits is generally the responsibility of the bank's management or of the Assets and Liabilities Committee (ALM Committee). Also, based on the reports submitted by the banks, the NBM monitors: • Limits on FX position, also the compatibility of the activities conducted by the bank with Article 26 of the LFI (Report on the Bank's open currency position - submitted daily). • Equity investments (quarterly). • Maturity mismatches, depending on the sensitivity of assets, liabilities and off-balance sheet items to interest rate (FIN27 report—Exposure to interest rate risk - submitted quarterly).
EC3	The supervisor determines that the bank's policies and processes establish an appropriate and properly controlled market risk environment including: (a) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of market risk exposure to the bank's Board and senior management; (b) appropriate market risk limits consistent with the bank's risk appetite, risk profile and capital strength, and with the management's ability to manage market risk and which are understood by, and regularly communicated to, relevant staff; (c) exception tracking and reporting processes that ensure prompt action at the appropriate

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	level of the bank's senior management or Board, where necessary; (d) effective controls around the use of models to identify and measure market risk, and set limits; and (e) sound policies and processes for allocation of exposures to the trading book.
Description and findings re EC3	According to the provisions of Regulation on Internal controls, banks shall have in place procedures to manage and control its risks, which may appear within bank's activity. These procedures must ensure: implementation of bank policies related to the management and control of its activity risks; adequate evaluation, management and monitoring of risks; continuous identification and evaluation of bank position against the risks assumed; reporting to bank management bodies of all risk exposures with the view to take adequate decisions on identified significant risks assumed by the bank; undertaking of necessary measures to mitigate and limit bank's exposures to risks that affect achievement of bank objectives; identification and monitoring of risks related to new products and activities and significant modifications of current products characteristics and activities, like operational flow of activity performance; performance of crisis stress tests for each risk type depending on the level of assumed risk and the specifics of the bank's activity, which includes dimension, complexity and diversification of bank's operations. The banks must carry out stress tests as a diagnostic to understand the bank risk profile. Banks are required also to have adequate information systems to identify, aggregate, monitor and report in general and specific for interest rate risk and FX risk for the banking book, including reporting and controlling. During on-site examination the supervisor assesses if these policies, procedures and reporting are in place. There are no requirements for banks to have limits specific for FX risk, because the NBM has fixed these limits. First, the total net open foreign position of the bank at the end of every business day should not exceed 20 percent of its regulatory capital. Second, the net open foreign position in every foreign currency at the end of every business day should not exceed 10 percent of its regulatory capital. There are no limits required with regard to interest rate risk.
EC4	The supervisor determines that there are systems and controls to ensure that banks marked-to-market positions are revalued frequently. The supervisor also determines that all transactions are captured on a timely basis and that the valuation process uses consistent and prudent practices, and reliable market data verified by a function independent of the relevant risk-taking business units (or, in the absence of market prices, internal or industry-accepted models). To the extent that the bank relies on modeling for the purposes of valuation, the bank is required to ensure that the model is validated by a function independent of the relevant risk-taking businesses units. The supervisor requires banks to establish and maintain policies and processes for considering valuation adjustments for positions that otherwise cannot be prudently valued, including concentrated, less liquid, and stale positions.
Description and findings re EC4	As noted above, the NBM applies Basel I and thus the risk management framework of the market risk amendment is not applied. While limits are set for FX risk, capital charges are not imposed. Nonetheless, the NBM has established risk management requirements for a number of market risk related issues. The Regulation on Internal controls applies risk management standards to market related risks including, internal control systems; procedures for planning, authorizing and initiating new

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	activities, methods for monitoring the volume of risk exposures, etc. These limits shall comply with transaction time, volume and type and shall include, where appropriate, data on counterparts, economic branches, country geographical positioning, liquidity, deviation of interest rates and position limits on securities as well as limits on open positions (over the day and overnight) on FX operations, futures, options, swaps, etc. The level of the Held for trading portfolio is insignificant within Moldovan banking system. The portfolio is valued according to the IFRS market based approach. The Manual on on-site controls lists the procedures to be carried out in the area to verify proper valuation of market risk positions. Thus, during on-site inspections, supervisors determine whether banks properly classify their assets according to accountancy standards. As regarding the classification of transactions with local banks and foreign banks, the banks usually appoint a responsible person who compiles all the necessary information in a file for each counteragent, and based on the information gained (financial reports, various indicators, rating awarded by the appropriate institutions, etc.) creates the suitable provision. For the purpose of prudential supervision and negative impact mitigation of a potential banking crisis, stress testing is performed quarterly on each bank, group of banks and the banking system by Special supervision and off-site division.
EC5	The supervisor determines that banks hold appropriate levels of capital against unexpected losses and make appropriate valuation adjustments for uncertainties in determining the fair value of assets and liabilities.
Description and findings re EC5	Banks classify their assets and submit the report to the NBM on a quarterly basis. The balance sheet (FIN1, which reflects the assets minus depreciation on IFRS) and various other FIN reports are submitted monthly. Based on reported data, the NBM verifies the size, quality and provisions of the bank's assets and calculates the total regulatory capital and capital adequacy. During the on-site inspections, inspectors verify the accuracy of the classification of assets and conditional commitments, deducting the loss allowances from the capital and adjusting the capital adequacy calculation. Both the NBM and banks perform stress tests which can lead to the NBM requiring the bank to undertake remedial measures depending on the results for capital and capital adequacy. According to the documents presented to the assessors this measure was rarely imposed.
EC6	The supervisor requires banks to include market risk exposure into their stress testing programs for risk management purposes.
Description and findings re EC6	According to the Regulation on Internal controls (article 30.8), banks must perform stress tests in crisis situations for each risk type, taking into account the level of assumed risk and the specifics of bank's activity, which includes the size, complexity and diversification of bank's operations.
Assessment of Principle 22	**LC**
Comments	In the 2008 FSAP it was recommended to continue to promote adequate policies and practices for risk management and encourage banks to perform effective stress testing covering significant risks and also to implement a capital charge on market risk. Through the Regulation on internal controls, the NBM has established policies and procedures that clearly articulate roles and responsibilities related to identification, measuring, monitoring

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	and control of market risk but only in relation with FX risk (Regulations on banks' open FX positions) and Interest rate risk. The NBM does require banks to do stress tests for FX risk and IRR (see Regulation on internal controls). Also, the NBM required limits for FX position and IRR but didn't require banks to use a Basel I methodology to calculate the capital requirement for market risk, at least for FX positions (banks should be required to hold 8 percent capital against global net FX positions). Also, the NBM is in the process of starting the implementation of Basel II/III under a Twinning program. To align the provisions of the above-mentioned agreements, taking into account the risk profile of the country, new capital requirements have been introduced (capital adequacy shall be more than 16 percent and Total Regulatory Capital—minimum MDL 200.0 million). The NBM should continue to: • Promote adequate policies and practices for market risk management, including an independent risk management function. • Include in the draft Regulation on internal control system requirements for managing market risks in the trading book.
Principle 23	**Interest rate risk in the banking book**. The supervisor determines that banks have adequate systems to identify, measure, evaluate, monitor, report and control or mitigate interest rate risk[96] in the banking book on a timely basis. These systems take into account the bank's risk appetite, risk profile and market and macroeconomic conditions.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have an appropriate interest rate risk strategy and interest rate risk management framework that provides a comprehensive bank-wide view of interest rate risk. This includes policies and processes to identify, measure, evaluate, monitor, report, and control or mitigate material sources of interest rate risk. The supervisor determines that the bank's strategy, policies and processes are consistent with the risk appetite, risk profile and systemic importance of the bank, take into account market and macroeconomic conditions, and are regularly reviewed and appropriately adjusted, where necessary, with the bank's changing risk profile and market developments.
Description and findings re EC1	Banks are required to have in place (article 30 of the Regulation on internal controls) procedures to manage and control its activity risks, including interest rate risk consistent with the nature, volume and complexity of their activities. In this respect NBM issued a specific Regulation on managing interest rate risk. Both regulations (article 13 and 14 of Regulation on internal controls and article 11 of Regulation on managing interest rate risk issued in 1999 and

[96] Wherever "interest rate risk" is used in this Principle the term refers to interest rate risk in the banking book. Interest rate risk in the trading book is covered under Principle 22.

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	amended in 2001 and 2008) stipulate that policies are: • subject to the Board approval; • implemented by the executive bodies; and • subject to regular review. The policy must contain basic elements, such as adequate supervision by the Board and executive body and a complex process of risk management, which effectively establishes, evaluates and supervises the risk. During the on-site inspections, the NBM inspectors analyze whether bank's policies and procedures on interest rate risk management are in place, assess the quality and effectiveness of these policies, as well as check whether the Board has reviewed the policies at least annually. Banks with a high level of exposure to interest rate risk and/or inappropriate methods of risk control are required to take corrective actions. Also, stress tests on interest rate risk are performed, gap analysis being commonly used by banks, to see the impact on the bank. NBM monitors also the risk off-site through reports requested from banks with a monthly frequency.
EC2	The supervisor determines that a bank's strategy, policies and processes for the management of interest rate risk have been approved, and are regularly reviewed, by the bank's Board. The supervisor also determines that senior management ensures that the strategy, policies and processes are developed and implemented effectively.
Description and findings re EC2	The NBM assesses strategy, policies and processes during each full on-site inspection, including through review of Board documents. The NBM regulations stipulate that policies and procedures should be approved and reviewed by the Board, and if the inspection finds a failure to meet this standard, corrective measures are imposed. The ALCO (committee on assets and liabilities management) is responsible for drafting policy of interest rate risk management and for its submission to the Board for approval. This policy shall include combined management of different risks such as: interest rate risk, liquidity risk, maturity risk; provisions regarding to the compliance with NBM regulations; controls on implementation. The activity of the ALCO is reviewed during on-site inspections, by examining ACLO reports, the accuracy of information filled in the report on exposure to interest rate risk (FIN 27), internal methods used to measure interest rate risk, and the quality of the management in terms of interest rate risk management. The FIN 27 report was introduced in January 1, 2012, and presents the financial assets and liabilities which are sensitive to interest rates, at their carrying value, classified by the earliest date from the contractual date of interest rate change or maturity date (up to a month, including 1–2 months, including, etc). Also, a detailed analysis of interest rate risk is presented in the annual audited report which is submitted to the NBM no later than April 30 of each year and is published on the bank's website. This information is cross checked by the NBM.
EC3	The supervisor determines that banks' policies and processes establish an appropriate and properly controlled interest rate risk environment including: (a) comprehensive and appropriate interest rate risk measurement systems; (b) regular review, and independent (internal or external) validation, of any models used by the functions tasked with managing interest rate risk (including review of key model assumptions);

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	(c) appropriate limits, approved by the banks' Board and senior management, that reflect the banks' risk appetite, risk profile and capital strength, and are understood by, and regularly communicated to, relevant staff; (d) effective exception tracking and reporting processes which ensure prompt action at the appropriate level of the banks' senior management or Board where necessary; and (e) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of interest rate risk exposure to the banks' Board and senior management.
Description and findings re EC3	During the on-site examination, the supervisor assesses if the bank has in place an adequate system for measuring interest rate risk, whether the policies are approved by the Board and implemented by the executive bodies and regularly reviewed; instructions on the level of interest rate risk accepted by the bank, including limits on the interest rate risk for assets, liabilities and off-balance sheet accounts are in place; appropriate internal controls and provisions are included in the internal audit program of the bank to ensure the integrity of the management process of the bank's general risk, including interest rate risk; effective information system for accurate and timely identification, aggregation, monitoring and reporting to the ALCO Committee and consequently to Board.
EC4	The supervisor requires banks to include appropriate scenarios into their stress testing programs to measure their vulnerability to loss under adverse interest rate movements.
Description and findings re EC4	Pursuant to the provisions of the Regulation on managing interest rate risk (11.9, article 2), banks are required to perform regular (at least quarterly) stress test for interest rate risk. Banks mainly use gap analysis. These tests must include a "worst case" scenario. During the on-site inspections, the NBM inspectors check whether stress tests are conducted and analyze the scenarios that were modeled, as well as the conclusions and proposals being recommended.
Additional criteria	
AC1	The supervisor obtains from banks the results of their internal interest rate risk measurement systems, expressed in terms of the threat to economic value, including using a standardized interest rate shock on the banking book.
Description and findings re AC1	During the on-site inspections, supervisor determine whether banks conduct stress tests for interest rate risk, by evaluating and analyzing the correctness of scenarios used, as well as verifying the correct implementation of the measures. However, banks do not report these results to the NBM by any reports or requirements. There are not requirements for banks to compute and submit to NBM the results of their internal interest rate risk measurement systems, expressed in terms of the threat to economic value, including using a standardized interest rate shock on the banking book. The assessors were informed that the on-site inspection teams include a member of the NBM's Crisis management and prevention section who is responsible for verifying the bank's stress test data.
AC2	The supervisor assesses whether the internal capital measurement systems of banks adequately capture interest rate risk in the banking book.
Description and	This criterion does not apply as Moldova was using the Basel I standard at the time of

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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findings re AC2	assessment.
Assessment of Principle 23	**LC**
Comments	The regulatory framework for interest rate risk management is generally adequate, providing a good mix of qualitative and quantitative requirements and also general standards for conducting stress test scenario (mainly gap analysis). Moreover, banks are required to publish on their website FIN 27—report on interest rate risk. However, in the Regulation on internal controls there are no specific requirements for an independent risk management function and no detailed guidelines for conducting stress tests. There are no requirements for banks to compute and submit to NBM the results of their internal interest rate risk measurement systems, expressed in terms of the threat to economic value, including using a standardized interest rate shock on the banking book. More detailed guidelines to banks for interest rate risk management are in draft. The NBM is encouraged to promote adequate policies and practices for interest rate risk management and to have in place adequate risk management processes, including an independent risk management function. It is also recommended to: • Prescribe more clear provisions for banks to calculate potential changes in their economic value resulting from changes in the levels of interest rates, in accordance with their risk profile and risk management policies, • Require banks to compute and report to the NBM the change in their economic value as a result of applying a sudden and unexpected change/changes in interest rates standard shock prescribed by the NBM (for example a 200 basis point shock, in both directions, regardless of the currency).
Principle 24	**Liquidity risk**. The supervisor sets prudent and appropriate liquidity requirements (which can include either quantitative or qualitative requirements or both) for banks that reflect the liquidity needs of the bank. The supervisor determines that banks have a strategy that enables prudent management of liquidity risk and compliance with liquidity requirements. The strategy takes into account the bank's risk profile as well as market and macroeconomic conditions and includes prudent policies and processes, consistent with the bank's risk appetite, to identify, measure, evaluate, monitor, report and control or mitigate liquidity risk over an appropriate set of time horizons. At least for internationally active banks, liquidity requirements are not lower than the applicable Basel standards.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to consistently observe prescribed liquidity requirements including thresholds by reference to which a bank is subject to supervisory action. At least for internationally active banks, the prescribed requirements are not lower than, and the supervisor uses a range of liquidity monitoring tools no less extensive than, those prescribed in the applicable Basel standards.
Description and findings re EC1	For the purpose of promoting a sound and competitive financial sector, avoiding excessive risks in the financial system, protecting the interests of depositors and ensuring the availability of an adequate level of bank liquidity banks are required by LFI (article 28) and Regulation on bank's liquidity to implement policies and practices in order to maintain an adequate level of liquidity

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	but no less than the coefficient of liquidity ratios, accordingly banks shall comply with the following requirements related to liquidity: Principle I—the amount of a bank's assets, with a remaining maturity period of more than two years, shall not exceed the amount of its financial resources (defined in Regulation) = long-term liquidity; Principle II—the liquid assets shall not be less than 20 percent of the bank's total assets = Short–term liquidity. Banks must comply with the limits of short- and long-term liquidity and must report their liquidity position monthly. Compliance with the principles is monitored either through off-site supervision (through the reports submitted monthly by banks—long-term liquidity, and daily - current liquidity) or during the on-site examinations.
EC2	The prescribed liquidity requirements reflect the liquidity risk profile of banks (including on- and off-balance sheet risks) in the context of the markets and macroeconomic conditions in which they operate.
Description and findings re EC2	The NBM Regulation on bank's liquidity establishes principles for the maturities of assets and liabilities. Compliance with the required maturities reduces liquidity risk as well as risk from interest rate movements. Principle I of liquidity is an indirect method of liquidity control, by limiting the maturity mismatch between illiquid long-term assets and short-term liabilities. Principle II establishes minimum level of liquid assets which is considered to be appropriate. Off-balance sheet commitments are not included in the liquidity requirements, however. In reviewing liquidity management examiners check, inter alia, the following: the existence of appropriate policies and procedures; compliance with bank policies; methods of liquidity and interest rate risk management; effective planning including the extent and sufficiency of planning long-term liquidity and the financing needs of the bank; and adequacy of the internal audit function of the bank regarding the liquidity and interest rate risk management etc. The adequacy of oversight carried out by the Board, the executive body and ALCO is also assessed through the analysis of the quality and frequency of information contained in relevant documents. The NBM, through the Council of Administration, can establish individual liquidity requirements for each bank, responding to the specific profile and including both quantitative and qualitative elements. In the period 2009-2013 NBM imposed limits for liquidity ratios in two cases.
EC3	The supervisor determines that banks have a robust liquidity management framework that requires the banks to maintain sufficient liquidity to withstand a range of stress events, and includes appropriate policies and processes for managing liquidity risk that have been approved by the banks' Board. The supervisor also determines that these policies and processes provide a comprehensive bank-wide view of liquidity risk and are consistent with the banks' risk profile and systemic importance
Description and findings re EC3	The Regulation on banks' Liquidity (chapter 3), requires banks to have an appropriate liquidity management policy, procedures and internal guidelines on the assessment, monitoring and ongoing maintenance of a sufficient level of liquidity, but not less than the coefficient of liquidity provisions ratios. Moreover, the Regulation on Internal controls (Article 13), states

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	that the Board is fully responsible for approving adequate and efficient internal control systems and for ensuring regular reviewed. According to law and regulation, banks are required to have sufficient liquidity to withstand a range of stress events (Regulation on banks' liquidity chapter 3). This tool tests the way banks react to unfavorable developments in the banking sector regarding liquidity. In case of any deviations from the prudential regulations on liquidities or if the bank has a low level of liquidity, the management of the bank is informed and required to take corrective measures. Further, there is a list of requirements regarding liquidity risk management, including organizational structure, policies, procedures, internal limits, contingency funding plan, identifying and monitoring (Regulation on bank's liquidity chapter 3). Through off-site and on-site monitoring the NBM determines banks' compliance. During the on-site examination the supervisors assess the minutes of the ALCO meetings and relevant decisions of all governing bodies relating to liquidity risk management. Liquidity is a key component in the CAMELS rating and receives significant attention from the NBM. A review by the assessors of examination reports and related annexes, disclosed detailed analysis and discussions of liquidity.
EC4	The supervisor determines that banks' liquidity strategy, policies and processes establish an appropriate and properly controlled liquidity risk environment including: (a) clear articulation of an overall liquidity risk appetite that is appropriate for the banks' business and their role in the financial system and that is approved by the banks' Board; (b) sound day-to-day, and where appropriate intraday, liquidity risk management practices; (c) effective information systems to enable active identification, aggregation, monitoring and control of liquidity risk exposures and funding needs (including active management of collateral positions) bank-wide; (d) adequate oversight by the banks' Board in ensuring that management effectively implements policies and processes for the management of liquidity risk in a manner consistent with the banks' liquidity risk appetite; and (e) regular review by the banks' Board (at least annually) and appropriate adjustment of the banks' strategy, policies and processes for the management of liquidity risk in the light of the banks' changing risk profile and external developments in the markets and macroeconomic conditions in which they operate.
Description and findings re EC4	In the Regulation on banks' liquidity, several requirements are stipulated. Thus, an adequate policy shall include: appropriate information systems on the assessment, monitoring and reporting the level of liquidity; stress tests to identify the weaknesses and potential vulnerabilities of bank's liquidity level in unforeseeable conditions; management plans for different stress scenarios on liquidity for unforeseen circumstances; and liquidity risk management. The regulation on bank's liquidity does not require banks to establish intraday liquidity risk management practices. During on-site examinations supervisors assess whether the Board has drafted strategy, policy, procedures and a methodology for measuring and controlling liquidity risk, as well as whether this is regularly reviewed. The NBM therefore assesses whether the bank is operating according

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	to its own established procedures and achieving the objectives set.
EC5	The supervisor requires banks to establish, and regularly review, funding strategies and policies and processes for the ongoing measurement and monitoring of funding requirements and the effective management of funding risk. The policies and processes include consideration of how other risks (e.g., credit, market, operational and reputation risk) may impact the bank's overall liquidity strategy, and include: (a) an analysis of funding requirements under alternative scenarios; (b) the maintenance of a cushion of high quality, unencumbered, liquid assets that can be used, without impediment, to obtain funding in times of stress; (c) diversification in the sources (including counterparties, instruments, currencies and markets) and tenor of funding, and regular review of concentration limits; (d) regular efforts to establish and maintain relationships with liability holders; and (e) regular assessment of the capacity to sell assets.
Description and findings re EC5	The Regulation on banks' liquidity (chapter 3) stipulates that the Board should review the liquidity policy. Procedures and internal instructions on information systems must ensure that the bank's liquidity is duly assessed and examined by bank administration to take appropriate decisions on liquidity management. Such systems must have the ability to calculate liquidity positions in all currencies in which the bank operates, future cash flows, as well as to be flexible to adapt them to various unforeseen circumstances that may occur. Supervisors verify whether the banks have met the terms of the liquidity regulation through on-site examination. The capacity to sell liquid assets is not required to be assessed by the bank. Also, according to the Regulation, the bank is required to have risk management and control procedures, including performing stress tests for every risk type depending on the level of risk assumed. Again, NBM inspectors verify this aspect during on-site inspection. NBM inspectors also assess the activity of the ALCO Committee and the process of managing the assets, liabilities and off-balance sheet positions, in order to determine whether the management plans adequately the liquidity needs and whether the bank can effectively cover the anticipated and potential liquidity needs. Inspectors also verify the accuracy of preparing the reports on the interest rate and liquidity (including whether the 20 percent of liquid assets required by Liquidity Principle II includes encumbered liquid securities). The NBM also checks all bank loans and placements, their profitability and necessity, the proper classification, interest rates charged, etc. Based on Article 28 of the LFI and according to the Regulation on FX, banks are obliged to observe certain limits. Based on the daily and monthly reports submitted by banks, the supervisors verify the observance of the limits established by NBM, as well as the positions to the main foreign currencies traded by the bank (euro, USD, Russian ruble). Correspondent banks are required to confirm the balances, whether these are encumbered by any rights, the holding period, etc. In the context of banks' concentration of placements in certain counterparties, BRSD made changes in the Regulation on large exposures, according to which "large" exposures are considered any investment, regardless of its maturity, including Nostro accounts in the banks with ratings worse than BBB-/Baa3. The deadline for compliance is end June 2014. These new

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	provisions will be closely monitored during off-site supervision and examined during on-site inspections.
EC6	The supervisor determines that banks have robust liquidity contingency funding plans to handle liquidity problems. The supervisor determines that the bank's contingency funding plan is formally articulated, adequately documented and sets out the bank's strategy for addressing liquidity shortfalls in a range of stress environments without placing reliance on lender of last resort support. The supervisor also determines that the bank's contingency funding plan establishes clear lines of responsibility, includes clear communication plans (including communication with the supervisor) and is regularly tested and updated to ensure it is operationally robust. The supervisor assesses whether, in the light of the bank's risk profile and systemic importance, the bank's contingency funding plan is feasible and requires the bank to address any deficiencies.
Description and findings re EC6	The NBM requires banks to prepare contingency plans, which specify the measures to be taken in the event of a liquidity crisis. Also, these plans must indicate the structures responsible for decision-making process and the units responsible for monitoring and reporting of risks. The quality of the bank's risk management and controls, including contingency planning, is assessed primarily during on-site inspections. In case of detection of deficiencies in these plans, NBM could require banks to adjust them so that they are consistent with their risk profile.
EC7	The supervisor requires banks to include a variety of short-term and protracted bank-specific and market-wide liquidity stress scenarios (individually and in combination), using conservative and regularly reviewed assumptions, into their stress testing programs for risk management purposes. The supervisor determines that the results of the stress tests are used by the bank to adjust its liquidity risk management strategies, policies and positions and to develop effective contingency funding plans.
Description and findings re EC7	The Regulation on banks' Liquidity stipulates that plans for the management of different stress scenarios on liquidity for unexpected circumstances shall include: various options to provide a clear picture of available measures on liquidity management in unexpected situations; internal procedures that allow bank management to take timely and well as reasoned decisions and to implement prompt and effective measures in unexpected situations. During the on-site examinations, stress-tests conducted by the bank are checked by NMB inspectors to ascertain whether it is specific to the condition and the bank's activity, whether the modeled scenarios are representative and appropriate and whether the conclusions and proposals are reasoned and concretely on the topic or they have a general nature, etc. Any deficiencies or weaknesses, identified during on-site inspections are noted in the inspection report and recommendations are made to the bank to revise its models.
EC8	The supervisor identifies those banks carrying out significant foreign currency liquidity transformation. Where a bank's foreign currency business is significant, or-the bank has significant exposure in a given currency, the supervisor requires the bank to undertake separate analysis of its strategy and monitor its liquidity needs separately for each such significant currency. This includes the use of stress testing to determine the appropriateness of mismatches in that currency and, where appropriate, the setting and regular review of limits on the size of its cash flow mismatches for foreign currencies in aggregate and for each significant currency individually. In such cases, the supervisor also monitors the bank's liquidity needs in each significant currency, and evaluates the bank's ability to transfer liquidity from one currency

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	to another across jurisdictions and legal entities.
Description and findings re EC8	In order to reduce FX risk (Regulation on FX), the NBM has established the following limits: (a) long open FX position ratio for each foreign currency shall not exceed "+10 percent"; (b) short open FX position ratio for each foreign currency shall not be less than "-10 percent"; (c) sum of long open FX position ratios for all currencies shall not exceed "+20 percent"; (d) sum of short open FX position ratios for all currencies shall not be less than "-20 percent." Also, the ratio of the sum of balance-sheet assets in foreign currency and the sum of balance-sheet liabilities in foreign currency shall not exceed '+25 percent" or be less than "-25 percent". The liquidity stress test in foreign currency, conducted quarterly by the NBM, assesses the liquidity of the banking system on the basis of inflows and outflows of liquid assets for the duration of a month, taking into account the systemic impact of a liquidity crisis. Individual shocks are applied for each inflow and outflow to simulate the stress scenario, and to create a more realistic scenario the connection with the solvency of each bank is taken into account.
Additional criteria	
AC1	The supervisor determines that banks' levels of encumbered balance-sheet assets are managed within acceptable limits to mitigate the risks posed by excessive levels of encumbrance in terms of the impact on the banks' cost of funding and the implications for the sustainability of their long-term liquidity position. The supervisor requires banks to commit to adequate disclosure and to set appropriate limits to mitigate identified risks.
Description and findings re AC1	According to the reporting instructions issued to banks (December 2011), encumbered assets may not be included in the calculation of Principle II (current liquidity). In order to verify the accuracy of liquid assets reported by the bank, the NBM requires confirmation of non-encumbrance by the bank's counterparties. This practice was also confirmed by the external auditor interviewed by the assessors.
Assessment of Principle 24	**LC**
Comments	In the 2008 FSAP it was recommended that NBM's on-site inspectors should ensure that banks undertake effective analysis of risk under currently valid, alternative stress test scenarios. The regulatory framework for liquidity management is generally adequate, providing a good mix of qualitative and quantitative requirements and also for conducted stress test scenario; moreover. Further, banks are required to prepare FIN 26—report on liquidity risk. In Moldova, the highest liquidity risk is the counterparty risk, because in few banks the liquidity buffer mainly consists in placements with foreign banks. Moreover, in case of few banks it was noticed that there is a practice of circumvented of the NBM Regulation on bank's liquidity by taken deposits from cross-border banks on a long term and placing them on a short term just in order to meet the requirements of Liquidity Principle II (short-term liquidity). The mission identified several flaws under this CP: The off-balance sheet commitments are not included in the prudential liquidity requirements; consequently the risk profile of the bank did not capture risks arising from these exposures.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	Under the new reporting framework FIN 26 financial guarantees are taken into account when determining liquidity gaps. The regulation on bank's liquidity does not require banks to have appropriate intraday liquidity risk management practices and to take into account off-balance sheet commitments. The capacity to sell liquid assets is not required to be assessed by banks. More detailed guidelines to banks for liquidity risk management are in draft. In addition, in the draft Regulation for internal controls there are no specific requirements for banks to: • have in place an independent risk management function; • assess the capacity to sell liquid assets; • have in place an adequate liquidity buffer aligned with the risk tolerance of the bank; and • have formal alternative funding plans. The NBM is encouraged to: • Complete amendments to the Regulation on internal control system and in the liquidity risk management to prescribe banks to (i) regularly assess their capacity to sell liquid assets; (ii) have in place an adequate liquidity buffer aligned with the risk tolerance of the bank; (iii) establish formal alternative funding plans; (iv) set limits to manage day-to-day liquidity; and (v) set limits on correspondent banks. • Amend the regulation on liquidity to take into account the off-balance sheet commitments when determining liquidity ratios.
Principle 25	**Operational risk**. The supervisor determines that banks have an adequate operational risk management framework that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, assess, evaluate, monitor, report, and control or mitigate operational risk[97] on a timely basis.
Essential criteria	
EC1	Law, regulations or the supervisor require banks to have appropriate operational risk management strategies, policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk. The supervisor determines that the bank's strategy, policies and processes are consistent with the bank's risk profile, systemic importance, risk appetite and capital strength, take into account market and macroeconomic conditions, and address all major aspects of operational risk prevalent in the businesses of the bank on a bank-wide basis (including periods when operational risk could increase).
Description and findings re EC1	There is no specific and detailed regulation emanating from the NBM that govern operational risks (OR). OR is in fact addressed through the NBM regulation on internal control. The latter contains several references to operational risk but the language is rather laconic. Operational risk is defined as the risk of direct / indirect losses resulting from inadequate or failed internal

[97] The Committee has defined operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The definition includes legal risk but excludes strategic and reputational risk.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	processes and *because of certain external persons or events*. The same text refers to *information security* (maintaining confidentiality, integrity and availability of data) as well as to the *information security management system* defined as a component part of the internal control system.[98] The general requirements related to operational risk management can be found in article 31 of the NBM "Procedures for ensuring activity continuity" of the Regulation on internal control systems. The NBM also sent on December 13, 2011 a letter communicating to banks the detailed requirements on contingency plans and operational risk management. The NBM also issued in November 2011 a regulation on outsourcing banks' activities and operations.
EC2	The supervisor requires banks' strategies, policies and processes for the management of operational risk (including the banks' risk appetite for operational risk) to be approved and regularly reviewed by the banks' Board. The supervisor also requires that the Board oversees management in ensuring that these policies and processes are implemented effectively.
Description and findings re EC2	As part of the overall regime for internal control, NBM requires banks' strategies, policies and processes for the management of operational risk to be approved and regularly reviewed by the banks' Board. The supervisor also requires that the Board oversees management in ensuring that these policies and processes are implemented effectively.
EC3	The supervisor determines that the approved strategy and significant policies and processes for the management of operational risk are implemented effectively by management and fully integrated into the bank's overall risk management process.
Description and findings re EC3	According to the NBM regulation on internal control, OR should be part of the overall risk management process. This includes definition of policies and procedures in relation to OR and approval of management. Moreover, as stipulated in the regulation, the internal audit function is required to verify the performance of continuous monitoring of risks that can eventually affect financial activities (credit risk, interest rate risk, FX risk, liquidity risk, country risk, operational risk, including IT risk, transfer risk, image risk). During the full-scope on-site visit, the NBM examiners will assess if the approved strategy, policies and processes for all types of risks, including OR, are implemented effectively.
EC4	The supervisor reviews the quality and comprehensiveness of the bank's disaster recovery and business continuity plans to assess their feasibility in scenarios of severe business disruption which might plausibly affect the bank. In so doing, the supervisor determines that the bank is able to operate as a going concern and minimize losses, including those that may arise from disturbances to payment and settlement systems, in the event of severe business disruption.
Description and findings re EC4	The NBM regulation contains provisions on disaster recovery and requires banks to have a business continuity plan in place. Part of this plan is assessing critical business operations, scenarios, solutions and operations to secure continuity and communication strategies. It is also

[98] Which is based on information security risks and is formed of a complex of technical and organizational measures (e.g., normative acts, internal procedures, human resources, IT processes, IT resources and services, etc).

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	stipulated that banks should periodically analyze and review the business continuity plans. The BCP assessors were told that the quality and adequacy of the internal procedures relating to business continuity are assessed during on-site examinations and by the crisis management and prevention unit of the BRSD.
EC5	The supervisor determines that banks have established appropriate information technology policies and processes to identify, assess, monitor and manage technology risks. The supervisor also determines that banks have appropriate and sound information technology infrastructure to meet their current and projected business requirements (under normal circumstances and in periods of stress), which ensures data and system integrity, security and availability and supports integrated and comprehensive risk management.
Description and findings re EC5	The regulation on internal control contains several references in relation to IT policies, including on the so-called "Information Security Management System". These aspects are captured during on-site visits. It is noteworthy that several banks have very old and outdated IT systems and are in the process of correcting the situation by acquiring brand new systems.
EC6	The supervisor determines that banks have appropriate and effective information systems to: (a) monitor operational risk; (b) compile and analyze operational risk data; and (c) facilitate appropriate reporting mechanisms at the banks' Board, senior management and business line levels that support proactive management of operational risk.
Description and findings re EC6	NBM on-site examiners verify banks' compliance with the regulation on internal control, and as part of this exercise, they cover whether OR is well captured by the bank under review, including the existence of internal monitoring for OR, analysis of OR data and reporting mechanisms.
EC7	The supervisor requires that banks have appropriate reporting mechanisms to keep the supervisor apprised of developments affecting operational risk at banks in their jurisdictions.
Description and findings re EC7	There reporting mechanisms on OR are not optimum. The NBM seems to capture only frauds in relation to cards. The "instruction on reporting information related to the use of payment instruments and services" require banks to report on "frauds with registered personal cards" as well as on "attempts of fraud with registered personal cards."
EC8	The supervisor determines that banks have established appropriate policies and processes to assess, manage and monitor outsourced activities. The outsourcing risk management program covers: (a) conducting appropriate due diligence for selecting potential service providers; (b) structuring the outsourcing arrangement; (c) managing and monitoring the risks associated with the outsourcing arrangement; (d) ensuring an effective control environment; and (e) establishing viable contingency planning. Outsourcing policies and processes require the bank to have comprehensive contracts and/or service level agreements with a clear allocation of responsibilities between the outsourcing

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	provider and the bank.
Description and findings re EC8	The NBM issued in November 2011 a regulation on outsourcing banks' activities and operations. It establishes the conditions for outsourcing the banks' activities /operations, the requirements and procedures for obtaining the permission for outsourcing materially important activities, the minimum content of the outsourcing contract, as well as the requirements on risk management and control of outsourced activities and operations. Outsourcing activities is rather rare in Moldova. From the interviews with banks and also with external auditors, the assessors understand that none of the banks' materially important activities have been outsourced. Only a few banks have externalized minor operations (mostly related to "plastic" money). Also, during interviews, banks indicated to the mission that they established contingency planning. The Procedures for ensuring activities continuity are contemplated in the regulation on internal control. According to section 32, banks are required to undertake all measures to satisfy themselves that they are able to get back to "business as usual" as quickly as possible after a disaster. The approach for ensuring continuity should include (i) the analysis of risks that might lead to incidents causing dysfunctions; (ii) impact of the incident on basic activities, (iii) strategies for restoring activities after a disaster; (iv) testing of continuity plans, (v) staff training program in relation to; or/and (vi) plans and procedures to ensure the continuity of outsourcing activities. Regarding particularly the IT operational risk, the NBM utilizes a system of indicators developed in-house. In 2012, the quality and sufficiency of contingency plans were assessed by the Crisis management and prevention unit, as part of off-site supervision. These plans are also checked during on-site inspections, particularly their adherence to the recommendations of the Crisis management and prevention unit. In the course of its on-site inspections, the NBM monitors the quality and comprehensiveness of business resumption and contingency plans.
Additional criteria	
AC1	The supervisor regularly identifies any common points of exposure to operational risk or potential vulnerability (e.g., outsourcing of key operations by many banks to a common service provider or disruption to outsourcing providers of payment and settlement activities).
Description and findings re AC1	
Assessment of Principle 25	**MNC**
Comments	As discussed under EC 1, operational risks management is captured through the regulation on internal control. However, the language regarding OR is rather laconic. With the exception of a detailed regulation on outsourced activities and a letter (that might not be binding) on detailed requirements for contingency plans and operational risk management, the country is still lacking a comprehensive regulation on this matter. NBM has established a year ago a draft regulation to improve OR management in banks, but it is still being reviewed by the National

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	Bank of Moldova. Moreover, the Regulation on internal control contains very general provisions on the need to establish information technology policies and processes to identify, assess, monitor and manage technology risks. Several banks in Moldova have outdated IT systems and are precisely in the process of revamping their platform and internal processes. In that context, ii would be advisable to include in the draft regulation on OR clear prescriptions for banks to have appropriate and sound information technology to ensure data and system integrity, security and availability. It is therefore recommended to speed up the issuance of the regulation on Operational Risks and subject banks to more detailed reporting obligations on OR, beyond the mere report on frauds.
Principle 26	**Internal control and audit**. The supervisor determines that banks have adequate internal control frameworks to establish and maintain a properly controlled operating environment for the conduct of their business taking into account their risk profile. These 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[99] internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have internal control frameworks that are adequate to establish a properly controlled operating environment for the conduct of their business, taking into account their risk profile. These controls are the responsibility of the bank's Board and/or senior management and deal with organizational structure, accounting policies and processes, checks and balances, and the safeguarding of assets and investments (including measures for the prevention and early detection and reporting of misuse such as fraud, embezzlement, unauthorized trading and computer intrusion). More specifically, these controls address: (a) organizational structure: definitions of duties and responsibilities, including clear delegation of authority (e.g., clear loan approval limits), decision-making policies and processes, separation of critical functions (e.g., business origination, payments, reconciliation, risk management, accounting, audit and compliance); (b) accounting policies and processes: reconciliation of accounts, control lists, information for management; (c) checks and balances (or "four eyes principle"): segregation of duties, cross-checking, dual control of assets, double signatures; and

[99] In assessing independence, supervisors give due regard to the control systems designed to avoid conflicts of interest in the performance measurement of staff in the compliance, control and internal audit functions. For example, the remuneration of such staff should be determined independently of the business lines that they oversee.

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	(d) safeguarding assets and investments: including physical control and computer access.
Description and findings re EC1	The LFI requires banks to establish the Board and Censors Committee and set out their responsibilities. In particular, the Censors Committee is responsible for the adequacy of external and internal audit functions of the bank, including reviewing the scope and results of audits carried out in respect of the operations of the bank and the independence and objectivity of the bank's external auditors. Also, the LFI and Regulation on internal controls, require banks to implement internal control frameworks that are adequate to establish a properly controlled operating environment for the conduct of their business, taking into account the risk to which the bank might be exposed. Article 18 of LFI stipulates that a bank's governing body is represented by the general shareholders meeting, the Board, the executive body and the Censors Committee. The internal control framework is the responsibility of the Board and/or executive body and deals with: organizational and administrative controls; methods of activity management; segregation of functions and obligations; procedures for authorization and approval; bookkeeping, security, verification, assessment procedures; risk management and control procedures; business continuity procedures. During the full scope on-site examinations the supervisor verifies whether banks' internal control systems are adequate and appropriate. Checks should take into account the volume, number and type of transactions, variety of operations, the degree of risk associated with each area of activity, of the management control in daily work, of centralization and decentralization, and the extent and methods of electronic database processors use.
EC2	The supervisor determines that there is an appropriate balance in the skills and resources of the back office, control functions and operational management relative to the business origination units. The supervisor also determines that the staff of the back office and control functions have sufficient expertise and authority within the organization (and, where appropriate, in the case of control functions, sufficient access to the bank's Board to be an effective check and balance to the business origination units.
Description and findings re EC2	The bank must ensure, according to the Regulation on Internal controls, an adequate segregation of duties for all the bank's processes in order to avoid possible conflicts of interest. Risk management reporting must be presented directly at the management Board and/or another managerial level at the bank. In this respect banks must have in place procedures to ensure that: different persons are responsible for the maintenance of registers, assets, authorization, initiation and supervision of transactions and assigned commitments; segregation should ensure that no person may intentionally or unintentionally illegally acquire any assets, falsify information or record incorrectly any transaction or operation without this being detected later. The Regulation on internal controls requires an internal audit function to be established, and describes its responsibilities. The regulation prescribes that, in accordance with its responsibilities, the internal auditor must review the effectiveness of policies, procedures and controlling mechanisms, the quality of the performance of administrators, the organizational structure of the bank, the safeguarding of activities and assets, the evaluation of risk management processes, the integrity of accounting records, and other critical control functions.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	During the on-site inspections, NBM inspectors evaluate the work of internal audit and its supervision by the Board. The scope of the NBM's inspection includes a determination of the adequacy of the resources and expertise of the internal auditing department; a determination of the independence of the internal audit function including its reporting lines to the Board and access to all records and personnel of the bank and its affiliates; determination that the function employs an appropriate and adequate methodology; and confirmation of preparation of an audit plan based on its own risk assessment. Supervisors determine whether back office and control functions serve as an effective check on the front office. For instance, supervisors review the reporting lines in the credit administration and control functions, and assess whether these functions report to management independent of marketing operations. Supervisors also review the composition of the credit or loan committee to determine if there is balanced representation of credit marketing and credit control.
EC3	The supervisor determines that banks have an adequately staffed, permanent and independent compliance function[100] that assists senior management in managing effectively the compliance risks faced by the bank. The supervisor determines that staff within the compliance function are suitably trained, have relevant experience and have sufficient authority within the bank to perform their role effectively. The supervisor determines that the bank's Board exercises oversight of the management of the compliance function.
Description and findings re EC3	According to the Regulation on Internal Control (article 23.1), banks shall examine the legal provisions, including all regulations of the NBM, on a continuous basis to ensure due compliance of the bank's activity with legal requirements. There are no specific requirements in the regulation with respect to the existence either a separate compliance function or for its suitability. In the majority of banks in Moldova the compliance function is under the responsibility of the audit function. Also, the bank's compliance with the legal provisions is assessed during the on-site inspections. The NBM prescribes remedial measures and/or sanctions when deficiencies are identified.
EC4	The supervisor determines that banks have an independent, permanent and effective internal audit function[101] charged with: (a) assessing whether existing policies, processes and internal controls (including risk management, compliance and corporate governance processes) are effective, appropriate and remain sufficient for the bank's business; and

[100] The term "compliance function" does not necessarily denote an organizational unit. Compliance staff may reside in operating business units or local subsidiaries and report up to operating business line management or local management, provided such staff also have a reporting line through to the head of compliance who should be independent from business lines.

[101] The term "internal audit function" does not necessarily denote an organizational unit. Some countries allow small banks to implement a system of independent reviews, e.g., conducted by external experts, of key internal controls as an alternative.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	(b) ensuring that policies and processes are complied with.
Description and findings re EC4	The Regulation on Internal controls sets requirements for the independence of the internal audit from the operational activities of the bank and requires a direct report to the Board. The Censors Committee oversees the internal audit function, liaises with the external auditors and communicates with the Board. The Board itself is responsible for regular approval and reviewing, at least once a year, of internal control systems, including the NBM reporting requirements, as well as the internal procedures. 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 the 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. At the same time, examiners determine whether the internal audit fulfilled its functions related to: financial and operational risk supervision; analysis of the bank's internal control system and determine compliance with these controls; ensuring that all procedures developed for transactions processing cover respective controls; ensuring that the bank obeys all applicable laws, regulations and requirements of the NBM and the bank's internal policies and procedures; preventing and detecting fraud and crimes, such as money laundering, and the existence of systems to reduce the likelihood of fraud within the bank. The Censors Committee is governed by the provisions of Article 20 of the LFI, and Articles 71 and 72 of the Law on Joint Stock Companies and has as its main responsibilities: to assess the operation of the bank's internal control systems so as to ensure observance of all laws and regulations applicable to the bank; to assess the activity of internal audit; to examine internal audit control reports, including the recommendations made and the modalities of implementation thereof; to cooperate with external auditors; to determine the security and accuracy of the information submitted to the bank management and external users; to elaborate recommendations for the bank management on external audit.
EC5	The supervisor determines that the internal audit function: (a) has sufficient resources, and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing; (b) has appropriate independence with reporting lines to the bank's Board or to an audit committee of the Board, and has status within the bank to ensure that senior management reacts to and acts upon its recommendations; (c) is kept informed in a timely manner of any material changes made to the bank's risk management strategy, policies or processes; (d) has full access to and communication with any member of staff as well as full access to records, files or data of the bank and its affiliates, whenever relevant to the performance of its duties; (e) employs a methodology that identifies the material risks run by the bank; (f) prepares an audit plan, which is reviewed regularly, based on its own risk assessment and

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	allocates its resources accordingly; and (g) has the authority to assess any outsourced functions.
Description and findings re EC5	According to the Regulation on internal controls, each Internal audit department should be organized as an unit taking into account the following principles: • internal audit unit shall operate under an internal regulation on internal audit, approved by the Board and shall include information on internal audit unit organization, the rights and responsibilities, cooperation with other bank subdivisions, etc. The Regulation shall be brought to the notice of all bank employees; • the structure and the number of employees in the internal audit unit shall be determined by the Board. The staff number shall be sufficient to carry out internal audit targets and objectives and to solve all issues related to internal audit; the unit's staff shall not be directly involved in any bank transactions and operations; • the head of internal audit unit shall be appointed by the Board; and • the internal audit unit shall report to the Board and its executive body as soon as possible following the conclusions of internal audit controls. Along with current reporting, internal audit shall, at least once per year, prepare a report for the bank Board that will include an activity analysis in terms of internal audit added value to the bank's activity. Compliance with these requirements is reviewed during the on-site examination process. The supervisors have raised questions about the quality of the internal audit function overall; remedial actions were required when deemed necessary. While the LFI stipulates specific fit and proper requirements for administrators (Board, executive body, Censors Committee, the chief accountant, manager of a branch of a legal entity, etc.), there is no such requirement for the head of the audit function.
Assessment of Principle 26	**LC**
Comments	The LFI and Regulations on internal controls set general principles for banks relative to their internal control framework. The NBM regulation, in particular, strengthens the requirements for establishing a strong internal control environment, requiring Board's responsibilities in establishing and ensuring an adequate internal control apparatus, and requiring internal audit function to evaluate control systems. According to the Manual on on-site controls, NBM examiners shall assess compliance with these principles. There are no specific requirements in the regulation with respect to the existence either a separate compliance function or for suitability. No specific requirements for professional qualification and fit and proper standards are compulsory for the head of the audit function. To improve the level of compliance with CP 26, it is recommended to: • Require improvements in the internal audit function to enhance overall effectiveness; • Speed up the approval process of the new Regulation on internal controls • Introduce in the regulation on internal control an explicit prescription on professional qualification and fit-and-proper assessment for heads of internal audit and impose an obligation on banks to notify the dismissal of the Head of internal audit;

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	• Exchange, on a regular basis, views on the quality and independence of internal audit with the external auditors during tri-partite meetings.
Principle 27	**Financial reporting and external audit**. The supervisor determines that banks and banking groups maintain adequate and reliable records, prepare financial statements in accordance with accounting policies and practices that are widely accepted internationally and annually publish information that fairly reflects their financial condition and performance and bears an independent external auditor's opinion. The supervisor also determines that banks and parent companies of banking groups have adequate governance and oversight of the external audit function.
Essential criteria	
EC1	The supervisor[102] holds the bank's Board and management responsible for ensuring that financial statements are prepared in accordance with accounting policies and practices that are widely accepted internationally and that these are supported by recordkeeping systems in order to produce adequate and reliable data.
Description and findings re EC1	According to Article 29 of the LFI, banks shall keep at their headquarters, in electronic form or on paper, accounting records that clearly and accurately reflect the activity of the institution, its operations and financial situation and detailed daily records of operations performed for each client and their account balances. Further, financial institutions shall prepare periodic financial statements, both on an individual and on a consolidated basis, in accordance with the generally accepted accounting practice (article 33 LFI), respectively IFRS. In this context the NBM issued accounting and reporting standards, including those for setting up of appropriate provisions for doubtful and bad assets. The integrity and accuracy of the financial statements are under the supervisory responsibilities of the Board and the Censor Committee (Article 20 of the LFI).
EC2	The supervisor holds the bank's Board and management responsible for ensuring that the financial statements issued annually to the public bear an independent external auditor's opinion as a result of an audit conducted in accordance with internationally accepted auditing practices and standards.
Description and findings re EC2	LFI (article 34) and Regulation on the procedures for the preparation and submission of audit reports (chapter II) stipulates that annually, banks shall sign a contract with an independent audit firm, accepted by the NBM, these being appointed by the General shareholders meeting. By law, banks are required to have their financial statements audited by an external audit firm which is also expected to provide an opinion on the bank's financial statements subsequent to the audit (article 34 letter b LFI). Within four months of the end of the financial year, banks must publish their balance sheet in accordance with IFRS and external auditor's opinion in the national newspapers as well as local newspapers where the bank has branches and must provide the public with free copies of the annual report. Oversight of the external auditor in

[102] In this Essential Criterion, the supervisor is not necessarily limited to the banking supervisor. The responsibility for ensuring that financial statements are prepared in accordance with accounting policies and practices may also be vested with securities and market supervisors.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	relation to the bank's financial statements is the responsibility of Censors Committee. The audit must be conducted in accordance with the "International Standards on Auditing" and "International Financial Reporting Standards" (chapter III of Regulation on the procedures for the preparation and submission of audit reports). The audit of a financial institution must be performed by a qualified auditor who is certified for the purpose by the NBM in accordance with the Regulation on issuing the qualification certificate of the financial institutions auditor (Chapter 2). Further, the regulation stipulates criteria for the selection of these auditors (including educational qualifications and certification for general audit). The NBM requires the external auditor, to prepare the audit report and opinion in accordance with the provisions of the LFI and Law on Audit, as well as the management letter complementing the financial statements. The management letter should at least provide comments and observations on: accounting records, operating systems, and internal control systems; issues identified by the auditor during the audit which might have a significant impact on the operations of the bank, including any fraudulent activity committed by any employee of the bank; any other issues considered by the auditor to be addressed to the Board.
EC3	The supervisor determines that banks use valuation practices consistent with accounting standards widely accepted internationally. The supervisor also determines that the framework, structure and processes for fair value estimation are subject to independent verification and validation, and that banks document any significant differences between the valuations used for financial reporting purposes and for regulatory purposes.
Description and findings re EC3	According to Regulation on the procedures for the preparation and submission of audit reports, the bank audit shall be performed in accordance with International Auditing Standards and International Financial Reporting Standards. Thus, impairments for loan loss reserves and other valuation rules related to fair value accounting must be reflected in the financial statements based on IFRS. The NBM requires the external auditor, as part of the scope of the audit work, to test the accounting processes and framework for valuing accounts that are subject to these accounting rules (article 34 LFI). The supervisors review the framework established by the bank and the accounting practices employed during both off-site an on-site review.
EC4	Laws or regulations set, or the supervisor has the power to establish the scope of external audits of banks and the standards to be followed in performing such audits. These require the use of a risk and materiality based approach in planning and performing the external audit.
Description and findings re EC4	Article 34 of the LFI establishes the audit scope respectively to: assist the bank in keeping the accounts in accordance with the principles established by the NBM; prepare an annual report on bank's activities and an opinion on the reliability of the reports that reflect the financial situation of the bank; review the adequacy of audit and internal control methods and procedures and make recommendations for remediation. In discharging their duties, auditors must comply with the International Standards for Audit. Accordingly, the auditors should have in view ISA 320 on Materiality in planning and performing an audit which requires auditors to apply the concept of materiality in planning and performing an audit of financial statements and shall determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	and extent of further audit procedures. Recently the NBM has decided to order a special audit and a diagnostic study of a bank, the scope being to provide an accurate picture of the bank's condition, in particular with reference to the quality and performance of the bank's assets, the adequacy of its provisions and reserves, and the quality of its earnings.
EC5	Supervisory guidelines or local auditing standards determine that audits cover areas such as the loan portfolio, loan loss provisions, non-performing assets, asset valuations, trading and other securities activities, derivatives, asset securitizations, consolidation of and other involvement with off-balance sheet vehicles and the adequacy of internal controls over financial reporting.
Description and findings re EC5	According to chapter III of the Regulation on the procedures for the preparation and submission of audit reports, the audit must be performed in accordance with International Auditing Standards and International Financial Reporting Standards. Therefore the annual report covers areas such as accounting policies, loan portfolio, loan loss provisions, non-performing assets, assets valuation, trading and other securities activities, consolidation of and other involvement with off-balance sheet vehicles and the adequacy of internal controls over financial reporting. LFI (article 34) requires that the external auditor evaluate a bank's internal control system to ensure that it is in compliance with other regulatory requirements. The report, audit opinion and the letter to the management, prepared by an independent audit firm, are reviewed by NBM off-site and on-site function according to Internal Procedures on monitoring audit reports and letters to the management. Thereafter, banks and external auditors are informed by the NBM about the objections found as a result of the analysis of the report, the audit opinion and the letter to the management regarding the compliance with the LFI and the above-mentioned Regulation and requires the submission of explanations/comments which have caused the violations committed during the audit and, also, requires their removal.
EC6	The supervisor has the power to reject and rescind the appointment of an external Auditor, who is deemed to have inadequate expertise or independence, or is not subject to or does not adhere to established professional standards.
Description and findings re EC6	NBM has the power to approve the external auditor selected by a bank, and has established criteria for the selection of an external auditor that focuses on auditor's education and qualifications. The attestation shall be performed by a commission, approved based on the ordinance of the Governor of the NBM, which meets once per quarter. Each member of the committee shall evaluate the attestation's results based on a 10 point system, minimum seven points shall give the right to the applicant to perform financial institutions audit. NBM also is empowered to withdraw the qualification certificate of the financial institutions auditor based on the Decision of the Certification Committee in case of intentional withholding of information, which prevents the possibility of performing the audit control, or inadequate reflection in the reports (more than twice) of the financial situation of the audited bank or the auditor conclusions (chapter VI Regulation on issuing the qualification certificate of the financial institutions auditor).
EC7	The supervisor determines that banks rotate their external auditors (either the firm or individuals within the firm) from time to time.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
Description and findings re EC7	The supervisor requires banks to rotate the auditing firm or the auditing partner managing the audit contract every seven years from the date of appointment of the auditor. Based on the provision of the Article 11 article (4) (g) of the Law on Auditing no. 61-XVI of 16.03.2007, the auditor is prohibited from participating in audit activities in the bank for a minimum of two years subsequent to the rotation taking effect. Moreover, an audit partner managing the audit of a bank is prohibited from joining the bank as an administrator for a period of two years subsequent to the audit contract. Conditions prescribed in the Law on Audit are verified by the NBM.
EC8	The supervisor meets periodically with external audit firms to discuss issues of common interest relating to bank operations.
Description and findings re EC8	Meetings with external auditors are on an ad-hoc basis in relation to specific issues that arise, for example, when errors are noted in regulatory submissions by the banks. The NBM also has regular meetings with the external auditors to discuss audit findings and issues specific to each bank separately, and other key aspects of the banks activity and audit findings.
EC9	The supervisor requires the external auditor, directly or through the bank, to report to the supervisor matters of material significance, for example failure to comply with the licensing criteria or breaches of banking or other laws, significant deficiencies and control weaknesses in the bank's financial reporting process or other matters that they believe are likely to be of material significance to the functions of the supervisor. Laws or regulations provide that auditors who make any such reports in good faith cannot be held liable for breach of a duty of confidentiality.
Description and findings re EC9	Article 34 of the LFI requires the external auditor to report to the NBM any fraudulent act committed by an employee of the bank or its branches and any irregularity in the management and operations that could lead to material losses for the bank or its branches (only one case was reported). In addition, the management letter report must include its findings and comments on the bank's accounting system, internal controls.
Additional criteria	
AC1	The supervisor has the power to access external auditors' working papers, where necessary.
Description and findings re AC1	There is no specific legal requirement that expressly states that the NBM has the right of access to the working papers of the external auditors. The NBM has had discussions with the external auditors about certain aspects of the audit, but with the agreement of banks or in the presence of their representatives.
Assessment of Principle 27	**LC**
Comments	Financial statements must be published annually and audited in accordance with IFRS on solo and consolidated basis. In the last two years, the vast majority of banks' financial statements were audited in the vast majority by a single audit company. However, during interviews, the mission was told by a prominent external audit company that banks pay little consideration to qualified opinions; instead, banks prefer to get a qualified opinion rather than making the appropriate provisions. This "culture" undermines the impact of external audits.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	The NBM may wish to: • Take more forceful action for ensuring audit quality by actively challenging external auditors and banks' management when understatement of provisions is identified; • Arrange more frequent periodic meetings with the auditors to discuss issues of common concerns and exchange information on important accounting, financial and auditing matters; • Give NBM examiners the power to access external auditors' working papers, where necessary; • Increase level of expertise among NBM staff to deal with IFRS issues.
Principle 28	**Disclosure and transparency**. The supervisor determines that banks and banking groups regularly publish information on a consolidated and, where appropriate, solo basis that is easily accessible and fairly reflects their financial condition, performance, risk exposures, risk management strategies and corporate governance policies and processes.
Essential criteria	
EC1	Laws, regulations or the supervisor require periodic public disclosures[103] of information by banks on a consolidated and, where appropriate, solo basis that adequately reflect the bank's true financial condition and performance, and adhere to standards promoting comparability, relevance, reliability and timeliness of the information disclosed.
Description and findings re EC1	Disclosure requirements are clearly provided by the article 30 of the LFI and the Regulation on publishing information on financial activity by licensed banks of the Republic of Moldova. Thus, banks shall disclose information related to their activity, shall adopt formal policies for: complying with the requirements of transparency and disclosure; assessing the appropriateness of their disclosures, including verification and frequency; assessing whether their disclosures provide market participants a complete picture of the risk profile. The main objective of the regulation is to ensure the disclosure of financial information by banks on their financial activity, with the view to foster market discipline and competitiveness and strengthen financial stability by promoting transparency of banks' activities and risk exposures, as well as to ensure for stakeholders transparent information on the bank's true financial condition and performance, thus allowing prompt assessment of the bank's financial statements, operational activity and related risks. Article 35 of the LFI requires banks to publish their audited financial statements on an annual basis. Banks also publish monthly, quarterly, annually in the press, on the board in bank offices as well as on their websites, a broad range of information established by the Regulation on publishing information on financial activity by licensed banks.
EC2	The supervisor determines that the required disclosures include both qualitative and quantitative information on a bank's financial performance, financial position, risk management

[103] For the purposes of this Essential Criterion, the disclosure requirement may be found in applicable accounting, stock exchange listing, or other similar rules, instead of or in addition to directives issued by the supervisor.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
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	strategies and practices, risk exposures, aggregate exposures to related parties, transactions with related parties, accounting policies, and basic business, management, governance and remuneration. The scope and content of information provided and the level of disaggregation and detail is commensurate with the risk profile and systemic importance of the bank.
Description and findings re EC2	The NBM has developed a regulation that governs transparency and disclosure requirements. The regulation requires banks to disclose quantitative and qualitative information mainly on the following: • Information on the main strategic directions of the bank's activity, statute of the bank, its ownership, organizational structure, corporate governance, general description of risk management. • Accounting policy of the bank accompanying the financial statement. • Annual report; Annual audited balance sheet and profit and loss account: Audit opinion. • Capital and liquidity factors. • Risk exposures. • Efficiency and profitability ratios. • Conditions of issuing loans and taking deposits. • Any other information that is relevant in assessing the financial situation, bank's activity and exposure.
EC3	Laws, regulations or the supervisor require banks to disclose all material entities in the group structure.
Description and findings re EC3	LFI (article 33) specifies that the accounts, registers and financial institution's statements shall reflect the operations and financial condition of its subsidiaries and branch offices, both on an individual and on a consolidated basis. Further, accounting standards require the disclosure of all material entities in the group. Every year, within 4 months of the end of the financial year, banks must publish their balance sheet and external auditor's opinion, on both an individual and consolidated basis.
EC4	The supervisor or another government agency effectively reviews and enforces compliance with disclosure standards.
Description and findings re EC4	The NBM is responsible for reviewing compliance with disclosure requirements established by the LFI and Regulation on publishing information on financial activity by licensed banks. Both the on-site and off-site function is involved in this review. Also, the annual audited financial statements and management letters are reviewed not only by off-site function but also by specialized departments within NBM such as accountancy department. If financial or prudential reports are deemed to be inadequate or incorrect, the supervisor may direct the institution to restate and republish the financial statements. In the event the bank fails to comply with provisions of this Regulation, remedial measures and sanctions shall be imposed on the bank in compliance with the legislation in force.
EC5	The supervisor or other relevant bodies regularly publishes information on the banking system in aggregate to facilitate public understanding of the banking system and the exercise of market discipline. Such information includes aggregate data on balance sheet indicators and

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	statistical parameters that reflect the principal aspects of banks' operations (balance sheet structure, capital ratios, income earning capacity, and risk profiles).
Description and findings re EC5	In order to promote a strong and competitive financial sector, and to increase public confidence in the banking sector, by ensuring the access of the public to relevant information on banks, the NBM publishes a range of monetary and financial statistics aggregated data regarding the banking system, aggregated data on financial indicators of the banking sector, covering a number of indicators divided in the following sections: equity, fixed income and profitability, liquidity, FIN1-balance sheet and FIN2-profit and loss account, as well as individual bank's data on structure of the loan portfolio by type of borrowers, by currencies and branches; structure of deposits; information on the number of separate subdivisions and number of staff employed in the banking sector (starting June 2013). Additional aggregated data can be found in the NBM's annual report.
Additional criteria	
AC1	The disclosure requirements imposed promote disclosure of information that will help in understanding a bank's risk exposures during a financial reporting period, for example on average exposures or turnover during the reporting period.
Description and findings re AC1	Multiple reports and financial indicators disclosed by the NBM and the banks allow for an understanding the financial conditions of banks and banking sector as a whole and provide for a broad picture about the financial stability of the banking sector.
Assessment of Principle 28	**C**
Comments	NBM ensures that banks regularly publish financial statements in line with IFRS disclosure requirements, as well as its own regulations requirements. Also a bank's manager shall bear primary responsibility for compiling and publishing information in compliance with the legislation in force. In case of publishing misleading information that does not comply with the NBM's requirements and the legislation in force, the bank shall publish a justification and shall rectify the information in compliance with the NBM's requirements. It was noted during the mission that the NBM objective is to implement Basel II provisions; therefore disclosure requirements need to be adapted to the Pillar III framework.
Principle 29	**Abuse of financial services**. The supervisor determines that banks have adequate policies and processes, including strict customer due diligence (CDD) rules to promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities.[104]

[104] The Committee is aware that, in some jurisdictions, other authorities, such as a financial intelligence unit (FIU), rather than a banking supervisor, may have primary responsibility for assessing compliance with laws and regulations regarding criminal activities in banks, such as fraud, money laundering and the financing of terrorism. Thus, in the context of this Principle, "the supervisor" might refer to such other authorities, in particular in Essential Criteria 7, 8,

(continued)

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
Essential criteria	
EC1	Laws or regulations establish the duties, responsibilities and powers of the supervisor related to the supervision of banks' internal controls and enforcement of the relevant laws and regulations regarding criminal activities.
Description and findings re EC1	The NBM determines whether the banks comply with their own AML policies, practices and procedures as prescribed by the Law on Prevention and Combat of Money Laundering and Terrorism Financing (AML law #190-XVI of July 26, 2007). In addition, to verify and enforce compliance with anti-money laundering obligation, the NBM can carry out inspections and impose administrative sanctions using its powers of Article 38 of the LFI. As discussed in CP 11, there are several limitations that undermine effectiveness of supervision, including in the area of AML/CFT. Absence of legal protection for NBM staff, interference of the MOJ in secondary legislations and lack of deterrent sanctions particularly when it comes to pecuniary sanctions raise question about enforcement of the relevant laws and regulations regarding criminal activities. The AML identifies all public institutions that are empowered to supervise reporting entities in their respective fields, including the Office for Prevention and Control of Money Laundering (OPCML- the Financial Intelligence Unit). This unit, which is an independent section of the Centre for Combating Economic Crimes and Corruption (CCCEC) can regulate and issue guidelines to banks as well as conduct verifications of the observance of AML requirements by the reporting entities, at the request of their respective primary supervisors. In practice however, it is the NBM which conducts, occasionally, targeted on-site inspection at the request of the Office.
EC2	The supervisor determines that banks have adequate policies and processes that promote high ethical and professional standards and prevent the bank from being used, intentionally or unintentionally, for criminal activities. This includes the prevention and detection of criminal activity, and reporting of such suspected activities to the appropriate authorities.
Description and findings re EC2	Supervisory expectations with regard to the existence of policies and processes to guard against financial abuse are contained in the 2007 law and subsequent regulations issued by the NBM, in particular the 2011 regulation regarding banks' AML obligation and the guideline on the Risk Based Approach to be applied in relation to customers, including the monitoring of their transactions. The AML law contains provisions on customer due diligence requiring banks to adopt, develop and implement control mechanisms to prevent and detect activities related to ML/TF. More precisely, financial institutions are required to (i) establish proper due-diligence policies and methods regarding the clients, including KYC (Article9); (ii) approve action plans for prevention and control of ML/TF according to the recommendations approved by the NBM; (iii) set up internal control mechanisms to detect unusual activities; (iv) establish procedures to report suspicions to the FIU, and (v) appoint an officer in charge of communicating these

and 10. In such jurisdictions, the banking supervisor cooperates with such authorities to achieve adherence with the criteria mentioned in this Principle.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	transactions to the OPCML. In this regard, Article 8 of the AML law requires banks to report immediately to the OPCML any type of operation or transaction that is deemed to be suspicious. Banks are also required to keep the necessary confidentiality regarding all the information transmitted on the basis of this framework. Moreover, banks are obliged to report automatically to the FIU any single cash transaction exceeding Lei 100,000 or its equivalent, and transactions effectuated electronically with a total value exceeding Lei 500,000. From the discussions with staff of NBM and the analysis of several on-site inspection reports, the mission observed that during its on-site inspections, whether general or targeted, the NBM pays special attention to the adequacy of AML/CFT internal policies in banks. In the methodology used by examiners (completely revamped on July 4, 2013 with the assistance of a US Treasury expert), specific procedures have been designed precisely to evaluate the way banks identify and monitor their risks, detect suspicious activities and train their staff accordingly. Regarding STRs obligation in particular, it is noteworthy that in the course of their on-site examinations, NBM inspectors examine samples of transactions with the aim, among others, to detect possible suspicious activities. The mission was also told that, in several occasions, the NBM reported to the OPCML suspicious operations that banks did not detect and should have been reported. The Moldovan regime provides that banks should adopt a Code of Ethics that sets out the general principles and values that govern the actions and ethical standards expected of all members of the bank, including senior staff. Lastly, the AML law stipulates that the reporting entities should apply written policies, practices and procedures with the aim of promoting high ethical and professional standards and preventing banks from being used, intentionally or unintentionally, by organized criminal groups or their associates. However, it is important to recall that the issue of non-transparent ownership of banks constitutes a significant constraint in this regard.
EC3	In addition to reporting to the financial intelligence unit or other designated authorities, banks report to the banking supervisor suspicious activities and incidents of fraud when such activities/incidents are material to the safety, soundness or reputation of the bank.[105]
Description and findings re EC3	According to the provisions of Article 42 of the Regulation on bank's activity on prevention and combat of money laundering and terrorist financing, approved by the Decision of the Council of Administration of NBM no.172 of 04.08.2011, banks are required to inform, where appropriate, the NBM about any suspicious activities and transactions, fraud affecting essentially the safety, stability or reputation of the bank.
EC4	If the supervisor becomes aware of any additional suspicious transactions, it informs the financial intelligence unit and, if applicable, other designated authority of such transactions. In

[105] Consistent with international standards, banks are to report suspicious activities involving cases of potential money laundering and the financing of terrorism to the relevant national centre, established either as an independent governmental authority or within an existing authority or authorities that serves as an FIU.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	addition, the supervisor, directly or indirectly, shares information related to suspect or actual criminal activities with relevant authorities.
Description and findings re EC4	In case of non-observance of the reporting obligations by banks, the AML law (Article 10(3)) requires the NBM to inform the OPCML and submit to the office all details in relation to the suspicious activities. The mission was told that during the course on its on-site visits, the NBM transmitted to the Office information on suspicious activities that had not been identified as such by the bank under review.
EC5	The supervisor determines that banks establish CDD policies and processes that are well documented and communicated to all relevant staff. The supervisor also determines that such policies and processes are integrated into the bank's overall risk management and there are appropriate steps to identify, assess, monitor, manage and mitigate risks of money laundering and the financing of terrorism with respect to customers, countries and regions, as well as to products, services, transactions and delivery channels on an ongoing basis. The CDD management program, on a group-wide basis, has as its essential elements: (a) a customer acceptance policy that identifies business relationships that the bank will not accept based on identified risks; (b) a customer identification, verification and due diligence program on an ongoing basis; this encompasses verification of beneficial ownership, understanding the purpose and nature of the business relationship, and risk-based reviews to ensure that records are updated and relevant; (c) policies and processes to monitor and recognize unusual or potentially suspicious transactions; (d) enhanced due diligence on high-risk accounts (e.g., escalation to the bank's senior management level of decisions on entering into business relationships with these accounts or maintaining such relationships when an existing relationship becomes high-risk); (e) enhanced due diligence on politically exposed persons (including, among other things, escalation to the bank's senior management level of decisions on entering into business relationships with these persons); and (f) clear rules on what records must be kept on CDD and individual transactions and their retention period. Such records have at least a five year retention period.
Description and findings re EC5	The requirements for customer identification are laid out in the AML law (Article5). Customer Due Diligence and KYC requirements are generally comprehensive when it comes to banks. KYC requirements encompass: customer identification including the beneficial owner, verification and due diligence program particularly in relation to high-risk customers. In the case of legal entities and individuals which carry out entrepreneurship activities, according to paragraph 17 (2) of the AML/CFT Banks' Regulation, banks shall obtain the following information: full and abbreviated name (if there is any), legal form, headquarter and mailing address other than the headquarter (if there is any), information on the state registration: state identification number (tax code) and date of state registration in accordance with the registration certificate and/or extract from the State Register issued by the body authorized with the right to make state registration, certified copy of documents of incorporation, as amended and supplemented, if applicable (or copy made by the bank form

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	the original documents), information on the person's identity who are invested with the right to open and/or have the account, to lead and represent the person and individual which carry out entrepreneurship activities, telephone number, fax, e-mail, as appropriate, information on the nature and purpose of the activity. Paragraph 18 of the same regulation stipulates that the bank shall identify the beneficial owner of the customer and shall apply reasonable risk-based measures to verify its identity so as to be convinced who is the beneficial owner in order to understand the ownership and control structure of the customer. To identify the beneficial owner, the bank shall implement the measures described in item 17 above. In practice, some AML officers in banks are facing difficulties to identify the UBO, especially when it comes to companies registered in off-shore centers like Cyprus, BVI and the Dutch West Indies. Sometimes, banks identify the "nominal owner" but not the ultimate beneficiary of the account or transactions. In terms of record keeping, rules have been set up on what records must be kept on customer identification and individual transactions. The law stipulates that financial institutions should implement procedures for storing all data about their customers, including information on customer identification and individual transactions. All information and documentation must be kept for a period of not less than five years that can be extended at the request of the NBM or other supervisory body. In addition, banks are required to adopt policies and processes to monitor, identify and report suspicious transactions. The law also provides in Article 9 internal control mechanisms to monitor identity and report unusual transactions to the OPCML and place under enhanced scrutiny transactions with non-cooperative jurisdictions.[106] Further, the AML law requires banks to adopt action plans for preventing and controlling ML/TF to be approved by senior management. Banks should also appoint an AML officer responsible for ensuring the compliance of the policies and procedures. (Article 9) and the persons' name should be provided to the OPCML (Article 9(2)). For Politically Exposed Persons (PEPs), the AML law requires banks to adopt procedures for mitigating risks arising from PEPs. In particular, banks should obtain approval from management bodies for concluding or continuing business relations with such persons; adopt adequate measure to determine the source of funds and conduct enhanced and permanent monitoring of these specific business relations. The on-site interviews demonstrated that the representatives of the banking system were generally aware of the obligations arising from Law and Regulation in relation to PEPs. As part of its on-site work, the NBM verifies compliance with CDD/KYC stipulations and other requirements as mentioned above. BCP assessors read a sample of on-site examination reports and noted that inspectors are given particular attention to these topics. In the cases reviewed, there were several observations or comments in relation to the lack of proper documentation, as well as weaknesses in the way unusual transactions are determined and monitored. The

[106] The AML does not use the word NCJ but the language of Article 6(6) is closed to that concept: "natural or legal persons (receiving) or (sending) funds from /to the countries that lack norms regarding money laundering and financing of terrorism or have inadequate norms regarding this subject or represent enhanced offence and corruption risks and/or are implied in terrorist activities (English translation)."

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	mechanisms for reporting suspicious activities to the OPCML are also examined during on-site visits. In several instances, corrective measures were required at the end of the inspection (see below). Also, in two or three instances, the NBM examiners themselves reported to the FIU unusual transactions detected in the course of their on-site visit and that were not identified as such by the bank.
EC6	The supervisor determines that banks have in addition to normal due diligence, specific policies and processes regarding correspondent banking. Such policies and processes include: (a) gathering sufficient information about their respondent banks to understand fully the nature of their business and customer base, and how they are supervised; and (b) not establishing or continuing correspondent relationships with those that do not have adequate controls against criminal activities or that are not effectively supervised by the relevant authorities, or with those banks that are considered to be shell banks.
Description and findings re EC6	The AML law requires banks to apply enhanced CDD measures in relation to cross border banking. Banks should undertake one or more of the following actions (Article 6(4)): • Accumulation of sufficient information regarding a correspondent institution in order to fully acknowledge the nature of its activity and ascertain from available public information its reputation. • Policy evaluation regarding prevention and combating ML/TF applied by the respondent institution. • Approval obtaining from management bodies before setting new relations with correspondent institutions. • Confirming the fact that the correspondent institution has checked the identity of clients and has applied permanent security measures. It is noteworthy that the NBM has under preparation a document (recommendation) that aims to provide further guidance to banks on due-diligence to be applied in relation to correspondent banking. AML law also expressly prohibits continuation of business relations with shell banks or with a bank that is known as allowing shell banks to use its accounts (Article 6(7)). However, the law does not expressly prohibit banks to establish business relationships with correspondent financial institutions incorporated in jurisdictions that do not require physical presence or establish correspondent relationships with foreign financial institutions when they allow their accounts to be used by shell companies. The NBM has not issued specific rules regarding correspondent banking relationships with Transnistria. From a risk perspective, such recommendation would be of particular relevance.
EC7	The supervisor determines that banks have sufficient controls and systems to prevent, identify and report potential abuses of financial services, including money laundering and the financing of terrorism.
Description and findings re EC7	In order to confirm that banks have sufficient controls and systems in place for AML purposes, the NBM has set up a Unit made of 3 staff within the Department for Banking regulation and Supervision. On an annual basis, as part of full-scope on-site inspections, examiners of this Unit evaluate banks' AML/CFT risk management system and their level of conformity with current

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	laws and regulations. In particular, the NBM considers whether policies, procedures and control mechanisms in place allow banks to properly identify measure, monitor and control ML/TF related risks. Also, on-site evaluations are conducted to verify the adequacy of the reporting mechanism to the relevant authorities. In addition, this Unit can perform occasionally targeted AML/CFT in-situ visits at the request of the OPCML. In July 2013, a new methodology has been conceived consisting in several detailed inspection processes that are used by the NBM during their on-site work. Previously, the AML methodology was part of the general on-site inspection manual. With the TA of the U.S. Treasury, a specific methodology has been designed only for AML/CFT supervision purposes and that defines each steps of the work to be carried out by examiners, when assessing risks. This manual is complemented by a questionnaire that provides guidance to inspectors during the interviews with the AML office. In addition, the NBM examiner has to determine, based on its finding, a rating for the bank ranging from low, moderate or high. Also, the CAMELS rating of the bank will be adjusted depending on the outcomes of the mission. AML/CFT compliance is embedded in the "M" and in the "S" of the rating. Also, ML/TF risks are considered as an operational risks according to the NBM even though it is not clearly indicated in the relevant regulation on OR. Off-site supervision for AML includes the collection of data of STRs. Banks are required to report to the NBM on a quarterly basis information about number of STRs. In the field, examiners perform transactions sampling (cash, international transfer) and verify a sample of customer files to assess the effectiveness of internal AML/CFT procedures. They also meet with internal control departments and with the AML compliance officer to determine its role and independence; in the case of a major local bank, NBM observed that the CEO was directly responsible for AML. NBM also verifies that annual reporting on AML are sent to the bank's Board (in some banks, this reporting is made quarterly). The inspection cycle is very short in the sense that every year, as part of the full-scope visits, each bank is subject to an AML/CFT review as indicated in the table below. These inspections
	that can span 3 to 4 weeks depending on the size of the bank have led to the identification of a series of violations also shown in the table below.

Year	Full Scope Inspections	Thematic Inspections
2008	16	5
2009	15	5
2010	15	10
2011	13	1
2012	14	1
2013	13	1

EC8	The supervisor has adequate powers to take action against a bank that does not comply with its obligations related to relevant laws and regulations regarding criminal activities.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)

	Supervisory Powers, Responsibilities and Functions
Description and findings re EC8	The AML law contains a very general provision regarding enforcement of AML/CFT violations. The law, Article 10 (3) reads: "In case of non-observance by reporting entities of the obligations stipulated in this law, the authorities empowered to supervise the reporting entities can apply the remedial measures and sanctions established by the legislation. The application of the mentioned actions does not exclude the possibility of realization, according to the legislation in force, of other measures for the purpose of combating money laundering and financing of terrorism." More details on NBM enforcement power can be found in Article 38 of the LFI that provides the NBM with a full range of corrective actions and sanctions ranging from written warnings to withdrawal of license. On-the-spot, checks were carried out over the past few years on the degree of compliance with internal AML programs and these inspections led to warnings and fines, sometimes directly applicable to senior management and Board members. Since the last FSAP, the NBM applied seven fines and issued 43 warnings as detailed below.

Year	No. of Violations with AML Rules	Fines	Warnings
2008	25	1	4
2009	15	2	4
2010	50	1	18
2011	45		7
2012	46	1	6
2013	46	1	4

EC9	The supervisor determines that banks have: (a) requirements for internal audit and/or external experts[107] to independently evaluate the relevant risk management policies, processes and controls. The supervisor has access to their reports; (b) established policies and processes to designate compliance officers at the banks' management level, and appoint a relevant dedicated officer to whom potential abuses of the banks' financial services (including suspicious transactions) are reported; (c) adequate screening policies and processes to ensure high ethical and professional standards when hiring staff; or when entering into an agency or outsourcing relationship; and (d) ongoing training programs for their staff, including on CDD and methods to monitor and detect criminal and suspicious activities.

[107] These could be external auditors or other qualified parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
Description and findings re EC9	The Moldovan regime defines all requirements that banks should meet in relation to risks management and internal audit. According to the AML law (Article 9(3)) banks should establish proper AML/CFT programs, with the view to evaluate the relevant risk management policies, processes and controls. The same AML regulation stipulates what the internal control system should perform a series of diligence specified in the law. The NBM regulation # 96 of April 30, 2010 on Internal control Systems in banks also covers AML/CFT obligations. It provides that internal auditors should evaluate the relevant risk management policies, processes and controls, including on AML/CFT. As part of its prudential oversight, the NBM oversees internal control activities. The law also establishes policies and processes to designate compliance officers at the management level. The NBM evaluation manual contains procedures to be followed by examiners for assessing the performance of the Compliance/AML Officer function. The mission was told that all banks have appointed an AML officer. Moldova is also equipped with screening policies and processes to ensure high ethical and professional standards when hiring staff. In effect, in the case of hiring staff, the AML law (Article 9(3)) expressly requires banks to have strict employee-selection programs to ascertain their high professional profile. The AML law (Article 10(3)) also stipulates an ongoing personnel training program, which must include various aspect of the process of preventing and combating ML/TF by the AML regulation (Article 49).
EC10	The supervisor determines that banks have and follow clear policies and processes for staff to report any problems related to the abuse of the banks' financial services to either local management or the relevant dedicated officer or to both. The supervisor also determines that banks have and utilize adequate management information systems to provide the banks' Board, management and the dedicated officers with timely and appropriate information on such activities.
Description and findings re EC10	The AML regulation requires that the programs on preventing and combating ML/TF should provide procedures for internal and external reporting regarding suspicious activities and transactions (Article11). Especially, the reporting mechanism about suspicious activities should have clear procedures that are known by all personnel. In regard to management information systems, the AML regulation (Article6) requires that the internal audit or other controlling unit should carry out an independent evaluation, and the evaluation results should be provided to the bank Board, as well as NBM. During on-site visits, the NBM verifies compliance with these requirements. It is not rare to find situations where the AML compliance function is not segregated from the executive function. As an example of this is the case of bank A in which the person responsible for leading the bank's activity in preventing and combating ML/TF was the first vice president of the Management Committee.
EC11	Laws provide that a member of a bank's staff who reports suspicious activity in good faith either internally or directly to the relevant authority cannot be held liable.
Description and findings re EC11	The AML law stipulates that banks and their employees are exempt from disciplinary, administrative, civil and penal liability for submitting the information to the competent authorities for the purpose of executing the provisions of the AML law (Article15(5)).

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
EC12	The supervisor, directly or indirectly, cooperates with the relevant domestic and foreign financial sector supervisory authorities or shares with them information related to suspected or actual criminal activities where this information is for supervisory purposes.
Description and findings re EC12	The NBM has signed cooperation agreements with a series of domestic authorities that play a role in the AML/CFT regime, namely the OPCML, the Tax authorities, the NCFC and the Public Prosecutor office, with the view to exchange information on AML/CFT related issues. In addition, article 24 of the LNBM provides powers to the NBM relative to engaging in collaborative arrangements with foreign bank supervisory authorities. As a result, the NBM has signed letters of agreements with foreign supervisors in the domain of supervision, especially with countries which banks have acquired significant interest in the capital of local banks or have opened branches on the territory of the Republic of Moldova, namely Romania, Russia, Belarus, Kazakhstan, and Georgia.
EC13	Unless done by another authority, the supervisor has in-house resources with specialist expertise for addressing criminal activities. In this case, the supervisor regularly provides information on risks of money laundering and the financing of terrorism to the banks.
Description and findings re EC13	Within NBM, a specialized unit was set up in 2009 that is responsible for conducting AML/CFT examinations, coordinating training with the OPCML and other activities. The unit is made of 3 staff, 2 of whom just graduated from university (respectively 22 and 23 years old). This is not proportionate to the risks the banking sector is facing. The head of the Unit was appointed in 2009 and previously hold a position of economist in the Special Supervision Unit of the NBM. This staff received assistance from the US Treasury who provided training, particularly on conducting AML/CFT examinations in banks. The expert also participated in on-site inspections to provide direct hands-on capacity building to the AML Unit's examiners. Also, inspectors from the On-site Inspection Unit can participate in AML/CFT on-site visits as needed. Staff also participated in seminars and conferences abroad hosted by FIUs and the Council of Europe (France, Austria, and Germany). NBM has also provided training to banks, in cooperation with the FIU and communicates with the FIs on amendments made necessary to existing practice resulting from changes in law or international best practice. According to the AML law (Article 10(4)), the NBM is also required to inform banks on ML/TF activities, including new methods and trends in this area.
Assessment of Principle 29	**MNC**
Comments	The assessors are of the view that Moldova has paid close attention to ML/TF related issues. In this regard, Moneyval assessed the AML/CFT regime of Moldova in 2012 and came to the conclusion that "*AML/CFT supervision is effectively carried out by the NBM with regard to the financial institutions within its remit (banks and FX entities*)." [108] The present mission acknowledges progress made by Moldova in this regard. The approval by the Parliament, of the National Strategy to combat ML/TF is a significant step forward. Sanctions for AML/CFT violations have been taken against banks. Along the same lines, key amendments made to the Penal Code enter into force in 2014, reinforcing sanctions in case of AML/CFT breaches. All

[108] 2012 Mutual Evaluation Report; see page 179, paragraph #1006.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	banks are subject to an annual AML on-site visit. In addition, the Office for Preventing and Combating ML requested in November 2013 TA to carry out the ML/TF National Risk Assessment of Moldova based on the World Bank methodology. Last but not least, efforts to equip NBM staff with advanced AML/CFT methodology have been pursued. Despite these positive steps, the NBM is still facing important challenges that seriously hamper the effectiveness of ML/TF surveillance in banks. These challenges, described below, led the assessors to apply MNC for CP 29. **The AML Unit is understaffed**. As described under EC 7, the AML unit of the NBM is made of three staff; two of them assigned to overseeing AML/CFT have just graduated from university and have virtually no experience in this area. As a result, the human resources for AML/CFT supervision appear to be very low and not proportionate to the risks the banking industry is facing. **Massive cross-border operations originated from and/or directed to off-shore centers have been detected**. According to the Financial Intelligence Unit, cross-border transactions of major proportions (amounting to about 1 <u>trillion</u> LEI[109]) involving Moldovan banks have been detected. These transfers seem to be performed by companies operating from off-shore centers with undisclosed UBO, likely for tax evasion purposes according to NBM's senior management opinion. These operations have not been subject to intense scrutiny so far. **All operations with Transnistria have been declared suspicious.** Another matter of concern relates to the situation with Transnistria.[110] Unrecognized by any United Nations member state, Transnistria is designated by the Republic of Moldova as the Autonomous territorial unit with special legal status. From an AML/CFT standpoint, the region is a *black hole* that led the authorities to declare suspicious any single transaction, irrespective of the amount, between Moldovan banks and Transnistrian banks.[111] Besides, these outbound financial flows are quite significant (2 billion LEI in 2013) and are operated by companies with unknown beneficial owners. The payment system department of the NBM is responsible for monitoring these transactions on a daily basis, but besides that, there is not much that can be done. The supervisory authorities, at least the NBM, have little room for maneuver and to adopt remedial actions as it would bring immediate political reaction.
	Banks have not yet performed their own risk assessment of ML/TF risk. As described above, banks are subject to a series of AML/CFT obligations, in particular to take all necessary measures to protect themselves from being abused by criminals. However, none of the banks in Moldova has performed an ML/TF risk assessment. The NBM issued a recommendation in 2013

[109] This figure has been provided to the mission by the FIU. The NBM considers, however, that the information about 1 trillion lei is exaggerated.

[110] Transnistria is located largely on a strip of land between the River Dniester and the eastern Moldovan border with Ukraine.

[111] There are no branches or subsidiaries of the Moldovan financial institutions in the area of Transnistria. The NBM acts as an administrator of all payments through a Centre established in Transnistria which effects real-time payments in Moldovan lei.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (continued)	
Supervisory Powers, Responsibilities and Functions	
	suggesting banks to do such exercises; however, banks have not followed this recommendation. This is key as banks cannot really define their risk appetite and adjust their internal limits and surveillance mechanism accordingly in the absence of such analysis. **Two significant recent developments in banks raise questions about transparency.** The first case concerns the selling of NPLs by a domestic systemically important bank. In 2013, a major bank in Moldova sold its NPLs portfolio (one-third of the total portfolio) because the bank was not complying with its minimum capital adequacy ratio. While the transaction, amounting to Lei 1.2 billion (approx. US$ 87 million) was justified in light of the prudential regulation, the conditions under which the transactions were performed are questionable. In effect, both the identities of the companie(s)—and their UBOs alike—as well as the origin of funds used to buy these bad assets were not disclosed to the NBM, despite its request. The second case relates to another Moldovan systemically important bank that increased in 2013 its total deposits from Lei 6.2 billion to 9.8 in one year only (US$ 236 million) which is a significant number;[112] the bank is now ranked number 1 in terms of deposits in the market. What raises concerns is that no interest rate was applied to these deposits, and according to the bank, depositors selected the bank "*because of its good reputation*". **Sanctions applied so far do not seem dissuasive and deterrent.** The NBM has imposed fines and warnings to banks for failure to comply with AML/CFT obligations. However, in case of persistent and recurrent breaches, the response has not been increased (see CP 11 for more details).

[112] Commercial companies account for about 50 percent in this increase.

Table 3. Detailed Assessment of Compliance with the Basel Core Principles (concluded)	
Supervisory Powers, Responsibilities and Functions	
	Against this background, the following recommendations are proposed: • perform targeted on-site visits –preferably in conjunction with OPCML- to determine the nature, magnitude and economic rationale of the cross-borders transactions identified by the FIU and determine proper supervisory response; • increase level of scrutiny in banks by doing more targeted on-site inspections in the area of PEPs, UBO, correspondent banking relationships; • instruct banks to perform their internal ML/TF risk assessments; • increase sanctions in case of recurrent violations of AML/CFT regulation by the same institution; • equip NBM examiners with proper software to conduct AML/CFT on-site visits. Sampling of transactions for example is done manually; and implement without delay aspects of the AML/CFT National Strategy that relates to the NBM mandate. In effect, this strategy for 2013-2017 that was approved by the Parliament in June 2013 contains several activities that are directly under the ambit of the National bank.