ACCESS TO CREDIT INITIATIVE/MOLDOVA

Mortgages, Fixed Income, Leasing

Report on Preparations for the Establishment of the Regulatory Authority For Non-Bank Financial Institutions in Moldova

The Pragma Corporation

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*NOTE: These are separate documents which are NOT included in this report as they are documents of the respective institutions. If the CNVM/Mega Regulator would like to view these documents, a request should be made to the Country Director of ATCI/Moldova.

A Executive Summary.

Moldova is seeking to upgrade its regulatory and institutional framework with a view to improving the quality of its financial regulation and to meeting international standards. The report provides an assessment of the legal and regulatory framework as well as the prevailing enforcement and supervisory practices. The report will make policy recommendations where these are appropriate, and identify any gaps or deficiencies in the draft legislation, including changes which would have to be made to ensure the effectiveness operation of the new regulatory authority. Moldova will shortly set up a 'mega-regulator', a single regulatory authority for non-bank financial institutions (hereafter, the National Commission).

The appropriate legal and regulatory framework is a necessary but not a sufficient condition for an effective regulator. The report therefore identifies and explains the nature of the risk-based supervisory practices which should be adopted; the appropriate enforcement procedures and powers for the National Commission and the kind of sanctions which should be adopted and applied by an effective regulatory authority. As Moldova currently lacks both the capability and the resources enabling it to match international standards, the report suggests ways in which the National Commission could learn from the practices and procedures developed by other regulators. These will be designed to make the most efficient use of its resources in the immediate future.

The time-table for the establishment of the National Commission has already been decided. It is a demanding time-table. In order to maximize the value of these recommendations, each is assigned to the three phases of development.

1. Phase I. Adoption by Parliament of all draft bills.

These consist of the Law on Insurance, the Law on the Securities Market (including amendments), the Law of Savings and Credit Markets and the Law of the National Commission on Financial Market. It is hoped that the all of these draft bills will be adopted by Parliament by March 31st, 2007.

2. Phase II. Preparation for the Inauguration of the National Commission on July 1, 2007.

During this phase, which will being on April 1, 2007 and end on June 30th, 2007, the staff of the regulatory authorities will be brought together into the accommodation currently occupied by the

National Securities Commission. They will be organized into a single body in terms of the organizational chart, which has already been prepared and which will divide the responsibility for regulatory tasks into two major divisions: prudential and conduct of business. In addition, a procedural handbook for staff will be developed and further detailed regulations will be prepared.

3. Phase III. Further Preparation for the Full Operation of the National Commission.
Further work is anticipated during the rest of 2007 so that the National Commission is fully operational to international standards by the end of December 2007.

The workload for the staff in the time available is a heavy one, so the recommendations have been assigned to the appropriate phase of the work and have been prioritized in order to provide Moldova with as much support as possible in its efforts to improve the quality of financial regulation. The Government, the Commission and its staff are committed to the project and it is important that their enthusiasm is not diminished by overloading them but is enhanced by using their skills, knowledge and experience to best effect.

Section B. Summary of Recommendations.

The recommendations are also prioritized so that they fit into the planned development of the National Commission. Details of the recommendations and the reasons for them are set out in detail in Section C.

Phase I.

The key recommendation here concerns amendments to the Law on the National Commission on the Financial Market since this should be regarded as the enabling law, the framework law for the single regulatory authority. The following objectives, status and powers should be clearly stated in this Law.

- The objectives should be set out clearly in the legislation. Some of these are incorporated in the draft law but not in full or with sufficient clarity. These include the protection of investors and consumers; the assurance of fair, efficient and transparent markets; the reduction of financial crime and the promotion of public understanding of the financial system.
- The Commission should be able to promulgate binding and enforceable rules and regulations, independently of the approval of other government departments.

- The sole power to grant licenses and to set the terms on which those licenses should be granted in accordance with international standards. These should include the requirements concerning transparency of ownership as set out in Article 21 of the Law on Insurance.
- The right to information and information-sharing.
- The right to set the criteria for the licensing of recognized investment exchanges.
- Full powers of enforcement independently of restrictions imposed by the Administrative Code.
- Legal Immunity.
- An independent tribunal.
- Complaints handling for companies and an independent procedure for complaints from consumers, investors and market participants.
- A central depository and share registry.

Phase II. Setting up the National Commission.

- Develop a mission statement both as part of the explanation of the purpose of financial regulation both to the public and to the regulated businesses, and as a means of bringing staff together and focusing their attention in the years to come on the purpose of regulation.
- During this period, the key recommendation is that the focus should be on developing the handbook on risk-based supervision, accompanied by a period of intensive training on this approach, features of which may be unfamiliar.
- It is also recommended that this approach should be adopted in conjunction with the alternative organizational structure, which is likely to contribute to the effectiveness of this approach to supervision and a more efficient use of human resources.
- The National Commission already plans to produce the staff handbook and much of its time will be spent on this. It is recommended that care is taken to ensure that the rules set out in the handbook do not conflict with a more flexible approach to supervision.
- Finally a Code of Ethics for all the staff, which is compliant with international standards, should be developed as part of the handbook.

Phase III. Further Preparation for the Full Operation of the National Commission.

- During this period, work should continue on preparing further detailed rules and regulations. These should be issued as a handbook so that companies will have easily available all the regulations applying to each sector of the industry in one place. The National Commission then regularly up-dates the Handbook and also arranges for this to be published on the website as part of the transparency of its operations.

- It is also recommended that the Commission sets out a full statement of its enforcement procedures so that its powers can be used in a way which can be seen to be transparent, proportionate and consistent with its publicly stated policies.
- The Commission should begin work on its consumer protection policies, starting with the disclosure requirements as part of its conduct of business rules.
- It is also recommended that work begins on improving the operation of the insurance market.
- There are two recommendations designed to assist the Commission in its management of resources. These cover significant areas of the Commission's work regarding the supervision of savings and credit associations and joints stock companies.
- A review of the draft Code of Corporate Governance has been provided which is expected to come into force on January 1, 2008. The Code has moved some long way towards meeting the requirements of the OECD principles of corporate governance but more work should be done in this period to provide a fully adequate code which is effectively compulsory.

Section C. A Brief Review of the Proposed Legislation.

Each of the Laws which form part of the legal framework for the National Commission has been reviewed for its compliance with international standards. That includes the Law on Insurance, the Law on Savings and Credit Associations and the Law on the Securities Market. These laws are broadly compliant with the standards set by the International Association of Insurance Supervisors in the case of insurance, and the standards set by IOSCO in the case of the Law on the Securities Market.

In the case of the Law on Savings and Credit Associations, the Law is again broadly in conformity with the 'best practice' standards set out by the World Council of Credit Unions. Article 47 of the Law should make it clear that an external audit is obligatory and should incorporate the various provisions set out in the Model Law provided by the World Council in Part V section 5.20 regarding the appointment of the external auditor. The capital adequacy requirements are the single most important regulatory requirement for the effective management of risk in such organizations. These details are to be set out in regulations, which is acceptable.

But it should be noted that this regulation usually states that such an association should maintain a capital to assets ratio of 10% or more. Moldova plans to allow savings and credit associations to take on a wider range of activities, but they will have to apply for a higher category of license in order to do so. Such decisions must be taken carefully and such licenses must only be given if the association can prove that it has the experience, skills, ability to manage new risks and sufficient capital reserves to take on new activities.

There are, however, gaps in the insurance and securities laws as they stand, but where the draft laws fail to conform in full, the omissions should become part of the draft Law of the National Commission on Financial Market, since this is the body which should apply and enforce the laws and which should have the procedures in place and have all the powers necessary to do so.

For example, the Law on Insurance omits any reference to complaints handling, but instead of adding that (apart perhaps from a passing reference) to the Law on Insurance, it should be added to the Law of the National Commission on Financial Market. An independent complaints procedure should be available for complaints arising in the securities market and the savings and credit associations as well. The necessity for such a system should be part of the Law on the National Commission, which should also set out a requirement for companies to have their own complaints handling procedures.

In the case of the licensing and supervision of market intermediaries, the Law on the Securities Market in Article 52 states that procedures for issuing licenses and for license suspension will be set out by the National Commission or organizations authorized to issue the license in compliance with the legislation. Given the importance of the initial licensing, the whole process should be conducted by the Commission itself.

With regard to entry into the markets, IOSCO's principles require that regulation should provide for minimum entry standards for market intermediaries (Principle G, 21). This is expanded in Principle 12.3 regarding licensing and supervision, which states the 'regulation should determine whether participation in the market by an intermediary should be based on a demonstration of appropriate knowledge, resources, skills and ethical attitudes (including a consideration of past conduct).' Many regulatory authorities set out detailed criteria relating to education, training, experience as part of the 'fitness and properness' of the applicant before being licensed. Article 53 (5) of the Law on the Securities Market, states are the responsibility of the National

Commission, which may set ‘other requirements for professional participants in the securities markets, including requirements for their officers and employees.’

Other requirements involve a comprehensive assessment of the applicant and all those who are in a position to control or materially influence the applicant. In addition, any changes of control or material influence should be made known to the licensing authority, who can then decide whether its initial assessment of the intermediary remains valid. The license can be withdrawn if the change in control results in a failure to meet relevant requirements. There should also be a requirement for information about the market intermediary should be regularly up-dated and for any material changes in the circumstances of the company to be reported to the Commission.

The Commission sets out minimum capital requirements before granting a license, but the Commission should also ensure that a company maintains adequate financial resources to meet its business commitments and to withstand the risks to which its business is subject. Risk may result from the activities of unlicensed and off-balance sheet associated companies and the company should supply the Commission with information about these activities. The capital adequacy test has to take on board the risk faced by a market intermediary in terms of the nature and amount of business undertaken by the company concerned. These general licensing conditions and capital adequacy requirements are drawn from IOSCO Principle 12.3 for licensing and supervision requirements.

Similarly for insurance intermediaries, appropriate knowledge and ability is part of the professional requirements, as set out in Article 4 of the EU Insurance Mediation Directive, and, in more general terms, in the IAIS Supervisory Standard on Fit and Proper Requirements for Insurers, October, 2005. This can take the form of requiring insurance intermediaries to demonstrate appropriate levels of knowledge by taking a minimum competence test as a condition of entry. The National Commission should have the power to set out and publicize any additions to licensing conditions.

These have been outlined below and then summed up in the first recommendation for Phase I. The reason for the proposed amendments are, first, that the National Commission must have all the powers it requires to operate as the regulatory authority for non-bank financial institutions. The amendments to the Law of the National Commission on Financial Market are outlined below together with the development of the handbooks, including further details regarding the licensing conditions to match international standards.

Section D. Review of the Legal Framework for Financial Regulation.

(a) The Independence of the National Commission.

Article I describes the mega-regulator (hereafter, the National Commission) in the draft Law of the Republic of Moldova of the National Commission on Financial Market as an independent body of the central public administration, reporting to Parliament. However, its independence in rule-making is limited in that its proposed decrees, rules and regulations have to be referred to the State Committee for Regulating Entrepreneurial Activity, the 'guillotine' committee, as well as the Ministry of Justice and may be rejected. .The ideal situation should be for the mega-regulator to be free to set out detailed rules and regulations without the need to refer those to another Ministry and the 'guillotine' committee.

Given that the requirement to sign off the proposed rules and regulations is designed to ensure that they should conform to the existing framework of law, as understood and checked by the Ministry of Justice, then proposed rules and regulations should be accompanied by a detailed explanation of their purpose and the expected benefits (which is always a good discipline for the regulatory authority) together with an explanation of the way in which companies are expected to conform. The proposed rules and regulations may break new ground. However, since the Government is committed to ensuring that the standards of financial regulation in Moldova are in line with international standards and that they ultimately conform to the European Directives on the Single Market, then that should be part of the justification of the proposed laws and regulations submitted to the various bodies and the presence of such justifications should ensure that neither body can reject the proposals and that their reference to these bodies becomes a formality. The reviews outlined below will indicate the compliance or lack of it with EU Directives which are already in force, and the compliance or lack of it with international standards.

A further proposed amendment is that the proposed regulations and rules should be subject to a consultation process through their publication on the website of the National Commission. The length of time for the consultation process should be specified in the legislation, and given the size of the market, at present, six weeks will be sufficient. At the end of that period, the Commission should respond the comments made by market participants, the general public and other interested parties and explain why the proposed regulation is to be retained in its entirety or the reasons for any modifications. This response must also be timely and limited to not more than six weeks. The Consultation Paper should also set out the reasons for its introduction and the way in which the Commission expects it to be implemented. This both provides a context for the proposed regulations, enabling both the public and the market participants to understand its purpose, but it also enables them to prepare for its introduction, which may require staff to be trained or systems and controls to be altered. The Consultation Paper and its responses would also assist in the presentation of proposed rule changes to the guillotine committee and others.

(b) The Objectives of the National Commission.

Article 3 of the draft Law sets out the objectives of the National Commission, which are similar to those set out in the legislation governing financial regulators in developed countries. Clarification is still required, since the reference is to regulating, supervision and monitoring the capital market, but should refer to the financial services industry, which includes insurance, for example.(Article 3 (I b and 1e). The reduction in financial crime should also be considered as an objective, so that the Commission plays a part in monitoring, detecting and preventing financial crime. A further requirement should be included so that the National Commission is obliged to act in a way which is consistent with its objectives and which it considers to be the most appropriate way of doing so.

Objectives set out by other regulatory authorities include promoting public awareness of the benefits and risks associated with different kinds of investments and to educate the public so that they are in a better position to make choices for themselves and have confidence in making investments themselves. Furthermore, although the protection of the public is an objective for the National Commission, there is little evidence of this as the purpose of the proposed regulations. Protecting the consumer also means ensuring that firms are competent and financially sound. In this report, examples will be given regarding the way in which the laws and regulations should be developed in order to more directly protect the consumer.

(c) The Powers of the National Commission.

(i) The Power to Grant Licenses.

At present, the power to authorize or license insurance companies and savings and credit associations rests with the State Licensing Commission and will do so until June 30th, 2008, when this power will be transferred to the National Commission. Prior to June 30th 2008, the conditions for licensing an insurance company and savings and credit associations will be shared with the State Licensing Chamber in that insurance supervisors and supervisors of savings and loans associations will work co-operatively with the State Licensing Chamber. The National Commission already has licensing powers for institutions and individuals in the capital markets and will continue to do so after June 30, 2008.

However, the criteria for issuing a license when it becomes a matter for the decision of the National Commission on Financial Market from July 1, 2008, should be clearly set out in the accompanying regulations, and should not be an entirely paper-based exercise. It may be necessary and advisable to meet with the applicant, if the documents give any reason for uncertainty about the ability of the firm to meet the regulatory requirements, to manage the resources the firm has available, or to fulfill its business plan. The proposals set out here include both the payment of a fee for the process of obtaining a license, commensurate with the work involved, together with a guide for potential applicants explaining the steps involved. An appropriate time-limit should be set for an application to be considered and a decision made. If the application is rejected, this should be accompanied by a letter of explanation, and, what steps should be taken for an application to be reconsidered, if the Commission considers that the company could be licensed if certain improvements were made.

The criteria for obtaining a license include a description of the legal status of the firm, which in Moldova would either be a joint stock company, a limited liability company, or a partnership and the location of the applicant's head office and branches must be identified. Full details will be required of the owners, directors and controlling shareholders of the company before the application for a license can even be considered. These requirements are set out clearly in Article 21 of the Law on Insurance but are not echoed in the Law on the Securities Market. The crucial conditions relate to the firm has adequate resources to conduct the business and that the applicant is 'fit and proper'. These considerations will involve a detailed assessment of the applicant's resources, including finance, management, staff, systems and controls, looking at all the financial resources, including the minimum capital requirement, the ability to fund the development of the business, whether there are any indications that the firm may have difficulties in meeting the prudential requirements in the future or in meeting its debts or whether the firm or its directors and senior managers has been declared bankrupt, or failed to pay debts.

The Commission should also consider whether the client money, deposits, custody assets or the rights of policy holders will be placed at risk if the application is granted. The proposed business plan should have been tested for its viability and demonstrates a willingness to abide by the requirements of the regulator.

The application must also demonstrate the 'fitness and properness' of the firm itself and its directors and senior managers with regard to the firm itself and to individuals. Both must be free of any connection with crimes such as fraud, theft, money laundering, market abuse etc. or any previous enforcement actions by the regulators. The application should also state if any other individual or company has a close relationship with the applicant, which could present a risk to the applicant's financial resources for conducting the business.

The firm should be able to demonstrate the arrangements it has in place for ensuring compliance with regulatory requirements by all its staff, and that its management are competent and prudent, as well as being capable of exercising due care, skill and diligence, and that its human resources arrangements are designed, as far as it is reasonably possible to do so, to ensure that it only employs individuals who are honest and committed to the highest standards of integrity in carrying out their work. It may be difficult for applicants to fulfill these requirements, but, care taken at this stage, can prevent considerable damage at a later stage, both to consumers in terms of financial loss or even hardship and to the reputation and stability of the financial services industry as a whole. Article 8 (d) requires the Commission to keep a register of licensed companies, but that register should be published on the website, so that the public can check whether or not a company which claims to have a license really does have it. It is not unknown in some countries for companies to claim that they are licensed when they are not, which could mean that if the consumer invests with that firm and subsequently loses his money, then he will not be eligible for compensation either as the company was not in fact licensed.

(ii) The Right to Information and Information-sharing.

Despite the fact that the right to information is generally available in other laws, it is advisable to include formal powers for the National Commission to obtain the information it requires in order to carry out its statutory objectives. This should include the power to require information and documents directly from a licensed company, from recognized investment exchanges or clearing houses, or from persons 'connected' with a licensed company, such as its officers, senior managers, employees, agents, a controller or a member of the same partnership, even if that individual is no longer part of the company, organization or partnership. The regulatory authority should give written notice of the specific documents and information required, but a member of the National Commission may request the information to be provided at once. However, if the Commission has reason to believe that this would mean that the investigation would be frustrated, for example, the documents would be shredded or burnt, then it would not be necessary to issue a notice.

The Commission should also have the right to carry out a general investigation of a company or organization, if it seems to the Commission that there is a good reason to do so, but must give written notice of its intention. The investigation could include individuals who are no longer employed there. The Commission should also have the power to carry out a specific investigation if the circumstances suggest that certain criminal offences have been committed, such as insider dealing, market manipulation, misleading statements or unauthorized business. In all these cases, the Commission should be able to use the skills of a senior lawyer, an accountant, or someone with high levels of experience in the capital markets to prepare a report, the costs of which fall on the company or organization being investigation.

The Law should also state that information can be shared with relevant agencies in Moldova. In particular, the National Commission should have a Memorandum of Understanding with the National Bank of the Republic of Moldova. This will become increasingly important as banks, insurance companies and securities brokers become part of the same group of financial services companies; indeed, with eleven bank broker/dealers and one bank dealer only. Given that the National Bank is responsible for managing the systemic risk of the financial system as a whole, the Bank will require full information about the financial stability of the broking arm of the bank or, in the future, insurance companies and other financial services companies. The possibility of the deputy governor of the National Bank joining the Council of the National Commission and vice versa may be considered. The full Memorandum of Understanding between the Bank of England and the Financial Services Authority is included as Appendix III for information and consideration.

As the market in Moldova develops, the importance of co-operating with foreign regulatory authorities is likely to increase, and, indeed, would be required in certain circumstances, if Moldova became a member of the European Union. Given the pressures on Parliamentary time, it is recommended that the National Commission has the authority to undertake investigations on behalf of a foreign authority, which has the same functions as the Commission, if the case is sufficiently serious, and if it had some importance to the people of Moldova, should be written into the legislation. More generally, the Commission should also have the right to share information with other regulatory authorities, again with the same or similar functions, and should have the power to enter into Memoranda of Understanding with relevant domestic regulatory authorities for that purpose. Membership of IOSCO also carries with it the obligation to share information with other regulatory authorities, as stated in Principle D, which states that the regulator should have the authority to share both public and non-public information with domestic and foreign counterparts; establish information-sharing mechanisms about how and when information will be shared. These should also allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and the exercise of their powers.

(iii) Recognized Investment Exchanges.

The Law on the National Commission for Financial Market should also set out the requirements for the recognition of investment exchanges (although there is only one exchange at the moment, which would be 'grandfathered in'), and also set out clearly the relationship between the National Commission and recognized investment exchange. The rules for recognized investment exchanges should include the criteria for recognition of an investment exchange and sets out the nature of the supervision of the recognized exchange by the National Commission. It should be noted that the current draft of the Law appears to allow for only one exchange, the Moldovan Stock Exchange and 'OTC' trading. It is recommended that the Law should leave open the possibility of another exchange being recognized in the future.

The broad requirements for the recognition of investment exchanges together with the framework of supervision are set out in this report. As far as the requirements for recognizing an exchange are concerned, these should include:

(a) The exchange must operate market facilities which enable those using the facilities to enter into transactions and investments.

(b) the 'fitness and properness' of the exchange and must, in particular, ensure by its constitution, rules, practices, and that the systems and controls used are appropriate to the scale and nature of the exchange's business and that adequate procedures are adopted for making and amending the rules and keeping the rules under review, including the level at which decisions to change the rules or introduce new ones. These arrangements must include consultation with members and users of the exchange and notifying them of any rule changes, once the consultation process is completed and the new rules have been drafted. Since the National Commission has the authority to approve rules, it also has the power to reject proposed rules, although this should be a last resort for the Commission and the Stock Exchange, since these should be discussed and agreed by the two bodies. The final authority does, however, rest with the National Commission.

(c) The exchange must have sufficient financial resources for the proper carrying out of its regulated activities.

(d) The exchange must be able and willing to co-operate in the sharing of information or otherwise with the National Commission, another law enforcement agency or another body with regulatory or supervisory powers in Moldova or overseas regulatory authority.

(e) The exchange must be able and willing to promote and maintain high standards of integrity and fair dealing in carrying on regulated activities. This will include being able to assess the members' and users' compliance with the rules and the ability to take appropriate disciplinary action, including suspension and referring the non-compliant individual or company to other authorities for investigation or possible action.

(f) The exchange must have satisfactory arrangements for ensuring the timely discharge of rights and liabilities of parties to transactions carried out on the exchange, recording these transactions, monitoring and enforcing compliance with its rules and arrangements and investigating complaints.

(g) If the issuer does not comply with the disclosure rules, the rules must allow for the exchange to discontinue of the admission of the relevant securities to trading, suspension of trading in those securities, publication of the fact that the issuer still has not complied with the obligation of disclosure and for the exchange itself to make public any information which the issuer has failed to publish.

(h) Appropriate measures are taken to reduce the extent to which the exchange can be used for market abuse or financial crime.

(i) A recognized exchange is supervised by the regulatory authority, although it has the powers and responsibilities described above. The recognized exchange is obliged to provide the regulatory authority with all the information it requires for supervising the exchange. This includes any key changes of staff, membership and rules of standing committees, disciplinary action against key individuals, members or users of the exchange, proposed changes to its constitution and the reasons for it, financial information, including its budget, fees and incentive schemes, complaints or legal proceedings against the exchange and others.

The recognized exchange may develop its business in response to a changing market, but it must be able to assure the regulatory authority that when it does so, it is able to meet the recognition requirements, but it must inform the regulatory authority of all significant developments and of progress with its plans and operational initiatives. The changes here include the rules applicable to the exchange, which must be approved by the regulatory authority. The latter can also issue directions to the recognized exchange if there is a serious failure to satisfy the recognition requirements and may take immediate action if there is reason to believe that there may be serious losses to private customers or to market confidence.

These rules, which are standard requirements for the recognition of an investment exchange and for the supervision of an exchange by the regulatory authority, have the advantage of clarifying the relationship between the two. The Draft Law as it stands sets out the structure of the Stock Exchange, its membership, details regarding the management and employees of the Stock Exchange, and its power to make rules, which can only take effect upon their approval by the National Commission (Articles 44 to 47), but these are not criteria for recognition. It is important for the new 'mega-regulator' to establish both the rules and the conduct of its relationship with recognized investment exchanges. The rules, of course, lay down the rights and responsibilities of both parties, but it is also important that the relationship is conducted in an open and co-operative manner.

(iv) Central Depository and Registrars.

Articles 6, 7, 37,38 and 40 of the Law on the Securities Market, 1998, as amended, set out the requirements for independent registrars and for the central depository. These Articles do not prevent the establishment of the central depository as the central share registry as well, but may need to be amended to allow for this development to take place. The Central Depository is owned by professional participants of the securities market, none of whom can individually own more than 5% of the voting rights, except the Stock Exchange, which can own up to 75% of the shares, but does not apparently do so.

The Central Depository is currently considering the purchase of additional software to enable it to offer a fully electronic share registry, whereas the fourteen independent registrars offer only a paper-based service. It should be noted that IOSCO principles (The Secondary Market, Principle 13, Risk Issues in Clearing and Settlement Systems, 13.11) regards a central depository and registry is recommended. It states that 'a centralized securities depository or registry, linked with clearing and settlement system facilities provides a strong foundation for secure and efficient securities and settlement systems. Over time, jurisdictions should move to de-materialize securities or to immobilize securities in regulated depositories or registries'.

The Report on the Observance of Standards and Codes of May, 2004, conducted as part of the joint World Bank-IMF programme of reports, recommended that, in order to increase independence, reduce expenses, consideration should be given to the creation of a central registry to maintain ownership records of open JSCs (now public interest JSCs) and to removing the nominee ownership concept from the law. In view of previous recommendations and IOSCO's principles, adding a central share registry to the existing facilities of the Central Depository should be undertaken as soon as possible.

The members of the Stock Exchange and the Stock Exchange itself have an interest in an efficient and accurate clearing, settlement and registration of share ownership processes, so that the independent registrars may find it increasingly difficult to compete. A move towards a central register of securities would be in line with developments in some member states of the European Union, which may also provide clearing and securities settlement services.

(v) The Powers of Enforcement.

As set out in the Law of the National Commission on Financial Market in Article 8, the Commission has the power to review or suspend licenses, or to withdraw licenses from market participants. In the case of the insolvency or threatened insolvency of a licensed company, the Commission can impose a reorganization of the company and put in new management and a new strategy for the company in accordance with the Law on Insolvency. Article 9 also refers to the role of the National Commission in 'examining materials on administrative contraventions' and the application of 'administrative penalties' following the procedures established by the law'. These take the form of fines and under the present Administrative Code, the fines are limited to a maximum of 1000 lei for an individual and 60,000 lei for directors, managers and so on. The current Administrative Code does not regulate the level of fines on companies, so the Commission would be free to set fines at a high level if the breaches of the regulations seriously damage clients or consumers. It is a possible that a new Administrative Code, which was drafted in 1999, will be adopted by Parliament (it is now in Parliament for a second reading) later this year. In the proposed new Administrative Code, the fines are limited to a maximum of 3,000 lei for an individual and 10,000 lei for a company. There are some exemptions for the failure to pay tax. The Commission's hands could be tied by the Code in the near future.

It may be an unusual step, but the Commission should apply for an exemption from this Code on the grounds that financial services companies occupy a particularly significant role in the development of the economy and the importance of maintaining trust in the financial system and in the companies to which customers have entrusted their money in return for protection (insurance) and savings and investments. Failure to ensure that the Commission has comprehensive enforcement powers will mean that the National Commission does not conform with Principle 8, namely that the regulator should have comprehensive enforcement powers. These are set out in detail by IOSCO as follows:-

- Regulatory and investigative powers to obtain data, information, documents, statements, records from persons involved in the relevant conduct or who may have information relevant to the inquiry;
- Power to seek orders and/or to take other action to secure compliance with these regulatory, administrative and investigation powers;
- Power to impose administrative sanctions and/or seek orders from the courts or tribunals;
- Power to initiate or to refer matters for criminal prosecution;
- Power to order suspension of trading in securities or to take other appropriate action;
- Where enforcement action is able to be taken, the power to enter into enforceable settlements and to accept binding undertakings.

It is necessary to set out the powers of enforcement in the context of regulation and supervision. If a company fails to comply with regulations and this is discovered in the course of on-site inspections, market surveillance, or complaints from customers, for example, then the first step should be to agree with the company on a course of action in specified period of time to take the steps set out by the regulator to put matters right. If the company fails to take the necessary steps within the agreed period of time, and if the regulator is clear that the company is committed to taking the necessary steps and has taken some but not all of the appropriate steps, then enforcement action may be delayed or the regulator may not take any enforcement actions at all, once he is satisfied that the company is fully compliant with the regulations.

If, however, this process fails and despite warnings and time to put matters right, the regulatory authority decides to discipline an authorized firm or to impose a penalty for market abuse, it should issue a warning notice to the company concerned in writing explaining the reasons for the proposed action, giving a reasonable time for the company to make representations. If, after that time has elapsed, the regulatory authority still considers that action is necessary, then it should issue a decision and take the necessary enforcement action. Fines are frequently used as a form of disciplinary action, but trivial fines are insufficient to achieve any objectives of enforcement.

To strengthen enforcement actions, they should be accompanied by a public reprimand, explaining in detail the reasons for the fine. This would be published in the Official Monitor of the Republic of Moldova, as well as on the website of the National Commission and issued as a press release. The public has a right to know the manner in which the company with which they may wish to deal conducts itself and whether or not it is a company which they could trust.   The draft Law of the National Commission on Financial Market should set out such additional powers. Examples of the Final Notice of the requirement to pay a financial penalty issued by the UK Financial Services Authority and a Resolution to issue impose a fine issued by the Hungarian Financial Supervisory Authority can be found of the websites of the relevant regulatory authorities and should be used as examples for the new National Commission. The FSA also publishes its enforcement manual on its website, so that the regulated firms and individuals know what the FSA is supposed to do. The National Commission should adopt the policy of setting out its enforcement procedures and publicizing these on its website and publications.

Publication of the enforcement actions taken and the reasons for them, as many other regulators do, helps the regulator to adopt clear and consistent regulatory processes and be seen to do so. Publication assists the regulator helps the regulator to adopt processes which are consistently applied; comprehensible; transparent to the public and are fair and equitable. (IOSCO, Principle 6, 6.5). The UK Financial Services Authority regularly publishes enforcement actions on its website and examples can be seen there.

(vi) Immunity.

The Law, as it stands, states that members of the Administrative Council cannot be detained, arrested or called for administrative or criminal responsibility, unless upon summons issued by the Prosecutor General and with the due consent of Parliament. (Article 24 (2). However remote such an event may be, it still leaves members of the Administrative Council vulnerable and does not protect staff of the Commission. Nor does it set out the prime condition for any sort of immunity from claims for damages, namely that the actions taken are taken in the course of fulfilling the functions of the authority and acting *in good faith.*

It is important that both the National Commission itself and all its members of staff should not be liable for damages for any action taken, when acting, and only when acting as a member of the Commission and when carrying out their duties as a member of the Commission in furtherance of the aims, objectives and functions of the Commission. They all only have this statutory immunity if they are acting *in good faith.* If their actions can be shown to be carried out *in bad faith*, then they lose that immunity, and their actions can be challenged in the courts. This should also be accompanied by a code of conduct for regulatory staff and should observe the highest professional standards including appropriate standards of confidentiality. This will enable the Commission to carry out its duties without constant court appearances to face challenges, for example, over the refusal to grant a license and the independent tribunal allows for the right to appeal.

(d) Independent Appeals Procedure.

The Law of the National Commission on Financial Market allows for the decisions of the National Commission to be appealed in the courts. Some regulatory authorities have the same provision, but others set up a variety of independent appeals procedures in the interests of speed, efficiency, cost and the knowledge and experience of those deciding on the merits of the appeal. It is important that some such appeals mechanism exists, since single regulators do represent a concentration of power.

Two examples of an Appeals Procedure have been selected to provide the National Commission with a range of models, which it might be suitable for the adoption or adaptation. In the case of the UK Financial Services Authority, there is an independent tribunal, which meets as and when required. Those who feel that they have been wrongly treated and that the enforcement actions which have been taken against them are unjustified can appeal to an independent tribunal. The independence of the tribunal is ensured by the following procedures.

The appointment of a Panel of Chairmen is the responsibility not of the Treasury (Ministry of Finance) but of the Lord Chancellor’s Department, (somewhat equivalent to the Ministry of Justice) and members of the Panel must be lawyers with seven year general qualification and a

President and Vice President of the Panel with ten years' experience. The Minister also appoints a lay Panel of relevant experience. The tribunal has the right to consider any evidence relevant to the case under consideration, whether or not it was available to the Financial Services Authority at the time.

The decision of the tribunal has to determine what, if any, is the appropriate action for the FSA to take regarding the enforcement action the FSA proposed. The Tribunal may uphold the enforcement action, the FSA was about to take, but if it does not, the FSA has to withdraw the proposed course of enforcement action. The decision of the Tribunal must be set out in writing and the reasons for it, signed by the Chairman, and it must state whether or not the judgment was unanimous or supported by the majority. Both parties have to abide by the decision of the Tribunal. The decision may also include various recommendations to the FSA regarding its regulations or procedures used in an investigation, which, although the FSA does not have to follow them, may carry weight and influence its conduct of regulation. The tribunal is, of course, entirely free to find against the actions of the FSA, and has done so on occasion. If the complainant is still dissatisfied, then it is possible to take the complaint to the courts.

The Autorite des Marches Financier (AMF, the French Securities Commission) has adopted a different approach and has separated the functions of supervision and discipline. The Disciplinary Commission has exclusive authority to exercise the AMF's power to impose sanctions. The Commission is composed of 12 members, none of whom is also a member of the Board, including two justices of the Court of Cassation, six qualified individuals appointed by the Minister of the Economy after consultation with organizations representing issuers, intermediaries, investors and market undertakings, together with representatives of the employees of investment service providers, fund management companies, market undertakings, clearing houses, clearing and settlement systems and central depositories, also appointed by the Minister after consultation with the trade unions.

There are four stages in the process of enforcement. The AMF General Secretary initiates the inspections and investigations and the process of documentary and on-site examinations, and taking statements from witnesses are conducted with his authority and under his supervision. It is also possible to enter and search premises and confiscate documents under his supervision. The investigators prepare reports on the evidence they have acquired for the Board to consider whether the evidence is sufficient to start disciplinary proceedings. Their reports are never made public.

If the Board decides to open disciplinary proceedings, it services a written notice of the charges to the person or company concerned and forwards the case file to the Disciplinary Commission and again, this document is not made public. If the case is an urgent one, the Board may also order a provisional suspension of activity as far as the company is concerned at the same time as it is opening disciplinary proceedings.

Disciplinary proceedings are conducted by the Disciplinary Commission with one of its members acting as rapporteur, who prepares the case for both sides. He may assisted by the AMF staff in the preparation of the report, which is then submitted to the person who is charged, who can then put his observations in writing before attending a hearing before the Disciplinary Commission, which can be held in public if anyone who has been charged wishes. The rapporteur presents his report and the person charged and his counsel are heard with the defendant having the last word. If the charges are upheld by the Disciplinary Commission, then a fine may be imposed. The AMF has the power to impose fines not exceeding E1.5m or ten times the amount of the realized profit. It is important to note that the AMF states clearly the principle on which the amount of the fine is based. 'The amount of the fine set is based on the gravity of the acts committed and in proportion to the profits realized or other advantages gained by virtue of those acts'. Disciplinary decisions can also be made public in any way the Commission chooses. It is possible to appeal against the decision in the courts.

The AMF has other powers of enforcement, which include the following:

- Administrative injunction. The AMF Board may, after giving the person concerned an opportunity to provide explanations, order that company or individual to cease engaging in practices contrary both the AMF's General Regulations and to laws and regulations in general.
- Cease and desist order. The AMF chairman can ask for a court order asking for a company or individual to put an end to an established irregularity. The court may attach a penalty for failure to comply with the order.
- Sequestration order. The AMF chairman or general secretary, giving grounds for their request, may ask the chief judge of the regional court for an order taking temporary possession of funds, valuables, securities or rights belonging to persons believed by them to be guilty of wrongdoing.

These sanctions or penalties can be imposed on:

- professional entities (such as companies), which are supervised by the AMF, for any breach of professional obligations established by laws, regulations or rules of professional conduct approved by the AMF;
- individuals under the authority of or acting on behalf of the professional entities; and
- any other person whose practices contravene legislative or regulatory provisions, when such practices infringe investors' rights or impair the orderly operation of the markets.

All of these are designed to ensure that companies and individuals comply with the laws, rules and regulations.

Two features of the procedures adopted by the AMF should be noted. First of all, the sanction (fines in particular) is imposed according to the gravity of the offence, allowing for judgment on the part of the Commission, and the formula applied for the level of fines allows for that flexibility to be reflected in the actual sanction imposed. Whichever approach is adopted to enforcement, and the separate tribunal may well be the simplest option for the National Commission to adopt, the basic principle of the disciplinary action representing the gravity of the offence and of the system allowing the company or the individual concerned to present their case before the final decision is made regarding the sanction (as is the case both in France and the UK) and the right to appeal against the decision.

The procedure adopted by the AMF is perhaps too complicated for the National Commission at this stage of development. An independent tribunal is a simpler option for the Commission to adopt at this stage. Interviews at the National Commission suggest that it would be possible to appoint a panel consisting of five independent lawyers, who would be called upon to serve on the Panel as and when required, and paid accordingly. The tribunal members would be appointed by another department, such as the Ministry of Justice and funded by the same Ministry.

(v) Complaints handling.

At present staff at the regulatory authorities do handle complaints from the public, but there are no particular arrangements in place for an orderly and consistent process. The Law on the Financial Market should allow for the establishment of a complaints handling unit as part of the regulatory authority and, at a later stage, as an independent unit, separate from the National Commission. The Law should allow for the development of an 'Ombudsman' service, although the implementation date should be set for between three and five years ahead.

A full ‘Ombudsman’ service, which would also be funded by the industry, would involve establishing an independent service for settling disputes between businesses providing financial services and providing financial services and their customers. In the UK, it is funded by the industry and established by Parliament to settle disputes about a wide range of financial matters from insurance to mortgages and savings and investments. The service is entirely impartial and is an alternative to the courts. It is free for the consumer. The individual is free to reject the decision, and can go to court instead, but if the consumer does decide to accept the decision, it is binding on both parties. It is a large and well-staffed organization, independent of the Financial Services Authority, although there is a Memorandum of Understanding, which allows for an exchange of information between the regulator and the ombudsman service concerning trends in complaints and a large number of complaints about a particular company. This information may show that there is a serious lack of compliance with laws and regulations.

A full Ombudsman service is for the future as far as Moldova is concerned. But the general approach should be adopted, and applied within the National Commission. As has already been mentioned, individual members of staff do deal with complaints-some 159 insurance complaints last year, for example. These should be serviced by a small unit in the National Commission, dedicated to that purpose with a well-qualified member of staff (possibly a legal background) and administrative support. This will require new regulations setting out the procedures a firm must follow for dealing with complaints and the time-scale involved. A customer can only complain to the Commission if the company has dealt with the complaint and the customer is still not satisfied.

Section E. Recommendations for Phase 1.

That the draft laws should again be reviewed and that the National Commission should seek to ensure that they are adopted by the Government and the Parliament. Not all of these amendments should be implemented immediately, but, given the length of time taken in introducing new legislation or amending existing Laws and the fact that a complaints handling service and a compensation scheme will be necessary in the future, the law ought to allow for their introduction, set out the relevant Articles and an appropriate time-table of not more than eighteen months from the date of adoption of the Law of the National Commission on Financial Market. The independence of the National Commission and clarity concerning the extent and nature of its powers are essential elements of the new legal framework together with immunity from claims for damages, as described above. The obligation to share information with other regulatory authorities should also be properly described.

Section F. Setting up the National Commission-Phase II.

The time pressures for this phase of establishing the ‘mega-regulator’ is extremely short. It is expected to begin on April 1, 2007 and end on June 30th during which time the work will focus on ensuring that the ‘mega-regulator’ will be up and running on July 1, 2007. The staff of the regulator will largely be composed of existing staff of the State Inspectorate for Insurance non-State Pension Fund Supervision and State Service for Savings & Loans Association Supervisory Service and about ten newly appointed members of the Commission. Members of the Securities Commission, which forms the basis of the new regulatory authority, have not previously worked with members of the other two regulatory authorities. Integrating the staff will be an important task for the National Commission.

This may require further thought to be given to the internal organization of the National Commission. The present organizational chart indicates that the National Commission should be organized along functional lines with separate departments for prudential and market conduct supervision. In addition, there will be a strategy and analysis department and three directorates consisting of legal and services management as well as an internal audit department, which will report to the top management of the organization, the Administrative Council. Each member of the Administrative Council will be responsible for one of the departments. The internal audit department will supervise the planning and control procedures.

That is certainly one possible method of structuring the Commission, and two examples of alternative approaches, in the form of organizational charts, have been included in the report for consideration. There are dangers in organizing the Commission along the lines of insurance, securities and savings and credit association divisions, since they may continue to act as though they still existed as separate agencies and bring the pre-existing cultures with them. At present, there are no plans for overcoming these difficulties, which will persist unless they are tackled. However, the separation of prudential and conduct of business supervision in two divisions may well produce exactly the same results and is also flawed approach to supervision, since the two aspects of supervision cannot be separated; for example, the price war over premiums for motor insurance may well lead to insurance companies giving insufficient reserves to meet claims. This report will outline an approach to supervision, which helps to overcome difficulties caused by importing attitudes and practices of the pre-existing culture, as well as the equally important dangers of the prudential and the conduct of business divisions working as silos.

The first step in the plans so far drawn up by the members of the National Commission is to produce an internal rule book for the staff, a task which is expected to absorb much of the time during the preparation period between April and June. The rule-book is expected to include a code of conduct for the staff, and as part of the effort to integrate staff, it would be a useful exercise to consult the staff over the contents of the proposed code in small groups before a final version is added to the internal handbook. The proposed Code should comply with international standards, such as Principle 6 of IOSCO, which states:

- The avoidance of conflicts of interest (including the conditions under which staff may trade in securities;
- The appropriate use of information obtained in the course of the exercise of its powers and the discharge of duty;
- The proper observance of confidentiality and secrecy provisions and the protection of personal data;
- The observance of procedural fairness,

Understanding the purpose of the code will also help to ensure conformity with its requirements. However, it is also vitally important that the contents of the handbook do not conflict with the approach to risk-based supervision set out below, which requires flexibility in the way in which staff of the prudential, conduct of business and the strategic and analysis divisions, assuming the currently proposed structure is deployed.

There are a number of tasks which the National Commission should carry out before it becomes fully operational on July 1, 2007. These include preparing a Mission statement, followed by the preparation of the Handbook, which brings together all the rules and regulations for each section of the financial market, and which should be available on the website and for regulated firms in hard copy, so that these are accessible to the public as well as to the industry. A small unit within the Commission should have that responsibility. Two other handbooks should be prepared: the Enforcement Manual and the Supervision Manual. It would be impossible for the Commission to complete this programme of work between April and July. It is therefore recommended that the focus is first of all on developing the Mission statement followed by the Supervision Manual.

(i) The Mission Statement.

The statement should reflect the objectives of regulation as set out in the Law on the Financial Market, but may add other elements as well or the Commission may wish to have a mission statement, which is different from the statutory objectives, but which represents the aspirations and values of the Commission. The process of developing the mission statement should once again involve the staff in developing it in part by asking them to state how they would like to Commission to be viewed and what values they would like to see represented in their work as regulators. It may not be feasible to involve all the staff in meetings to discuss what form the contents should take, but a questionnaire regarding the values they would like to see. It may be a novel procedure but, hopefully, it will be rewarding and lead to a mission statement, which will be valuable in informing the public about what to expect from the regulator and guide the staff in their work.

The objectives set out in the Law on the Financial Market are similar to those of the UK Financial Services Authority, but the mission statement proposed by the then Chairman of the Financial Services Authority, Sir Howard Davies, proposed the following mission statement at the launch of the FSA in 1997. ‘The Financial Services Authority will aim to be a world-leading financial regulator, respected for its integrity both at home and abroad’. He highlighted the commitment to professionalism and integrity and explained that the FSA aimed to attract the brightest and best of those interested in the development of the financial market. The international focus was also important because of the growing need to improve international regulatory co-operation because of the increasing inter-linkages between financial markets.

Mission statements vary widely, as is illustrated by the following examples:

- Ba-Fin (the single financial services regulator in Germany) has three objectives: its paramount aim is to ensure the functioning of the entire financial system in Germany; to safeguard the solvency of banks, financial institutions and insurance undertakings and to protect clients and investors.
- Finansinspektionen (the Swedish Financial Services Authority): Our role is to promote stability and efficiency in the financial system as well as to ensure effective consumer protection.
- Gibraltar Financial Services Commission: To supervise and regulate Gibraltar’s financial services to protect the public and enhance Gibraltar as a quality financial centre.

The mission statement for the UK FSA has been added to the list, but its objectives were set out in the Financial Services and Markets Act, which also provides a good foundation for another kind of mission statement:

- Market confidence;
- Public awareness;
- Protection of consumers; and
- Reduction of financial crime.

It will be up to the National Commission to review these mission statements and others with a view to developing its own.

(ii) The Supervision Manual.

During the period from April 1 to June 30, 2007, the next phase of preparation for the launch of the National Commission should be on the development of the Supervision Manual. This should take priority over development of the Handbook and the Enforcement Manual. In the third phase from July 1, 2007 until the end of 2007, further rules and regulations (normative acts) will be developed, which can then be incorporated into the Handbook. These should be subject to a process of public consultation, which can also be used as a means of explaining to companies what is now required of them and giving them the opportunity to put the necessary systems and controls in place and training their staff. The Enforcement Manual, which is less demanding, can also be safely postponed until later in the year. The full procedure will also require the National Commission to take decisions regarding which part of the Commission has the responsibility of deciding to take enforcement actions and which appeal process to be used. Until these two manuals are produced, the Commission should use existing rules and procedures.

The first and most important step is to develop a risk-based framework for supervising non-bank financial institutions and, at the same time, for intensive training to take place. The general framework for supervision will be familiar –on and off-site examinations, meetings with the chief executive and so on, but its purpose and emphasis will be quite different. The supervisory process begins with planning and preparation for the on-site visit, the visit itself and the follow-up with the company. The staff involved in this process will be drawn from more than one division in the regulatory authority, partly because they bring specific skills to the process, such as analytic skills or knowledge, such as knowledge of the insurance industry, or experience in another sector. This is why the internal rule-book must allow this kind of flexibility. The

National Commission is still relatively small and will be responsible for supervising a growing industry. It must therefore make full use of the skills available so that staff may be easily involved in more than aspect of regulation and not confined to one particular segment of the work of the Commission.

This can work with the organizational structure which is drawn up along functional lines or with one that is organized along sectoral lines, provided the principles of risk-based supervision are applied to the regulatory process. In the early stages of development, it may be wise for each team (of three persons) to have a leader with some knowledge of the sector concerned, insurance, for example. The other two members of the team would be drawn from the strategic and analysis division, the prudential division and the conduct of business division. This will ensure communication between the separate divisions, since even an organizational structure along functional lines will not prevent the development of a 'silo' approach. The input from all three divisions is essential if the company risk, the sector risk and overall stability of the financial system can be properly assessed.

The risk-based approach to supervision itself requires contributions from the staff in each division of the regulatory authority. The process consists of identifying the risks posed by particular firms to the statutory objectives, using a wide range of information gathered from a variety of sources. The next step is to assess and prioritize the risks using a risk assessment process, but when the focus is on company specific risks, attention should be focused on control, business and consumer relationship risk. It also takes into account the impact of the failure of a company; for example, a car insurance company, where customers would end up with worthless policies, and the probability of a collapse of this kind. In some cases, such as the UK Financial Services Authority with over 29,000 firms, employing some 165,000 individuals to supervise and 2,800 members of staff, risk-based supervision enables the FSA to focus on firms which pose the greatest risk, especially in terms of on-site visits, although, of course, that was by no means the only reason for its introduction. Not only does it have the advantages outlined below, but it enables the FSA to identify the major risks for the financial system as a whole.

However, for smaller regulatory authorities, risk-based supervision has other advantages. It is mainly a tool of supervision which improves the effectiveness of regulation by adding to the information about the company derived from returns and off-site monitoring. It also allows for the verification of off-site information provided by the company and an assessment of the company's compliance with the laws and regulations to which it is subject. The on-site visit (when properly conducted and with careful preparation) provides the regulator with insights into the fitness and propriety of the management; evaluation of the soundness of the systems of control and the inherent risks; and evaluation of the effectiveness of the company's internal controls. The procedure should help the regulators to identify the early identification of potential problems and to evaluate the implementation of the future business plans. It often leads to agreeing a remedial programme for the company to carry out, rather than enforcement actions.

These are the issues to be addressed in the development of a Supervision Manual, which should be undertaken in the first three months. This need not be a long and complex undertaking, as indicated by the outline provided in Appendix I. A decision would have to be taken about making the Manual available to firms as some other regulators, such as the FSA, do. This sets out what the regulator expects to find when they visit the companies and what they can expect from the supervisor regarding the whole process of the on-site visits. What is much more important is the additional training which should accompany the production of the Supervision manual, as well as the training involved in the production of the manual itself. Drafts of the manual should be discussed with the staff, who will be using it to guide their regulatory work.

(iii) Training.

Risk-based supervision will require intensive training, since it is a different approach from a generally rule-based approach, requiring the development of suitable models and the exercise of judgment. The identification of risk does involve a question of judgment, since absolutely precise measures of risk are not available. A degree of objectivity can be increased by the use of risk models, which have been developed first for banking by the Bank for International Settlements and then by IOSCO and IAIS, but these are probably too complex for the industry in Moldova at this stage. Instead a simpler approach to risk assessment on the part of the National Commission should be adopted as outlined in Appendix I.

It is recommended that a period of intensive training for all staff involved in risk-based supervision should take place during Phase II and during Phase III. The training should be provided by one or two trainers working with the National Commission, providing work-shops to encourage active participation accompanied by role play, setting out the situations regulators are likely to meet during on-site visits and follow-up meetings.

Not all of the present staff or the new recruits for the National Commission expected this year or in the future have experience in insurance, the capital market or savings and credit associations. Distance learning courses are now provided by International Association of Insurance Supervisors and the World Bank Group. The Core Curriculum Materials are non-commercial training materials for insurance supervisors, consisting of 36 basic-level modules and five advanced level case studies, providing comprehensive training in the principal areas of insurance supervision. It is also possible to select specific topics which suit the needs of individuals. FSI Connect (provided by the Bank for International Settlements) provides online information and learning resources for banking supervisors (as well as a series of seminars). The National Commission does not, of course, supervise banks, but some of the elements of the course for banking supervisors would help those supervising savings and credit associations and others are more general in their application; for example, some of the elements of the course cover risk management, audit, governance and internal controls.

The National Commission should review these courses and consider making basic elements of the courses compulsory for its regulatory staff. These are designed to provide cost-effective means of building up the capacity of the new regulator. Other organizations also provide distance learning and examinations, such as Insurance Institutes, including Chartered Insurance Institute of London and the Securities and Investments Institute, also London-based. The latter provides not only distance learning courses but also provides facilities for computer-based multiple choice tests in Kiev and Bucharest. Some of the courses, such as the IAIS course, are demanding, but it is possible to make a selection of courses, which would suit the current staff and provide them with a basic knowledge of insurance, securities and savings and credit associations. In the future, all new recruits should be expected to undertake these courses as part of their induction to the regulatory authority.

One of the most effective forms of training is to send one or two members of staff to work as interns with another regulatory authority or with a large insurance company or a bank for a period of three to six months, but only under strict conditions, which include an agreement to return and to train other members of staff. The contract should also involve a commitment to remain with the National Commission for a period of time or face financial penalties. On these conditions, the internships would have to be funded by a donor agency.

Section G. Phase III. Further Preparation for the Full Operation of the Commission.

A number of issues will have to be addressed during this period from July 1, 2007 until the end of the year. Work should proceed on the completion of the Handbook, which will be composed of the various regulations which will be developed during Phases II and III, following a period of consultation. The Handbook should also be made available on the website.

(i) Enforcement Manual.

First of all, the manual should state the principles and purpose of enforcement actions. For example, as far as the AMF is concerned, its stated principle is that 'the amount of the fine is based on the gravity of the acts committed and in proportion to the profits realized or other advantages gained by virtue of these acts.' The FSA has a fuller statement of its policies on enforcement, which is as follows:

> *Enforcement powers are to be used in a way which is transparent, proportionate and consistent with its publicly stated policies. The aim is also to ensure fair treatment, giving an opportunity for both written and oral representations to be made, and that procedure is set out and made public. The FSA also has a range of enforcement powers to be used and will decide to use one or more of those powers depending on the circumstances, including the powers to intervene and oblige a company to make restitution to those who have suffered as a consequence of the company's actions. Again the FSA explicitly states that a 'financial penalty should be proportionate to the nature and seriousness of the contravention'.*

Once again, it is important that the National Commission is able to state the above principles as the guide to its enforcement sanctions, but if the proposed draft of the new Administrative Code is adopted by Parliament, then the Commission will lose that ability to impose fair and proportionate sanctions on companies. It will also be much less effective as a regulatory authority, since limited fines will not have the desired effect and then the Commission will only have temporary suspensions of the license or withdrawal of the license, which are actions to be taken as a last resort.

The Enforcement Manual should then set out the circumstances, that is, possible breaches of regulations, which may give rise to enforcement actions. These should be set out in some detail and are likely to include the concern that the firm may have acted in breach of the regulations and laws; the company may act in such a way as to prejudice the interests of consumers; a company may be used or may be being used for the purposes of financial crime or laundering the proceeds of financial crime; concerns about the ownership or control of the firm being in the hands of persons who do not conform to 'fit and proper' requirements, and market abuse. It should also indicate that a judgment will be made about the seriousness of the concerns, including the effect on consumers or market confidence or the duration of the breaches of regulation, the frequency and the type of breach involved.

The Commission should then set out information about the procedures if they believe that there are matters of concern and suspect breaches of the regulations and laws. The powers of the National Commission to investigate possible breaches and to require firms to provide all relevant documents and enter premises should be set out in the Manual together with the procedures involved.

The Commission should set out further requirements in its Manual concerning the process. A written notice should be given to the company to be investigated and the reason for the investigation. It should also state who is under investigation, if it involves a particular individual or the firm if it involves a group of persons and who is going to conduct the investigation. There may be exceptions to a formal written notice, if, for example, market abuse is the issue and the written notice in these circumstances would undermine the investigation.

Interviews with the individuals under investigation should be conducted on a voluntary basis, but if that does not produce the information required, the Commission should have be able to conduct compulsory interviews, and then the interviewee should be accompanied by a legal advisor and be given a record of the interview. In some circumstances, where criminal activity, such as fraud, is suspected the interview is conducted on the basis that the information could be used in court as evidence against him. The point here is that all procedures should be set out in the Manual so that all the members of the regulated entity should know what to expect.

The final stages of the procedure should also be set out. The company first should be issued with a warning notice which should set out in detail the reasons for the penalty and the amount of the fine. This gives the company a chance to argue its case against the statement and the fine, based on the evidence on which the authority has made its judgment. Those making the enforcement decision must be a separate division from those conducting the investigation. The company should be given a certain amount of time in which to defend itself or to agree remedial actions, sometimes including reparation to customers or others who have lost investments as a result of the company's actions.

The Commission need not issue a decision and follow that by the imposition of penalties, if the company agrees a programme of work to ensure its compliance with rules and regulations and also to repair any damage done to its clients, customers and investors as a result of its actions. That settlement has to commit the company to a serious project in which systems and controls will be overhauled, staff retrained, capital reserves built up or new internal procedures established within the company. It is important to note the importance of the Commission and the company agreeing on remedial action. Restitution may also be sought even if penalties have been imposed.

If the Commission finds that the company is unwilling to change its practices, then the decision is followed by the imposition of the penalty. This should be accompanied by a public announcement regarding the penalty and the reasons for it. The final resort of for the disciplined company is to appeal to the tribunal.

(ii) Consumer Protection.

This is one of the objectives of the National Commission together with a commitment to an ambitious programme of raising public awareness. The first step in that programme should be taken during the third phase of establishing the 'mega-regulator' and will also be part of the preparation of the detailed regulations which will take place during this period. The focus here should be on the purchase of policies from insurance companies, since, at present, scope for other investments is virtually non-existent. Future developments in the corporate bond market and the mortgage bond market, it is hoped, will provide opportunities for individuals to save and invest. At that stage, further disclosure requirements should be developed, following the guidelines set out below:

- Provide customers with simple, clear and understandable information about the services a company provides, how a product meets their demands and needs and the reasons for the advice;
- Produce information about the service the firm is providing and ensuring that customers get this information in an understandable format at the right time;

- Develop standards for advising and selling, to require that when advice is given and a policy is recommended that the policy is indeed adequate to meet the customer's needs;
- Develop standards for training and competence, to ensure that individuals selling and managing insurance contracts are competent for their roles;
- Develop product information, to ensure that customers get key product information at a time when it can influence their decision-making;
- Define measures to ensure the fair treatment of customers, such as an excessive charges rules and cancellation rights;
- Produce standards for claims handling, to ensure that claims are treated promptly and fairly; and
- Develop procedures for handling complaints, to ensure that complaints are handled properly and to provide access to the complaints-handling service.

At present, there are very few products or policies available for the consumer, apart from insurance products. As the market develops other products and investments will be made available. Much work has been carried out by the FSA to ensure that insurance contracts are as clear and straightforward as possible. Examples of insurance quotations and policy statements for car insurance and home contents insurance are referenced in Appendix IV. They may not quite fit the kind of policies which are generally purchased in Moldova, but it is hoped that they will provide a template for Moldovan policies.

(iii) Managing the National Commission's Resources.

The three recommendations outlined here are designed to enable the National Commission to manage its resources more efficiently and effectively. The first concerns the Savings & Credit Associations, the second concerns the number and range of joint stock companies required to submit their financial reports to the National Securities Commission (at present), and the third, concerns the supervision of insurance companies.

(a) Savings & Credit Associations.

The draft Law of Savings & Credit Associations establishes a central administration, whose prime purpose is to provide support, training and advice for the associations which are its members. A Stabilization Fund will be established in order to provide support to a savings & credit association, which is in difficulties for a variety of reasons, such as fraud, mismanagement or a serious failure to comply with regulations. The Law also allows for the appointment of an external administrator to manage the association and take control of its assets. The association may then be returned to the previous administration or its license may be withdrawn or a merger with another association may be arranged. Savings & Credit Associations are obliged to become members of the Stability Fund and must pay an initial contribution, followed by an annual contribution. It is hoped that the fund will grow through its investments.

Article 56 of the draft law allows the central administration to accept investments into the liquidity pool and to offer assistance to members with short-term liquidity problems by offering loans and guarantees to enable them to meet liquidity requirements. This is the practice in other countries, such as the USA, where the National Credit Union Administration (NCUA) has its Office of Examination and Insurance. This unit within the NCUA provides national guidance for NCUA's efforts to ensure the safety and soundness of federally insured credit unions. It also provides liquidity for all credit unions with the aim of providing stability and thus encouraging savings. The Office of Examination and Insurance is designed to provide short-term loans under strictly limited circumstances. These are:-

(a) Short-term adjustment credit to assist temporary requirements for funds or to cushion more persistent outflows of funds until the credit union can bring about an orderly adjustment of credit union assets and liabilities.
(b) Seasonal credit is available for longer periods in order to meet seasonal needs.
(c) Longer-term credit is available in the event of emergency or unusual circumstances arising from national, regional or local difficulties e.g. extreme weather conditions.

For NCUA, loans may be refused and that credit unions should have proper procedures in place to manage their own liquidity risk. On occasion, loans may also be granted on the condition that the credit union provides a liquidity restoration plan. This is likely to happen if the loan officer is concerned about the credit union; for example, if it consistently provides incomplete, vague or late information or if he suspects that the loan is being used for inappropriate reasons or if it seems to be unreasonably dependent on loans without making progress in the management of its liquidity risk.

There are lessons to be learned from this brief description of the approach adopted by the American National Credit Union Association. Offering short-term loans would enable an association to overcome its liquidity problems and delay the appointment of an external administrator. It would undoubtedly assist with keeping savings and credit associations afloat as well as maintaining confidence in their credibility and in this respect, follows the NUCA model outlined above. Lessons can still be learnt, despite the fact that NUCA is long-established and much larger than the Moldovan Association is or will be.

It does suggest one way of dealing with the fact that the regulation and supervision of the SACs at the National Commission will probably have only two experienced and knowledgeable staff members is to share the responsibility for the oversight of the stability fund and for ensuring the viability of savings and credit associations with the central administration and staff at the National Commission. As some of the staff from the State Supervisory Body of the Savings and Credit Associations with experience and knowledge of the SACs, it appears, will not be transferred to the National Commission, the possibility of employing them in the central admission should be considered. A system of reporting loans to the National Commission and the requirement for a liquidity restoration plan would be made jointly with the central administration and appropriate staff at the Commission. In general, the central administration, given that it will work closely with the SACs, should also work closely with the National Commission and both should ensure that there are appropriate information flows.

It has been proposed but not yet decided that the Rural Finance Corporation and the National Federation of Savings and Credit Associations should merge and form the Central Administration. If that does happen, then the staff at the regional offices (8 in the case of the Regional Finance Corporation and 9 in the case of the National Federation) together with staff from the State Supervisory body, who know the associations well should work together with the National Commission for more effective supervision. They can also work together to encourage mergers and acquisitions in order to reduce the number of associations as a means of ensuring their viability. It is a small sector, consisting of some 480 associations as at September 2006 with 105,700 members, but it is one in which there is a high risk of failure, especially when they will be allowed to take on further and more complex functions. If an association fails, the damage to consumers, though they may be small in number and in monetary terms, may well be severe. In addition, the collapse of an association may well undermine the credibility of other associations and discourage savings.

(b) Joint Stock Companies.

On January 24, 2007, the Chairman of the National Securities Commission announced that the new Law on Joint Stock Companies allowed for a reduction in the number of companies which are obliged to publish an annual statement of securities, quarterly financial reports and any relevant information about financial state of the company. The draft law to which the Chairman referred would remove the distinction between 'closed' and 'open' joint stock companies, but introduces the concept of a 'public interest company' which has to satisfy one of the following criteria, namely that its share capital is at least 500,000.00 lei with at least 50 shareholders or its shares are listed on the Stock Exchange. Companies of 'public interest' include 'commercial banks, insurance companies, investment funds, private pension funds, joint stock companies in the process of privatization and joint stock companies during the period when public placed securities are traded'.

The chairman advised that this would reduce the number of companies obliged to submit their financial returns and other information to the National Securities Commission (Issuers division) from 1100 to 650, when the draft Law on Joint Stock Companies is adopted by Parliament. This reduction is desirable, but the vast majority of these companies are not listed on the Stock Exchange: indeed, only 14 companies, mostly banks, are listed on the Stock Exchange and trade their shares.

Those receiving and analyzing the annual reports at the National Securities Commission point out that at present the profits reported in company financial statements do not always reflect the true state of a company's affairs, since companies conceal their profits in order to evade tax. Although the Joint Stock Companies Law requires every joint stock company to set up an audit committee elected by shareholders to guard their financial interests, these procedures have not solved the problems, since the audit committees do not protect the interests of the small shareholders, nor do they identify irregularities in financial operations because they are dependent on company management. Some of the 'independent' auditors do not reveal the true state of affairs but simply rubber-stamp the financial information submitted to them by management. This is not the only problem uncovered by the requirement for financial information to be disclosed. Some companies no longer trade from the location identified as the head office and the bank account is suspended. Others create a limited liability company for a short period of time, transfer all the assets to that company, then close the company bank account and disappear. Under the proposed law, these companies will face enforced liquidation.

These are the same problems as those reported to the IMF Corporate Governance Assessment in 2004. In that report, the IMF observed that a major obstacle to improving compliance with disclosure requirements is the large number of companies required to file. Interviewees reported the same problem in 2007. The National Commission is clearly pursuing a strategy which will help to reduce the number of companies that will fall under the National Commission in the future. In 2004, the IMF recommended establishing procedures which would enable companies to efficiently convert into other legal forms, if appropriate and under the supervision of the National Commission. That may still be an option for the Commission to consider.

It is a difficult problem to resolve. Reviewing company quarterly and annual financial statements is a time-consuming task for the Commission, which has sought to deal with it by reducing the number of joint stock companies as indicated in the IMF report on Corporate Governance. The Commission could take this approach. First of all, Moldova is committed to requiring international accounting standards and the Law on the National Commission states that the Commission and the Ministry of Finance will jointly work out and approve the specialized accounting and reporting to be followed by the professional participants of the financial market, issuers and self-governed organizations. This is unnecessary, since the International Accounting Standards Board has already developed appropriate standards in many cases, and all the Ministry of Finance and the National Commission need to do is to use the standards and guidance notes from the IAS.

Joint stock companies, including the ‘public interest’ companies should be obliged to follow the standards and producing accounts in accordance with National Accounting Standards, which are translations of international accounting standards, which are based on the IAS standards of 1993. The most important standards that do not have an equivalent in Moldova are IAS 29; IAS 39; IAS 40. When the standards were issued in 1996, the Government made significant changes to the original text, so that the accounting standards do not even conform to the 1993 edition and some standards do not have an IAS equivalent. The gap between Moldovan accounting standards and IFRS 2004 has widened as a result.

The Government is currently drafting a new accounting law, which is expected to have Parliamentary approval shortly. This law is expected to conform to IFRS standards and will be mandatory for the new ‘public interest’ companies from 2008. The Government (and hence the Commission) should simply adopt the IAS current standards, including the format for the presentation of financial statements. This should also be a matter for further action by the

National Commission in conjunction with other organizations to ensure that Finance Directors and its own staff are trained and auditing firms are brought up-to-date as well. It appears that there are currently no plans to provide training of this kind.

The Commission should require all the joint stock companies of public interest, and not just banks and insurance companies, to prepare and publish annual accounts on the company website and to send them in an electronic version to the Commission. These financial reports should be published on this website as well. Interviews and articles have indicated serious accounting failures, including the falsifying accounts or submitting accounts which do not give a true and fair view of the company's financial position. These are exactly the same complaints as the IMF study reported in 2004. The IMF also recommended that the NSC should design and build a simple electronic disclosure system with a goal of making public the complete statutory annual reports, including all non-financial information and the full financial statements (including notes and audit reports). It is even more important that this recommendation should be followed not only to protect the rights of shareholders, but also to enable the development of both the stock market and in particular, the corporate bond market. Until the electronic disclosure system is introduced, these financial statements can be published on the web sites of the National Commission and those of the companies themselves.

Responsibility for accurate reports belongs primarily to the management and the board of the company, then of the audit committee and the external auditors. The enforcement sanction available at present is suspension of the company bank account, but some of the activities reported amount to criminal activities and should be treated as such. Severe action taken by the Commission, when such instances emerge should have the effect of improving the quality of the accounts of all the 'public interest' joint stock companies. Reliable financial accounts would pave the way for the issuance of corporate bonds, which would then make it possible to assign a value to the company's assets at the very least and a proper indication of its profitability. That could lead to the unlisted company eventually deciding to list on the stock exchange, which is ultimately the way to protect the interests of the minority shareholders.

A number of interviewees argued that the procedure for issuing corporate bonds is at present is too complex and too expensive and that the issue has not been resolved in the draft law. The National Securities Commission puts too many obstacles in the way of the issuance of corporate bonds, possibly due to the fear of another major failure, such as occurred in the early 90s. The limit for the issuance of corporate bonds has been set too low, preventing their proper use.

Trading in bonds is also a difficult problem due to taxation problems. Some companies have expressed an interest in issuing corporate bonds but will be prevented from pursuing that objective if the regulatory system puts obstacles in the way. A review of the amendments to the draft law (Articles 13 to Article 20) would be useful both in itself, as a means of education and promotion.

It is important that such steps should be taken with an eye to the developments within the European Union. The plan to 'modernize company law and enhance corporate governance in the European Union' was proposed in 2002 and accepted by the Council of Ministers in March 2003. A set of new initiatives aimed either at modernizing the existing European Union company law instruments or at completing the European Union framework with a limited number of new tailored instruments are necessary to deal with the growing trend of European companies to operate cross-border in the Internal Market and the continuing integration of the capital markets amongst many other reasons. The main aims to be pursued by the EU Action Plan regarding companies are:

(i) to strengthen shareholder rights and third party protection with a proper distinction between categories of companies, and

(ii) to foster the efficiency and competitiveness of business.

The Plan covers six key areas: corporate governance, capital maintenance and alteration, groups and pyramids, corporate restructuring and mobility, the European private company, co-operatives and other forms of enterprises. With regard to corporate governance, a draft Code of Corporate Governance has been prepared and will be tested against the OECD principles in Section H. The most recent Directive concerns the formation of public limited liability companies and the maintenance and alteration of their capital. The Law on Joint Stock Companies seems to correspond to a considerable extent with this directive but it is not clear where the concept of a public interest company fits into the developing framework of company law within the European Union. Moldova is committed to aligning its legislation with that of the European Union. The problem with the majority owned joint stock companies remains and needs to be tackled as these companies will continue to create a regulatory burden for the National Commission as a priority. Being aware of developments in both financial regulation and company law is for the longer term and especially with regard to the development of the capital market, the adoption of some of the EU directives (such as MiFiD) is not for the early stages of the life of the National Commission.

(c) The Insurance Market.

The current insurance market consists of 33 insurers with a very high level of concentration; the top ten companies have over 83% of total premiums with the top two companies having 46% of the market. The focus of concern about the general insurance market is on the behaviour of the insurance companies with regard to third party liability insurance (TPLs), where experience suggests that insurance companies undercut each other with premiums for TPL and as a consequence may not be fully reserved for the cost of claims, even when those claims are not paid in full. The Insurance Law (Article 7 (5) namely), states that the insurance supervisor should regularly up-date the amount of insurance premium to be paid. There is also a lack of basic statistical data on which to calculate the amount of the premium, including a lack of claims history, which makes it difficult for both the supervisor and the insurance company to price TPL. Even where information is available as one of the largest insurance companies indicated, then although they are willing to share their database with other insurers in order to assess and monitor risks, other insurance companies or not.

Setting premiums is certainly a high risk activity for a regulator even if it has a full set of data on which to make a judgment, although some countries have followed that path for a short period in order to set insurers on the right track. It also implies that all insurance companies will charge the same rate unless the premiums to be paid are to be regarded as minimum or maximum rates. (It has to be remembered that the client history of those paying the premiums even for TPL to an insurance company will vary and the premium paid by the client, who has had more than one accident in three years, for example, should cost more than the premium paid by a client who has not had an accident for twenty years.) In the context of a minimum rate, the market effectively operates a tariff, but it guards against the threat of cutthroat underwriting which puts both the companies and their clients at risk, provided that the rates are the right ones. It is possible that a combination of setting the minimum rate together with monitoring the level of premiums might work for a limited period time, say, five years, with an annual review.

At the same time, work should begin on building up a national data base of relevant and reliable statistics and arranging a proper means of sharing information between insurance companies about claims (for example, fraudulent claims, or clients who are prone to accidents going from one insurer to another). Training in risk assessment and claims management both for insurance companies and insurance supervisors should be given high priority so that both can assess the risk, the capital necessary to back the risk and the proper assessment of damage together with payment of the appropriate compensation to clients who have made the claims. This work should be carried out with a view to establishing a competitive *market* as soon as possible in these and other areas of insurance. In addition to underwriters, loss adjusters are also required.

These developments are a requirement if Moldova is to match EU Directives on insurance. The Directives already in force include the Insurance Mediation Directive and the Fifth Directive on Motor Insurance. The purpose of these Directives is indeed to establish a single market in insurance, but in so doing the objective is also to raise and equalize standards in the industry across the European Union. Sections 14 and 22 of the Insurance Mediation Directive are highly relevant in this context:

> '*Insurance and reinsurance intermediaries should be registered with the competent authority of the Member State where they have their residence or head office, provided that they meet strict professional requirements in relation to their competence, good repute, professional indemnity cover and financial capacity'.*

This applies both to independent insurance brokers and to the direct sales force or agents which the insurance companies have in Moldova.

The second requirement has already been mentioned:

> *'There is a need for suitable and effective complaint and redress procedures in the Member States in order to settle disputes between insurance intermediaries and customers, using, where appropriate, existing procedures'.*

Although the Fifth Motor Insurance Directive refers to the Green Card system and not to domestic car insurance, Article 10 contains salutary wording for the domestic TPL system. It states:

> '*Member states' obligations to guarantee insurance cover at least in respect of certain minimum amounts constitute an important element in ensuring the protection of victims…The minimum amount of cover for personal injury should be calculated so as to cover fully and fairly all victims who have suffered very serious injuries… and Article 19, which refers to the policy-holder's right to request at any time a statement concerning the claims, or absence of claims, involving the vehicle(s) covered by the insurance contract at least during the past five years and 'to be able to justify his accident and claims record under the old contract'.*

References to these Directives indicate that much work has to be done to meet these standards. It will not be easy to achieve these standards in the absence of appropriate sources of training for the industry and for regulators. At senior management level, the Chief Executive of an insurance company underlined the absence of staff trained in risk management and the lack of statistics and meteorological records and models with regard to farming and insurance. At the level of insurance agents, basic training in advising clients and an understanding of the policies together with suitable competence tests are not available in Moldova.

The National Commission may wish to consider encouraging or obliging the Association of Insurers to take on certain responsibilities for the provision of training and competence testing. The Association would not take on this task itself but use the distance learning and, indeed, competence testing provided by multi-choice computerized testing as tools for training staff at junior to intermediate levels. There are many providers who could offer these facilities but the point of involving the Association is that some funding which benefited all could be made available. At senior levels, firms should be encouraged to send suitable staff for training outside Moldova and bear the expense themselves.

Section H. The Draft Code on Corporate Governance.

This analysis of the Code of Corporate Governance refers to the Final Draft as made available on February 15, 2007. These proposals have been reviewed against the OECD Principles of Corporate Governance (2004), each of the principles is set out and an assessment is made of the proposals as stated in the above draft.

Principle I. The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

The introduction to the draft Code echoes the aim of the corporate governance framework as set out above. However, it does not indicate the division of responsibilities among different supervisory, regulatory and enforcement authorities. That should be made clear in the Moldovan context.

Principle II. The corporate governance framework should protect and facilitate the exercise of shareholders' rights.

It appears that not all the shareholders' rights are protected by the draft code of corporate governance in terms of the details of the corporate governance code. The first part refers to secure methods of ownership registration. Companies currently either maintain their own registers, which is not satisfactory, or use one of the licensed registrars or as recommended by the IMF and also in this report, establish a central registry. [1]The IMF report also pointed out that the registers are not up-to-date, since large numbers of shareholders can no longer be located. The Code should therefore be accompanied by a requirement on the registrar to request confirmation of addresses or name changes in the annual contact with shareholders and for the shareholders to inform the registrar of such changes.

Principle II.B refers to the authorization of additional shares which is not mentioned in the draft code unless it is thought to be included in the reference to an amendment to the 'statutory capital', which has to have the approval of the AGM. The IMF commented that the ability of the board to legally increase the authorized capital by 50% without a shareholder vote is a serious violation of the OECD principles, and is an invitation for majority shareholders to dilute the minority. The IMF also commented that the reliance of the National Securities Commission, and in the future the National Commission, on fees from these transactions also creates a potential conflict of interests. If this is covered by the reference to statutory capital then the Code should spell this out in more detail.

Principle II.D refers to the requirement to disclose capital arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed. The law requires significant ownership by companies and shareholders so that those who acquire 25% direct or indirect ownership threshold must declare this within five days and the identity of all shareholders holding at least 5% must be disclosed in the annual report. The draft Code refers to the right to be informed about the structure of the capital and agreements allowing shareholders to exercise control of the company and reiterates the right of shareholders to know the identity of all shareholders holding more than 5%, but does not state where this should be published. But beneficial ownership and control disclosure was still a key concern in 2004 with the then practice of disclosure to the first level of nominee ownership and the IMF recommended then that the Code should include disclosure of ultimate ownership and control structures is required to meet international standards together with the removal of the right to hold shares in a nominee name. The draft Code does not state that this level of disclosure is required but should do so in order to comply with the OECD Principles nor does it remove the right to hold shares in a nominee name as recommended.

[1] Report on the Observance of Standards and Codes (ROSC), Corporate Governance Country Assessment, Moldova, May 2004.

It is linked with Principle II. E that ‘markets for corporate control should be allowed to function in an efficient and transparent manner’, although the current law requires that an individual or group of persons who has acquired more than 50% of an open joint stock company makes a tender offer to buy all the outstanding shares. But the company charter (or the general shareholders meeting) can exempt the company from this requirement or the bidders can agree to divide up their shareholdings into smaller packages and so avoid this requirement. They avoid the protection of the minority shareholders which allow investors with 90% or more of the shares to oblige the remaining shareholders to sell their shares, although for this to work effectively there should be a market price for small shareholders.

The same chapter seems to allow for the general meeting to ‘approve’ the members of the ‘Council’ or the supervisory board, but in fact shareholders should be able to elect and remove members of the board, and the nomination process of potential members of the supervisory board should be a formal and transparent process. Chapter VII sets out proper requirements for the organization of the general meeting and all relevant materials regarding potential candidates. Its provisions clearly fulfill all the requirements for the conduct of the general meetings. The only cause of concern could be 7.6 which does allow the supervisory board and the executive to refuse to disclose information if its disclosure contradicts the interests of the company, except for when the general meeting decides on its obligatory disclosure. This will require very careful oversight, since past history suggests that companies have frequently refused to disclose much information, even though where it was a legal requirement in the interests of commercial confidentiality.

Principles II (C) and III (A) make it clear that the corporate governance framework should protect and facilitate the exercise of shareholder rights, including the requirement that company procedures should not make it unduly difficult or expensive for shareholders to cast votes. It is noted that the votes for members of the supervisory board or Council are carried out by a ‘cumulative vote’, which is an unusual approach to voting at a shareholders’ meeting. There appears to be no requirement that the supervisory board should have a majority of independent directors, that is, independent of management and clearly in a position to be able to make entirely objective judgments about all the issues before the board. The criteria for ‘independence’ are set out in Chapter V, although the criteria set out are entirely sensible, two changes should be made. The first is to remove or at least restrict the right of a company to establish its own written criteria of ‘independence’, it should be made clear that these cannot contradict the criteria set out in 5.4 (a); 5.4(f) has been deleted and should be reinstated.

Many developed countries apply the principle of 'one share, one vote' and are supported by many associations and institutional investors. The OECD principles do not take a view on this matter or on the fact that companies may issue participation shares or shares without voting rights. The OECD requirement in these circumstances is that investors should be informed about the nature of their voting rights before they invest.

Principle VI (D). Chapter II.2 sets out the membership of the Council or supervisory board and its duties and responsibilities. These conform to a large extent to the responsibilities of the board as set out by the OECD Principles VI (D). But there are key omissions, such as 'selecting, compensating, monitoring, and when necessary, replacing key executives' and 'monitoring and managing potential conflicts of interest of management, board members and shareholders, including the misuse of corporate assets and abuse in related party transactions'. The issue of financial reporting should also be addressed.

Principle VI (A-C) sets out the responsibilities and duties of the Board. These principles require the board to act on a fully informed basis, in good faith, with due diligence and care and *in the best interests of the company and the shareholders* (italics added), and where the board decisions may affect different shareholder groups differently, the board should treat all shareholder groups fairly and should also apply high ethical standards. The draft Code would be improved by setting out these general duties clearly.

Principle V. Chapter VIII of the draft Code deals with financial transparency and external audit. These requirements satisfy the disclosure and transparency principles set out in detail in Principle V. Some of the items mentioned in Principle V (A) are not part of this chapter of the draft code but the omissions have already been covered elsewhere in this report. The other items which should be included a statement of the company's objectives include related party transactions; foreseeable risk factors; and issues regarding employees and other stakeholders. The IMF recommended with regard to disclosure and transparency in 2004 that the National Commission should initiate a long-term programme to improve disclosure and also to raise the standards of accounting and auditing, especially once the current internal accounting standards are adopted and promulgated. This work is still required and indeed even with a greater urgency.

Chapter IX refers to the implementation mechanisms for the protection of shareholder rights and argues that the self-discipline of the supervisory board and the executive council. No doubt this self-discipline has an important part to play, but it is not enough on its own. The Code should not be regarded as a voluntary Code. The reference to ‘comply or explain’ which is part of the Combined Code on Corporate Governance in the UK, does not refer to the voluntary nature of the Code. It is part of the listing requirements as set out by the UK Financial Services Authority, and listed companies are expected to comply with the demands of the Corporate Governance Code. A failure to comply has to be reported in the company’s financial reports and attracts not only the attention of the FSA but also the opprobrium of shareholders and the financial press.

Appendix I

Risk Based Supervision.

1. Organisational Structure and Risk-Based Supervision.

The alternative organizational structure proposed in this report is designed to ensure that skills and knowledge are put to the best use. The proposals for risk-based supervision are designed both to make use of existing knowledge and skills and to prevent the development of a ‘silo’ approach in which staff of separate divisions do not share information. Even an organisational chart which allows for a division between conduct of business and prudential supervision will not by itself prevent this.

A well-tried solution is to arrange for teams led by the person who has specialised in insurance and two other members of staff who have not. All three are involved in the process of risk-based supervision as it applies to a particular company. The team prepare for the on-site inspection by examining all relevant documents, such as financial reports, annual reports, notes of previous meetings, and also to request any additional information they may require from the company prior to the visit. The team as a whole then conducts the on-site inspection and the report back to the company together with any further regulatory action which needs to be taken.

2. The Purpose of Risk Based Supervision.

The procedure was designed to use resources to target the areas and the firms where the risks are greatest and the repercussions, especially for consumers, are likely to have the greatest impact. This approach aims to apply consistent standards of supervision across the financial services industry and to assess systematically whether companies continue to meet the criteria for authorisation, whilst being flexible enough to allow for the regulators to exercise judgment. The whole process should help the regulators to gain a better understanding of the quality of management, the characteristics of the business and the risks a company faces. Since a company’s management and the Commission have a common interest in ensuring that risks are properly identified and that adequate and effective control systems are established, the supervisory work should be of value to both parties.

3. The Supervisory Process.

Some of these steps will be a familiar part of the supervisory process, but the assessment of risk will provide a different purpose and orientation of the process. It calls for more than just checking whether or not all the detailed regulations have been followed. Failure to comply with detailed regulations may well signify much deeper problems with the company. That may depend in part on the extent of the failure to comply but will also depend on the way customers or clients are treated. The steps in the process are set out as follows:

(i) Step 1. Identifying the Key Risk Areas to be Assessed.

This the pre-assessment phase. The aim is to identify the key risk areas within the firm so that the Commission team can have a proper focus for its work during the assessment phase and decide whom to meet when carrying out its on-site work. This will involve examining all the information the Commission already has in its possession about how the company from both a business and a control perspective.

(ii) Step 2. Obtaining Pre-visit Information.

The purpose of this step is for the Commission to obtain any further information directly from the company, if necessary. This kind of preparation is essential for the success of the on-site visit. Background information may vary from company to company but would include management accounts, strategy documents, business plans and budgets, and the organisation charts of the legal and management structure as well as the external auditor's management letter. Sometimes parts of the business will be regulated by a foreign regulator and it may be necessary to contact that regulator.

(iii) Preliminary Assessment.

The objective of this phase of the supervisory process is to assess what the business and control risks are, where there are gaps in the information provided and to identify the persons in the company with whom these issues ought to be discussed. This assessment will involve looking at the key risk areas: financial soundness and capital; environment; business plan; controls; organisation and management. The team would meet and discuss these issues and jointly decide on the approach to the on-site visit.

The business risks of the company will be assessed in terms of financial soundness and capital, the business environment (for example, the market for the business and the competition it faces, and the general state of the economy). This part of the review consists of an analysis of the company's financial position, its overall business and external environment and its future strategy. This will facilitate a historical, current and forward-looking assessment of the company's key business risks. In analysing the controls over the business, the Commission will undertake an assessment looking specifically at controls, organisation and management. This will come from the information the Commission already has on its files and the supervisory team will seek to fill any information gaps when the visit takes place.

(iv) Step 4. Undertaking the On-site Visits.

The purpose of this visit is to gain an understanding of the risks of the company and especially on the most significant risks. The visit provides an opportunity to clarify any points arising from the preliminary assessment and to get a better understanding of the business undertaken by the company. The main focus of the meetings is on controls, systems and procedures in the company. The meetings should be held with the managing director, any other senior managers and if they exist, the head of risk management, internal audit, IT (where relevant) and human resources.

The discussions with management and personnel will focus on these high-level controls, strategy, the organizational structure and management. If the company does not have an internal audit, then the team should test sample files or transactions. Depending on the outcome, this might result in another more focused visit or a more extensive sampling of the files. At the end of the visit, after several interviews have been conducted, depending on the size and structure of the company, there will be a further meeting with the chief executive or general manager to share any initial concerns and to clarify any areas of concern.

(v) Step 5. The Final Supervisory Assessment.

On return from the on-site visit, the Commission will use the information from the on-site and off-site work to undertake a formal valuation of the risks arising from the way in which the company carries out its business. The team may also assess how the company's risk profile may change in the future; for example, if there is a downturn in the economy. At the same time, the team will also consider whether or not the company still meets the criteria for authorization.

(vi) Step 6. The Supervisory Programme.

The purpose of this step is to prepare a programme which will set out the work of the company and the Commission during this period. This work will focus on issues or concerns identified during this period. After undertaking the assessment, the Commission will prepare a supervisory programme, which will contain details of any remedial action that the company is required to undertake within a specified period of time. That will be linked to the areas of greatest risk and concern and should enable the management to understand fully why they must undertake a particular course of action. All of that should be conveyed in a draft letter to the chief executive or general manager.

The draft letter precedes a formal feedback of its findings, setting out in detail the Commission's views on both the business and control risks of the company, outlining any areas of specific concerns and remedial action sought from the company, which the company will have to carry out within a specified period of time, depending on the extent of the remedial action. This will be followed by formal final letter, which goes both to the chief executive or general manager and the board of directors. The company will be expected to respond to the requirements for remedial action to be taken and will receive other visits during that period and will be reviewed at the end of that time to see whether or not the company has complied with all the requirements. If no or insufficient improvements have been made, then the Commission will impose appropriate sanctions.

This example of risk-based supervision has been drawn from the methods developed by the Gibraltar Financial Services Commission, which shares some features with the proposed National Commission of Moldova. It is a relatively small regulatory authority, and, although the market has grown quite quickly in the last few years, it is still a small market. The population of Gibraltar is very small, some 30,000 in all, so it also has to compete for staff is a small pool of skills and so it takes in good graduates and trains them. The team approach both makes the best use of staff and is also a training programme in itself. They have access to many more training providers than are currently available in Moldova, but they do organise their own workshops and train themselves as well as making use of the distance learning courses mentioned here. It has developed into an effective regulatory authority and has received favourable assessments from the IMF
and FATF.