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A RAPID REVIEW OF MOLDOVA'S FINANCIAL SECTOR

Conditions, Constraints, and Opportunities

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ABBREVIATIONS

CLIR	Commercial Legal and Institutional Reform
CSD	Credit Securities Depository
DCA	Development Credit Authority
DGFBS	Deposit Guarantee Fund in the Banking System
EBRD	European Bank for Reconstruction and Development
EU	European Union
GDP	Gross Domestic Product
ICT	Information and Communications Technology
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IPO	Initial Public Offering
JSC	Joint Stock Company
L/C	Letter of Credit
MDL	Leu (Moldovan currency)
MFI	Microfinance Institution
MoEI	Ministry of Economy and Infrastructure
MoF	Ministry of Finance
MPF	Ministry of Public Finance
MSRP	Moldova Structural Reform Program
MTPL	Motor Third-Party Liability insurance
NBM	National Bank of Moldova
NBFI	Non-Bank Financial Institutions
NBR	National Bank of Romania
NCFM	National Commission for Financial Markets

ODIMM	National SME Agency
PEA	Political Economy Analysis
PMEC	Prime Minister's Economic Council
PIE	Public Interest Entity
SCA	Savings and Credit Association
SEM	Stock Exchange of Moldova
SME	Small and Medium-sized Enterprises
T-bill	Treasury Bill
USAID	United States Agency for International Development

EXECUTIVE SUMMARY

This report sets forth a snapshot of Moldova's financial sector, focusing on its overall ability to support economic growth, stability, and resilience well into the future. The Moldova Structural Reform Program of the United States Agency for International Development (USAID) prepared this report, specifically as part of the program's commitment in its Year One Work Plan to "assess and define key opportunities to contribute to [Moldova's financial sector reforms]."[1]

Today, Moldova's financial sector consists of a range of institutions—public, private, and not-for-profit—established to support the ability of individuals, businesses, and governments to save and transfer money, buy and sell assets, access credit, generate investment, reduce risk, and otherwise undertake "arms-length" transactions that build or protect their incomes and wealth. Following a banking crisis in 2014–15 which plunged the economy into recession, the banking industry in particular has recovered significantly, in part through intensive guidance and intervention from the International Monetary Fund (IMF). Yet key vulnerabilities remain, particularly within all types of institutions charged with overseeing and delivering financial services. Notwithstanding considerable efforts toward improving the sector's legal and regulatory underpinnings, institutions across the economy continue to exhibit weaknesses in their commitment and capacity to implement both the spirit and the letter of the law. Non-bank institutions, including microfinance institutions (MFIs), lack a coherent regulatory and oversight structure, despite their increasing popularity among smaller economic actors. Moreover, a persistent lack of faith in the ability of individuals and smaller enterprises to thrive in the economy contributes to continued outbound migration, which, in turn, has led to significant reliance on remittances at home.

This report provides an overview of key legal and institutional issues impacting Moldova's financial sector, with an emphasis on two areas where donor intervention may be warranted: (1) development of capital markets; and (2) regulation of non-bank financial institutions. Following an introduction that sets forth the recent background and context for the financial sector at large, the report follows a four-part structure long used by USAID for analysis of commercial environments: (a) legal framework; (b) implementing institutions; (c) supporting institutions; and (d) political economy considerations of general relevance. Finally, the report offers recommendations for how the Moldova Structural Reform Program (MSRP or the Program) may join other donors in helping Moldova embrace key opportunities for both expanding sources of capital and managing risk, in a way that will indeed support long-term economic growth, stability, and resilience.

[1] USAID Moldova Structural Reform Program, Year One Work Plan, Activity 2.7, "Conduct Financial Sector Rapid Review for Purpose of Defining Program Engagement in the Sector."

INTRODUCTION

Three years after protestors took to the streets to decry the disappearance by fraud of approximately $1 billion from Moldova's banking system—around 17 percent of gross domestic product (GDP) at the time—the country's financial sector has largely regained its footing. The Central Bank discount rate (its basic rate on short-term operations) plunged from 19.5 percent at the end of 2016 to 9.5 percent a year later.[2] The prime lending rate offered by commercial banks to their lowest-risk borrowers diminished from 14.28 percent in December 2016 to 10.3 percent in December 2017.[3] Although credit markets have tightened since the crisis, the rate at which Moldovans at all levels of society now entrust their money to formal financial institutions—defined not only as banks, but also as microfinance lenders, credit unions, cooperatives, and other non-bank constructs for saving or lending money—has increased significantly. According to the World Bank Global Findex databank (the "Findex"), the rate at which adults reported holding at least one account in a formal financial institution rose from 14 percent in 2014 to 43 percent in 2017.[4]

Key structural reforms in Moldova's banking sector since 2014—implemented with the close oversight and assistance of the International Monetary Fund (IMF)—have contributed to somewhat increased confidence in the economy. As noted by the IMF in late 2017, "Growth has returned, inflation has been relatively contained, the banking sector has been stable, and [Moldova's] external position has strengthened."[5] Although a range of vulnerabilities remain—chiefly with respect to bank governance, transparency, and commitment to rooting out corruption, areas on which the IMF continues to focus—the enabling environment for smaller players, in particular microenterprises and small and medium-sized enterprises (SMEs), is moving toward a potential tipping point that favors increased entrepreneurship and investments in domestic enterprise.

To reach this tipping point, Moldova requires continued forward motion with respect to a number of priorities: among them, improving both traditional and information and communications technology (ICT) infrastructure within and between centers of commerce; building human capital; and addressing regulatory constraints that interfere with entrepreneurship and investment. Within the financial sector specifically, the banking reforms shepherded by the IMF since 2015 will not be enough. Two critical constraints warrant closer attention by both the government and Moldova's community of donors. First, Moldova's system of capital markets today falls far short of its potential to raise capital for domestic enterprises, including larger companies and even SMEs. Accordingly, this report focuses on the institutions underlying capital markets as a foundation for potential action in this arena. Second, expansion of the non-bank credit sector—which partially offset reduced bank lending to the private sector in 2017[6]—presents risks that, if not addressed, may harm the very community of smaller economic players that it has the potential to empower. This report identifies a number of these risks and presents a set of ideas for addressing them.

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[2] CIA, World Factbook, Moldova, available at https://www.cia.gov/library/publications/the-world-factbook/geos/md.html.
[3] CIA, World Factbook, Moldova, *supra*.
[4] World Bank, Global Findex Database, 2017, available at http://datatopics.worldbank.org/financialinclusion/.
[5] International Monetary Fund (IMF), *Staff Report for the 2017 Article IV Consultation and Second Reviews Under the Extended Fund Facility and Extended Credit Facility Arrangements*, December 6, 2017, 5 (hereinafter *IMF Staff Report, 2017*).
[6] *IMF Staff Report, 2017*, 6.

APPROACH

This "rapid review" of Moldova's financial sector is structured according to the "commercial legal and institutional reform" (CLIR) methodology that has been implemented in various forms by USAID in more than 60 countries since 2000. Following a period of desk research and focusing of its inquiry, a team of three consultants enlisted by USAID's Moldova Structural Reform Program—Sean Keogh, Eugenia Stancu, and Oleg Grigoroi—undertook a qualitative inquiry from May 28 through June 8, 2018. The team conferred with more than 37 representatives of the public and private sectors. Interviews took place primarily in Chisinau, with additional travel to Costesti. The team encouraged candor among interviewees by assuring them that they would not be directly quoted in the report.

THE IMPORTANCE OF CAPITAL MARKETS MUST NOT BE UNDERESTIMATED

There is a correlation between local financial sustainability and the depth of a country's capital markets. A healthy capital markets system is also indicative of a more developed economy and acts as a differentiator amongst other developing economies. Having access to a capital markets system facilitates equity capital and debt financing, enhances access to finance, diversifies investment options, grows the institutional investor community, and mitigates certain systemic risks by broadening the financial sector. This access can help communities throughout the country access finance for projects that lend to infrastructure development, enhancing SME opportunities and growth. Capital markets provide transparency to all aspects of finance, from comparable equity pricing to indicative levels for interest rates along the yield curve. Ultimately, a transparent and true yield curve gives investors the ability to analyze risk appropriately. It informs government budgeting and serves as a barometer to measure relative economic health on an international scale.

The rapid review took place with awareness that certain aspects of Moldova's financial sector are already amply analyzed and supported by the donor community. As of mid-2018, the IMF continues to work closely with Moldova's banking institutions, while the World Bank is intensively studying the insurance sector, with the results of its work likely to have broad implications on how the donor community approaches this important subsector. Thus, this review drills down especially into capital markets and non-bank financial institutions (NBFIs), two areas that would benefit from increased engagement. Following an introduction to the Moldova financial sector's recent history and current context, this report presents findings in three sections, as described below:

- ***Implementing institutions.*** This section examines institutions that bear primary responsibility for implementing the financial sector's legal framework and enforcing laws and regulations. These include government ministries, authorities, and registries.
- ***Supporting institutions***. This section looks at the range of institutions that are critical to the development and implementation of financial resources. These include banks, microfinance institutions, other non-bank institutions, private services, and professional associations.
- ***Political economy considerations.*** To add additional context to findings derived from the directed review of the financial sector in May-June 2018, this section integrates a number of insights derived from the Moldova Structural Reform Project's first-level

political economy review that took place in November 2017[7] as well as "headline" issues pertaining to Moldova's upcoming and pivotal parliamentary elections.

Following this overview—where opportunities for more focused inquiry and future action are noted—the report presents a series of recommendations for consideration by USAID and other stakeholders in the financial sector.

BACKGROUND

The overall structure of the financial sector in Moldova consists of banks that are regulated by the National Bank of Moldova (NBM); non-bank financial institutions that are regulated by the National Commission for Financial Markets (NCFM); and the capital markets that are also regulated by the NCFM.

The non-bank financial institutions consist of microfinance institutions, savings and credit organizations, insurance companies, leasing companies, credit bureaus, and brokers. (Other non-bank institutions in Moldova include payday lenders, pawn shops, and proverbial, informal "loan sharks"; these entities are *not* regulated by the NCFM.) The capital markets consist of both the equity (stocks) and the fixed-income (bonds) market. Within these capital markets, investors are few, and primarily consist of the banks themselves. There is a substantial void of institutional investors—including pension funds—and reforms are still needed. In short, and as addressed later in this report, Moldova's capital markets are thin, illiquid, and nascent. There is no secondary market to speak of.

THE VIEW FROM 2018 (PART I): REFLECTING ON MOLDOVA'S BANK CRISIS

As noted, Moldova continues to recover from the dramatic collapse of its banking sector beginning in 2014. At the end of that year, a series of statements by Moldovan politicians indicated that three of the country's banks had been looted of $1 billion. "Popular panic and mass withdrawals" immediately followed, leading to a brief but sharp recession and a currency devaluation of nearly 40 percent against the euro and the dollar by early 2015.[8] As characterized by *The Economist* in 2017, "Relative to the size of its economy, [the scandal in Moldova's banking sector] may be the biggest bank fraud of all time."[9]

Initial investigations reinforced perceptions of cronyism and corruption as festering at the root of the scandal. The money removed from the banks was found in the NBM's early investigation to have been transferred directly to companies owned by politicians. External investigations that followed further revealed a pernicious culture of fraudulent banking practices executed by an

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[7] USAID Moldova Structural Reform Program, Year One Work Plan, Activity 0.2, "Launch Process of Sustainability Analysis (also known as USAID's Applied Political Economy Analysis), to be integrated into all program components.
[8] James George Jares, "The Unfolding Financial Crisis Threatening Moldova," *Forbes*, May 20, 2015, available at https://www.forbes.com/sites/realspin/2015/05/20/the-unfolding-financial-crisis-threatening-moldova/#4ed3bb022d8d.
[9] "How Moldova Escaped the Effects of a Giant Banking Crisis," *The Economist*, February 16, 2017, *available at* https://www.economist.com/europe/2017/02/16/how-moldova-escaped-the-effects-of-a-giant-banking-crisis.

"entrenched ruling clique" that had engaged in "plundering over 20 years or more."[10] Although resignations of a number of public officials, as well as several arrests and prosecutions, have taken place since the scandal, the damage to public confidence in the banking system remains severe.

The revelations in 2015 about Moldova's captivity to the opaque and oligarchical practices of its banks belied the country's reputation at the time as an economic reformer. Before, during, and since the scandal, Moldova has performed well in the World Bank's annual Doing Business rankings. Its key indicators of Getting Credit and Protecting Investors, for example, show good regulatory practice, at least in terms of the time, cost, and number of processes required of borrowers and investors located in the capital city (figure 1). Although in the 2000s Moldova's government put into place various systems aimed at facilitating the ability of individuals to launch, grow, and invest in new businesses, these systems ultimately made little difference in terms of securing the integrity of the financial structures so critical to the private sector's success.

Figure 1. **Moldova's Doing Business Rankings Over Time**

Rank (*out of 178–190 economies*)	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Overall	81	83	78	63	52	44	44
Getting Credit	40	40	13	23	28	32	42
Protecting (Minority) Investors	111	86	80	56	36	46	33

Source: Word Bank, Doing Business rankings, available at http://www.doingbusiness.org/rankings.

Still, the ramifications of the bank scandal could have been worse. Although Moldova's economy contracted in 2015, it bounced back to 4.3 percent GDP growth in 2016 and 4.0 percent GDP growth in 2017—respectable rates for the region. Through issuance of debt, the government managed to cover all the deposits in banks that failed, so that consumers and enterprises with accounts in those banks did not suffer directly. In further explaining why many Moldovans escaped the worst of the crisis, *The Economist* noted:

> The odd structure of the Moldovan economy also helped. It is heavily agricultural: about a third of workers are farmers. Most are smallholders. Few borrow much from banks, so few have noticed that credit has grown tighter. Good weather played a part: following dry conditions in 2015, cereal production rose by a third [in 2016]. A free-trade agreement with the EU [European Union] in 2014 provides a ready market for Moldovan commodities, including its delicious wine.
>
> Money sent back by Moldovan emigrants may have also softened the blow. Moldova is about twice as dependent on remittances as the Philippines, which is saying something. Though the flow has slowed, the weakness of the Moldovan leu ensures that expats sending money from the EU get a good deal.[11]

[10] Jares, "The Unfolding Financial Crisis Threatening Moldova," *supra*.
[11] "How Moldova Escaped," *The Economist*, *supra*.

Notwithstanding this relatively soft landing, Moldova's climb out of the conditions that led to the bank crisis has necessitated many remedies and reforms, in particular as a condition for future support from outside donors and multilateral institutions. The IMF has been engaged from the start, monitoring and analyzing progress along the way. As detailed in the IMF's 2017 Staff Report, key reforms since 2015 include the following:

- International standards and best practices are being introduced into law.
- Comprehensive bank diagnostics, including full onsite inspections, are underway, resulting in recommendations for improved governance, risk management, internal audits and controls.
- The National Bank of Moldova's governance, legal protection, and independence has been strengthened.[12]

Notwithstanding this progress, Moldova's banks in 2018 are not a popular destination for the holdings of most individuals or SMEs. Indeed, the IMF's findings of late 2017 point to the case for donors to direct their attention to institutional players in the financial sector *other* than banks:

> **[B]anks continue to have a limited role in supporting economic growth.** As in other banking crisis cases, the resumption of lending to the domestic economy often takes time. This is all the more likely in cases where financial intermediation was previously hampered by governance challenges. Slow resumption of lending has both supply and demand components. Better risk management in the banks, including stricter loan provisioning and tighter underwriting standards (including the refusal to accept undeclared income as a future source for loan repayments), while a vital part of the effort to strengthen the banking system, are reported as holding back credit supply. On the demand side, political uncertainty and concerns about the absence of rule of law are cited as restricting factors, although borrowers' repayment capacity is reported as stable or improving. As a result, and in view of continued cleansing and rehabilitation of the financial sector, credit growth remains negative. In this environment, loans to households and businesses from non-bank credit organizations increased significantly between end-2012 and 2017, with their share in total lending to the economy increasing from 7.1 to 15.5 percent according to the authorities' estimates.[13]

As a final reflection on the impact of Moldova's banking crisis, it is notable that perceptions of corruption in the country have only gotten worse in the intervening years (figure 2). Based on data compiled through its 2017 Global Findex, the World Bank estimates that 32 percent of individuals lack bank or financial institution accounts due to "lack of trust in the institution." Lack of trust is the third most common reason to not have an account (preceded only by insufficient funds and expense of services).[14] Moreover, in 2017, the World Economic Forum reported that businesses consider corruption the top constraint to their ability to grow and thrive as corruption, followed by political instability and government instability/coup.[15]

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[12] *IMF Staff Report, 2017*, 13–14.
[13] *IMF Staff Report, 2017*, 14, emphasis in the original.
[14] World Bank, Global Findex Database, 2017, *supra*.
[15] World Economic Forum, Global Competitiveness Index 2017–18, Moldova, available at http://reports.weforum.org/global-competitiveness-index-2017-2018/countryeconomy-profiles/#economy=MDA.

Figure 2. Moldova's Performance Over Time under Transparency International's Corruption Perceptions Index

2012: Ranked 94 out of 174 (score of 36/100) – tied with Benin, Colombia, Djibouti, Greece, India, Mongolia, and Senegal
2013: Ranked 102 out of 175 (score of 35/100) – tied with Ecuador, Panama, and Thailand
2014: Ranked 103 out of 174 (score of 35/100) – tied with Mexico and Niger
2015: Ranked 102 out of 167 (score of 33/100) – tied with Dominican Republic, Ethiopia, and Kosovo
2016: Ranked 123 out of 176 (score of 30/100) – tied with Azerbaijan, Djibouti, Honduras, Lao PDR, Mexico, Paraguay, and Sierra Leone
2017: Ranked 122 out of 189 (score of 31/100) – tied with Azerbaijan, Djibouti, Kazakhstan, Liberia, Malawi, Mali, and Nepal

Source: Transparency International, Corruptions Perceptions Index, available at https://www.transparency.org/research/cpi/overview.

THE VIEW FROM 2018 (PART II): INSECURITIES, PECULIARITIES … AND OPPORTUNITIES

Desperately seeking finance: Moldova's SME sector. As of late 2017, over 51,500 SMEs were formally registered in Moldova.[16] Among those, more than 44,000 (around 85 percent) are classified as microenterprises, meaning they employ fewer than 10 people.[17] According to the European Union, over 97 percent of enterprises in Moldova are SMEs, and they are responsible for over 50 percent of all jobs and generate more than 30 percent of the country's income.[18] Although some SMEs are found in the manufacturing of goods, they are primarily based in the services sector and focused on the domestic market.[19]

Moldova's National Development Strategy ("Moldova 2020") presents a vision of cohesive long-term sustainable economic development based on a diagnostic study of constraints to economic development.[20] Growth of SMEs is seen as instrumental to capitalizing on existing economic opportunities, to invigorate the local economy through unleashing new entrepreneurs, and to spur much needed job-creation.

As in most economies, owners of microenterprises and SMEs seek funding with which to launch and grow their enterprises. In late 2017, the Political Economy Analysis (PEA) conducted by the Moldova Structural Reform Program asked representative business owners where they could best

[16] EU4Business *Investing in SMEs in the Eastern Partnership: Moldova Country Report*, EU4Business, June 2018, 4. Report available at http://www.eu4business.eu/files/medias/country_report_2018_md_def_lr_0.pdf.
[17] Ibid.
[18] Ibid.
[19] Government of Moldova, Small and Medium Enterprise Sector Development Strategy for 2012–2020, available at https://www.etf.europa.eu/sites/default/files/m/C3B5E5CCD6AF7AEEC1257AC3005250A3_Moldova%20SME%20Strategy%202012-2020.pdf.
[20] Government of Moldova, Moldova 2020: National Development Strategy: 7 Solutions for Economic Growth and Poverty Reduction, available at http://particip.gov.md/public/files/Moldova_2020_ENG1.pdf.

access the funds they need. In general, the owners of smaller businesses expressed a view that commercial banks make it nearly impossible to obtain a loan due to cumbersome paperwork and time requirements, along with burdensome interest expenses and fees. Others remarked that, since most government officials and parliamentarians serve the interests of large domestic and foreign businesses, commercial banks are more inclined to lend to these [foreign] companies than they are to domestic SMEs.[21] Smaller business representatives further reported resorting primarily to savings or family and friends for their financing needs, a representation that is consistent with data from the World Bank's 2017 Findex survey (figure 4).

The other side of this story, as teased out by the PEA, is that many domestic SMEs themselves lack the requisite transparency to get a bank loan. Many hide their "real books" and, as a result, lack reliable financial reports. Similarly, it is common for SMEs to obscure their profits to reduce their tax burden or to pay "grey" salaries in cash. Banks rarely agree, therefore, to lend them money, due to their own responsibility to find indirect verification of a business's assets. Employees similarly do not see the benefit of paying taxes, which are perceived as high, while the return (pensions and health care) is minimal. During the PEA, a respondent commented that "this results in a vicious cycle of grey sales + grey salaries = grey economy—all driven a by a culture of low trust in institutions." An SME owner further noted that some "foreign buyers see Moldova as unreliable because of the grey economy—because even audit services are not seen as reliable."

In recent years, NBFIs have been moving to fill the financing gap left by the banks. NBFIs have increasingly sought to develop relationships with SMEs, and SMEs are responding. According to data from the National Commission on Financial Markets (NCFM), by December 31, 2017 there were 181 non-bank lending agencies registered in Moldova, of which approximately 130 were operational.[22] The important role of NBFIs is further discussed later in this report.

The outsized role of remittances. Due to high levels of out-migration from Moldova, remittances have been high in recent years (figure 3). Remittances often constitute the main income source of a household. They are distributed unevenly, however: just 25 percent of the households receiving remittances receive 75 percent of the total.[23] A 2009 estimate of remittances indicated that they account for 12 percent of total income; at the same time, most remittances go to relatively wealthier households that may be financially sound.[24]

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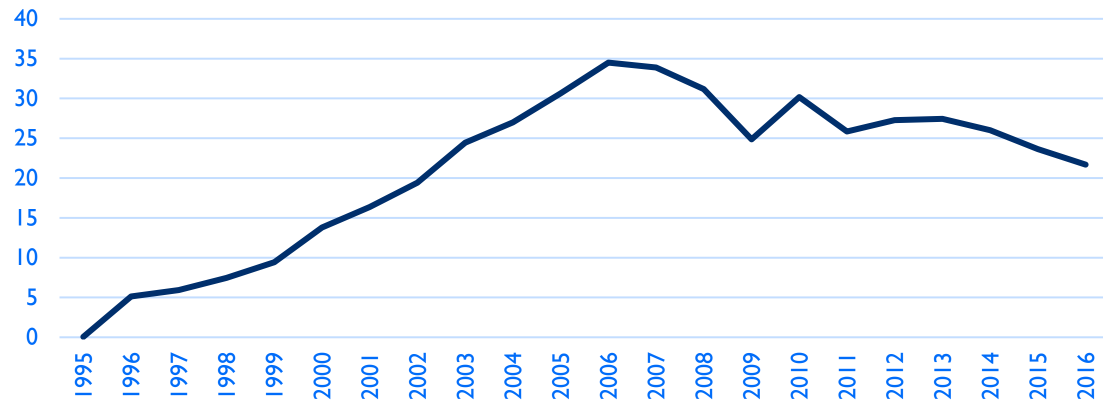
[21] Moldova Structural Reform Program, Political Economy Analysis, Annex E: Preliminary Scoping Study–Supporting the Business Enabling Environment for SME Growth in Moldova (December 2017).
[22] Basic indicators on the activity of microfinance institutions as of December 31, 2017.
[23] Eugene Hristev, Georgeta Mincu, Maya Sandu, and Mateusz Walewski, *Effects of Migration and Remittance in Rural Moldova*. CASE Network Studies & Analyses No. 389. 2009, available at https://www.files.ethz.ch/isn/103050/25599090_CNSA_389_June24.pdf.
[24] Ibid.

Figure 2. Remittances as % of GDP



Source: World Bank Development Indicators, available at http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators.

The process of sending and receiving remittances increasingly takes place through formalized processes. Data from 2017 show that these processes were used by 38 percent of people for this purpose, while cash-only remittances decreased by 30 percent.[25] Households receiving remittances tend to have higher investments, primarily in education.

It is possible that lower overall consumption levels and the substitution of remittances for formal lending could be negatively impacting financial sector development in Moldova. Thus, domestic policy aimed at encouraging SME development may have the added benefit of promoting a more diverse financial sector. A strong and vibrant SME sector can present new opportunities for young Moldovans to remain in Moldova, rather than taking their vital skills abroad. Halting "brain-drain" may thus play a significant role not only expanding the SME sector but also contributing more broadly to macroeconomic growth in Moldova.

Additional impacts of migration: lack of consumers and an aging population. Negative population growth from migration since 1995 has negatively impacted the markets for financial institutions, as disproportionate numbers of credit-worthy, educated, and younger citizens have left the economy. The aging population burdens the investment potential of the under-developed pension system and limits the flow of capital, especially since only 49 percent of people aged 55–59 are employed, and only 46 percent of adults reported receiving wages in the last year.[26] Moldova's pension system consumes about 8 percent of GDP, but until recently, there was little incentive for

[25] World Bank, Global Findex Database, 2017, *supra*.
[26] World Bank, Development Indicators, 2017, available at http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators.

younger generations to contribute or save. In 2017, a new pension law was enacted, increasing the percentage of wages received as pension and thereby raising the incentives to contribute.[27]

Digital Financial Services. As documented by the World Economic Forum's Global Competitiveness Index, Moldova punches above its weight—better than the regional average—in technological readiness, which includes ICT use and technological adoption.[28] Accordingly, compared to many economies of its size and degree of development, Moldova is poised to take advantage of key opportunities presented by the digital payment systems it currently supports: (1) as an engine for inclusive economic growth; and (2) as an emerging market business opportunity for providers.

Overall, digital financial services are on the rise in Moldova. Between 2014 and 2017, according to Findex data, use of digital payments increased 20 percent, while internet banking and online bill payment increased by 30 percent. Moldova's government undertook an e-Transformation Project in 2011, and by 2013, all public services and 14 commercial banks had adopted the "M-pay" mobile payment service.

Moldova's competitive advantage with respect to digital financial services—in particular digital payments—may unlock opportunities of special interest to SMEs. These include the ability to more efficiently move money across the domestic economy as well as to engage in international trade in goods and services. Although full exploration of digital economy opportunities is beyond the scope of this report, the issue is worth exploring as a complementary opportunity that goes hand-in-hand with continued investments in the financial sector.

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[27] "Moldova Government Approves Changes to Pension System, Plans to Raise Pensioning Age to 62 and 65 Years," Moldova.org, available at http://www.moldova.org/en/moldova-government-approves-changes-pension-system-plans-raise-pensioning-age-62-65-years/.
[28] World Economic Forum, Global Competitiveness Index (2017–18), Moldova, *supra*.

Figure 3. **Moldova's Findex Data**

What does Moldova have to learn from the Global Findex?

Since 2011, the World Bank's Global Financial Inclusion (Findex) initiative has compiled data on how individuals in an economy save and borrow money, make payments, and manage risks. The Findex measures people's use of financial services across countries and over time. As a survey of individuals, it reveals a great deal about public confidence in the financial sector in general, and, by extension, the sense of risk throughout the economy and the potential of individuals—as entrepreneurs and investors—for investing in enterprises and innovations at home. Comparative statistics from Romania are included in this table for the purpose of considering similarities and differences between Moldova and its western neighbor, which is a member of the EU with many commonalities with Moldova.

FINDEX Indicator	Moldova 2011	Moldova 2014	Moldova 2017	Romania 2017
Financial institution account (% age 15+)	18%	18%	44%	58%
No account because financial services are too expensive (% without a financial institution account, age 15+)	n.a.	n.a.	35%	25%
No account because of lack of trust in financial institutions (% age 15+)	n.a.	n.a.	24%	11%
No account because of lack of trust in financial institutions (% without a financial institution account, age 15+)	n.a.	n.a.	32%	26%
No account because of insufficient funds (% age 15+)	n.a.	n.a.	37%	25%
No account because of insufficient funds (% without a financial institution account, age 15+)	n.a.	n.a.	52%	58%
Used the internet to pay bills or to buy something online in the past year (% age 15+)	n.a.	10%	37%	19%
Saved to start, operate, or expand a farm or business (% age 15+)	n.a.	8%	11%	8%
Saved to start, operate, or expand a farm or business, primary education or less (% age 15+)	n.a.	3%	6%	5%
Saved at a financial institution (% age 15+)	4%	7%	9%	14%
Saved using a savings club or a person outside the family (% age 15+)	2%	5%	19%	5%
Saved any money in the past year (% age 15+)	n.a.	44%	55%	34%
Saved any money in the past year, primary education or less (% age 15+)	n.a.	32%	37%	28%

Saved any money in the past year, secondary education or more (% age 15+)	n.a.	47%	58%	36%
Borrowed from a financial institution (% age 15+)	6%	7%	9%	15%
Borrowed from family or friends (% age 15+)	42%	39%	38%	21%
Borrowed from family or friends, income, poorest 40% (% age 15+)	48%	43%	38%	22%
Borrowed from family or friends, income, richest 60% (% age 15+)	38%	37%	38%	20%
Coming up with emergency funds: not possible (% age 15+)	n.a.	28%	24%	30%
Sent or received domestic remittances in the past year (% age 15+)	n.a.	26%	26%	24%
Sent or received domestic remittances in the past year, income, poorest 40% (% age 15+)	n.a.	26%	23%	19%
Sent or received domestic remittances in the past year, income, richest 60% (% age 15+)	n.a.	26%	28%	27%
Sent or received domestic remittances: through a financial institution (% senders and recipients, age 15+)	n.a.	7%	38%	49%
Sent or received domestic remittances: in person and in cash only (% senders and recipients, age 15+)	n.a.	75%	45%	36%
Paid utility bills in the past year (% age 15+)	n.a.	68%	77%	79%
Paid utility bills: using cash only (% paying utility bills, age 15+)	n.a.	98%	75%	87%
Received wages in the past year (% age 15+)	n.a.	42%	46%	42%
Received wages: in cash only (% wage recipients, age 15+)	n.a.	73%	45%	32%
Received digital payments in the past year (% age 15+)	n.a.	13%	33%	41%

Source: World Bank, Global Findex Database, available at http://datatopics.worldbank.org/financialinclusion/.

KEY LAWS, INSTITUTIONS, AND CONTEXT

LEGAL FRAMEWORK

In general, Moldova benefits from a modern commercial law framework which reduces transaction costs compared to previous overly encumbered systems and increases legal certainty for commercial actors. However, implementation problems persist. Erratic implementation of laws harms SMEs more than larger companies, as SMEs generally do not have the extensive in-house legal staff necessary to adapt to varying legal systems.[29]

KEY LAWS

- Law on the National Bank of Moldova (1995)
- Law on Financial Institutions (1995)
- Law on Foreign Exchange Regulation (2008)
- Law on Capital Markets (2013)
- Law on Credit Bureaus ( )
- Law on Banks' Activity (2017)
- Law on Supplementary Supervision of Banks, Insurers/Reinsurers and Investment Firms in a Financial Conglomerate (2018)

Law on the National Bank of Moldova (1995).[30] Enacted in 1995, the Law on the National Bnak of Moldova requires that the central bank will ensure and maintain price stability as its fundamental objective. This law sets out the requirements applied by the NBM in the process of banks' licensing, their organization and administration, carrying out operations, reports and inspections, application of remedial measures, sanctions, and windup of banks. Most of the banking regulations currently in place in the Republic of Moldova reflect the rules set out in the original set of international standards (Basel I).[31]

Law on Financial Institutions (1995).[32] Under the Law on Financial Institutions, the NBM may address a range of problems in banks or violations of regulatory obligations. According to a 2016 IMF report, the NBM has used this authority in recent years to address a range of banking infringements, "particularly in relation to (i) insufficient size of Tier I capital; (ii) assets quality; (iii) misreporting; (iv) deficiencies in internal control systems; and (v) violations in preventing and combating Money Laundering/Terrorist Financing (ML/TF)." However, the IMF criticized the NBM for a lack of forcefulness in implementing the law.[33]

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[29] USAID, Revised Request for Proposals, RFP No. SOL-117-16-000002, dated December 28, 2016, Section C.

[30] *Law on the National Bank of Moldova*, no. 548-XIII of July 21, 1995, published in the Official Monitor of the Republic of Moldova no. 56-57/624 of October 12, 1995, unofficial translation available at https://www.bnm.md/en/content/law-national-bank-moldova-no548-xiii-july-21-1995.

[31] The text of Basel I is available at https://www.bis.org/publ/bcbs04a.pdf.

[32] *Law on Financial Institutions*, no. 5550-XIII of July 21, 1995, unofficial translation available at https://www.bnm.md/en/content/law-financial-institutions-no-550-xiii-21071995.

[33] International Monetary Fund, 2016, Republic of Moldova, Financial Sector Assessment Program: Detailed Assessment of Observance on the Basel Core Principles for Effective Banking Supervision, IMF Country Report No. 16/71, available at https://www.imf.md/press/7%20Moldova%20-%20IMF%20-%20FSAP_Observance%20on%20the%20Basel%20Core%20Principles%20for%20Effective%20Banking%20Supervision_cr1671.pdf.

Other relevant laws include the Law on Foreign Exchange Regulation (2008) (the "Forex Law)[34], the Law on Capital Markets (2013)[35], the Law on Credit Bureaus[36], the Law on Banks' Activity,[37] and many others.

IMPLEMENTING INSTITUTIONS

KEY IMPLEMENTING INSTITUTIONS

- National Bank of Moldova
- National Commission for Financial Markets
- Ministry of Finance
- Deposit Guarantee Fund
- National SME Agency (ODIMM)
- Central Securities Depository

National Bank of Moldova/Central Bank. As the central bank for the Moldovan economy, the National Bank of Moldova (NBM) oversees the banking sector, providing the traditional functions of both regulation and enforcement. The NBM is the public authority that regulates, supervises, and licenses financial institutions' activity, including banks.

The Central Bank (CB) division sets monetary policy and sells deposit notes. Since the 2014–15 banking crisis, there have been several new regulatory standards set in place—not only to settle the market volatility but also to mitigate future risk of bank fraud. These include the creation of the Financial Stability Division, which is responsible for working on the IMF's macroprudential policy framework. This framework focuses on crisis management and incorporates certain indicators such as stress-testing and capital-at-risk (CAR) and looks further at overall systemic risk for financial stability. Additionally, at the behest of the IMF, the NBM is hurriedly moving toward aligning with Basel III regulations, leapfrogging Basel II after having just put Basel I in place. Adoption of Basel III standards will require about 10–11 major changes[38] to bank requirements, including capital buffers.[39] The NBM plans to have the capital buffers regulations in place in July 2018. Implementation of Basel III requirements will unfold over time, with some adjustments introduced as late as year-end 2019. Although the NBM does not require banks to adopt International Financial Reporting Standards (IFRS), certain elements of IFRS (IFRS 9 specifically) align with the prudential measures implemented in 2018. The benefits of the strengthened regulatory environment for banks include stricter lending standards and a focus on risk due diligence. These efforts to ensure that banks are within global bank risk standards help strengthen the financial sector against systemic risk.

The NBM is one of the better funded government regulators and is well staffed with technically capable employees. The NBM is well aware of possible systemic risks to the banking system such as, for instance, currency rate risk. (The NBM has recent experience with this. It acted to stabilize

[34] *Law on Foreign Exchange Regulation*, no. 62-XVI of March 21, 2008, published in the Official Monitor of the Republic of Moldova no. 423–429 of December 9, 2016, Art. 859, unofficial translation available at https://www.bnm.md/en/content/law-foreign-exchange-regulation-no-62-xvi-21-march-2008.
[35] Available online at http://cnpf.md/en/leginorm/.
[36] Ibid.
[37] *Law on Banks' Activity*, no. 202-XVI of October 6, 2017, unofficial translation available at https://www.bnm.md/en/content/law-banks-activity-no-202-06-october-2017.
[38] "Major changes" according to interviews with the National Bank.
[39] Action Plan on Transposion (*sic*) Calendar of EU Requirement Package to the Legislation of the Republic of Moldova – CRD IV / CRR, available at http://www.bnm.md/files/ANNEX_1_EN.pdf.

the leu when it fell by over 20 percent in a 90-day period in late 2014; the leu eventually continued to fall, but more slowly, and it reached a stable plateau by mid-2015, giving the financial system time to adjust.) Within the NBM, there is also clear awareness of risks currently lurking in the NBFI system and realization that NBFIs are not as thoroughly and effectively regulated as the banks. There is some discussion of moving MFI regulation from the NCFM to the Central Bank, though this has not yet occurred.

CORE FUNCTIONS OF THE NBM:

- Monetary Policy
- Currency Issuance
- Supervision of financial institutions
- Payment systems

Meanwhile, a downside of NBM's efforts to align Moldova's system with so many international regulations is that the local Moldovan market lacks the capacity and/or willingness to integrate these reforms. Without proper local market context, some of these requirements could be misaligned with the reality on the ground. For example, the bank-required liquidity reserve is extremely high at 40 percent of short-term liabilities. This is very probably causing an artificially low interest rate environment in the government bond market. This is due to the banks' need to invest this 40 percent into liquid securities such as government T-bills (treasury bills), which, in turn, places downward pressure on interest rates. Furthermore, the high liquidity requirement, combined with a regulatory environment that is causing banks to tighten lending requirements, has caused the significant drop in bank lending since 2014. From a macroeconomic perspective, the government is getting cheap money for itself, but at the cost of reducing the availability of credit to the private sector.

National Commission for Financial Markets (NCFM). Established in the 1990s with support from USAID, the core objectives of the NCFM are "enhancing stability, transparency, security, and efficiency of the non-banking financial sector, by adoption and maintenance of an adequate regulatory and supervisory framework of the participants on the financial market, to reduce systemic risks and to prevent disloyal, abusive, and fraudulent practices in the financial sector with the scope of protecting the interests of clients and investors."[40]

Today, the NCFM oversees both Moldova's growing NBFI sector and its capital markets. The NBFI sector consists of microfinance institutions, savings and credit organizations, insurance companies, leasing companies, credit bureaus, and brokers. Other entities that would fall under the non-bank classification are payday lenders, pawn shops, informal lenders, etc. However, as of mid-2018, the NCFM does not regulate any of these.

Notwithstanding the breadth of its mission, the NCFM is under-resourced. It struggles to retain staff and suffers from high turnover. This, in turn, causes its employees to have less experience than their predecessors and, accordingly, less understanding of the markets that they are tasked to oversee. As further detailed below, the fact that the NCFM charges fees to the entities which it regulates also represents a serious conflict of interest.

In this weakened state, the NCFM is hard-pressed to keep up with the rapid growth of the NBFI sector, particularly with respect to microfinance. Since the beginning of 2015, the microfinance

[40] National Commission for Financial Markets, About, webpage available at http://www.cnpf.md/en/about/.

sector has grown the collective loan portfolio size from MDL 2.4 billion to MDL 4.6 billion by the end of 2017. This influx in capital and increase in lending activity came fast and unexpectedly, catching the regulators off-guard. Now, the NCFM—responsible for not only the MFIs but also the Savings and Credit Associations, pension funds, alternative investment funds, credit bureaus, and leasing sectors—is scrambling to prepare and enact legislation intended to strengthen the system. The office already has USAID MSRP support in drafting four normative acts. The law on non-bank credit organizations will enter into force on October 1, 2018. By that time, the NCFM should have drafted regulations applying to all non-bank credit organizations and leasing companies, covering the following:

1. Provisioning and criteria for the classification of receivables to cover losses on non-bank loans and related interests and for covering receivables related to the unrecovered leasing payments and associated interest rates.
2. Transparency of ownership structure of non-bank credit organizations and up-to-date information on founders (effective beneficiaries).
3. Disclosure of information on NBFI activities, including the procedures and the space for publishing the necessary information, as well as the obligation of indication of the effective annual interest rate in the provided pre-contractual information and in the non-bank credit contracts.
4. Reporting norms and rules.

The allotted timeframe for drafting is short, and stakeholders have expressed concern about the speedy nature in which many of these regulations are getting pushed forward (not only in these sectors, but also in the Moldova financial system at large). However, the growth of MFIs necessitates proper regulation and enforcement, as consumer protection concerns and systemic risks abound.

A deeper analysis of the MFI market is warranted, including a full mapping of regulations that can affect MFIs going forward. The focus should be on details regarding interest rates, fees, penalties, and various structures. In addition, it should include the quantitative risks of foreign currency borrowing and lending specific to the sector as well as the likely over-indebtedness of MFI consumers. This could grow out of the work that MSRP has already done with drafting regulations for the NCFM.

(It should be noted that there is an ongoing controversy about the appropriate level of regulation for MFIs. In 2017, a "scandal" arose in which the MFI sector was blamed for exploitive practices against consumers. However, upon investigation, it appeared that very few examples of such practices had actually occurred. During the interviews for this report, the researchers encountered numerous anecdotes about fraudulent or illegal practices in the MFI sector, including money laundering, deceptive advertising, and outright fraud. However, upon further research, none of these could be confirmed. Critics of the sector point to these anecdotes and say, basically, that where there is smoke there must be fire. Defenders note that there are very few journalistic investigations, Central Bank or NCFM findings, or court decisions that have provided support for the allegations. Reaching a conclusion is beyond the scope of this report, but future research should keep in mind that allegations are not facts.)

A potential conflict of interest for the NCFM exists because it depends in part on fees charged to NBFIs based on their total assets. Thus, there is an inherent incentive to desire growth in these sectors. This could be in conflict with the prudential need to restrain over-extension of the markets. Stakeholders reported that fees range from 0.2 percent to 1.0 percent of total assets per annum. Considering this is a yearly charge, there is a disincentive to enact regulations or directives that might slow growth.

A tangible example is the Savings and Credit Association (SCA) sector. The SCAs are organizations controlled by their members. The original official naming for these associations was "Savings and Credit Associations of Citizens," but regulators removed the word "Citizens" and moved them away from a cooperative-like structure. After this, the NCFM encouraged SCAs to move beyond the original scope of their immediate rural community and expand to branches in neighboring areas. This expansion is not in step with the original mandate of the SCAs original mandate, but it may align with the NCFM's interest in fee-generation. This is not to say that the NCFM intended to grow its fee base in this way. It is likely the NCFM indeed wants neighboring rural communities to have access to savings and credit. But the point underscores potential conflicts in the NCFM fee structure. The integrity of the institution would benefit from exploring alternative fee structures that align with the NCFM's regulation and enforcement mandate, and away from promoting rapid expansion. Such structures could implement flat licensing fees upon strict capital requirements and penalty fees for unethical or unlawful activities.

With respect to Moldova's capital markets, the NCFM regards both stock and bond markets as still in their beginning stages. It is possible that the markets were not originally set up correctly; many changes have been made over the years. In any event, there is no real bond market with no liquidity or secondary trading (there is a correlation between the two). Considering the lack of a market and the fact that the Ministry of Finance (below) issues the government securities while the NBM oversees the banks that participate in the auctions, the NCFM focuses mostly on the stock exchange. The primary problems with the stock exchange are the lack of corporations listed and the lack of institutional investors, which also leads to no liquidity in these markets. Currently, there is a transitionary period to transfer much of the capital markets responsibilities over to the Central Securities Depository.

As for the bond market specifically, the legal framework exists for corporate and local government issuance. To date, there has never been an initial public offering (IPO) or bond issuance in Moldova. This fact reveals an overall lack of financial literacy in the capital markets.

The NCFM desires a pilot issuance in the bond market. It would like to see support for the establishment of a framework for bond issuance and has suggested that the Chisinau municipality would be a good candidate. The NCFM believes the leadership of the municipality could understand the process and help signal to local authorities that the market is a viable option. This is a potentially promising opportunity for USAID to consider supporting. A framework and potential issuance would provide a significant signal of Moldova's economic growth, financial health, and international credibility.

Ministry of Finance (MoF). One of nine cabinet ministries that supports the executive branch of Moldova, the Ministry of Finance is charged with developing, promoting, and implementing the management of public finances in Moldova.

Among other roles, the MoF issues the Moldova government's debt securities in the bond market and oversees their management. Current assistance from the European Union (EU) focuses on institutional issues as well as contractual relationships with the primary dealers. The investor base for government securities consists mostly of commercial banks which hold about 85 percent of those securities, while bank customers hold the remaining 15 percent (non-residents hold less than 1 percent).

The current outlook for Moldova's debt is best captured by Moody's rating agency. In January 2018, Moody's improved its outlook on Moldova debt from "B3 negative" to "B3 stable." Though an improvement, this rating signifies highly speculative (albeit high-yield) credit—more loosely coined *junk bond* status. When announcing the change, Moody's explained that "Moldova's (B3 stable) credit profile reflects [the economy's] low economic strength, weak institutions and . . . vulnerability to external shocks." Still, the announcement said, "Upward pressure on Moldova's sovereign rating could arise if the contingent liability risks posed by the country's weak banking system were to diminish meaningfully or the new resolution framework proves to be sufficiently robust to avoid additional liabilities on the government's balance sheet."[41]

Aggressive monetary policy has lowered rates and increased market demand with strong "bid-to-cover ratios" on government auctions of about 1.5. Bid-to-cover reflects the number of buyers per bond, so 1.5 would indicate the bonds were 1.5 times oversubscribed. For the first time in Moldova's history, the MoF recently sold the 5-year bond directly into the market. This is now the longest dated maturity in the market. After its perceived success, the MoF is now considering extending the yield curve and issuing a 7-year bond. However, based on interviews conducted with banks during this assessment, a longer-dated security at this time appears inadvisable. There is still reluctance by banks to go too far out on the maturity scale and increase duration risk in this potentially ultra-low interest rate environment. Issuing a bond and having it be undersubscribed (a bid-to-cover ratio less than 1) would send a negative signal.

Due to the thin secondary market, the MoF aims to reduce the activity of auctions and reduce the amount of government securities in the market. While this may reduce redundancy and line items, it does not appear to improve secondary trading. The desire of the MoF to set preconditions for secondary trading is troubling. For example, the MoF plans to limit the bid/ask spread allowed for trading in the secondary bond market. This limitation would likely hurt the secondary market in the near-term and prevent any real market exchange from taking place, especially if the bid/ask spread was unreasonably tight. When a market is illiquid, there is less clarity as to where a bond should be accurately priced and a wider bid/ask spread protects liquidity providers such as broker/dealers from that market risk so they can provide a service to market participants.

According to the MoF, there is currently no capacity to support a bond issuance by a municipality or private enterprise in Moldova. While there is legislation in place to support local authorities to issue bonds, *there is currently no process* in which to execute one. This is yet another indication that there is need for outside support in developing this market. The MoF is also coordinating and promoting the legislation developed by the NBM and the NCFM. In addition to this work, the MoF

[41] Matthew Circosta and Marie Diron, "Moody's: Outlook for CIS Sovereigns is Stable, but Region Vulnerable to Negative Shocks," Moody's, January 30, 2018.

is directly responsible for developing the legal and regulatory framework for the Deposit Guarantee Fund.

Deposit Guarantee Fund. The Deposit Guarantee Fund in the Banking System (DGFBS) was established in 2003 and launched operations in 2004. Currently, it guarantees individual deposits up to MDL 20,000, which represents a recent (2017) increase from the previous limit of MDL 6,000. Proposed amendments to the relevant law[42], to be enacted in 2020, would raise the guarantee ceiling to MDL 50,000 and would also cover deposits by legal entities. The new amendments to the law would have the NBM categorize banks' risk in buckets (A lowest, B average, C high) and charge quarterly rates on deposits, in accordance to their risk score, at the rate of 0.08 percent, 0.1 percent, and 0.12 percent respectfully. Currently, the DGFBS charges banks 0.25 percent on total deposits per quarter. The DGFBS had MDL 408.7 million in its account as of end of year 2017, with MDL 50.2 million paid in total to four insolvent banks since its inception.

The fund is set up as a guarantor of deposits (as opposed to deposit insurance) so that it shifts the process of payment away from the banks directly to the depositors. Each year the DGFBS selects an *agent bank* to process payments in case of a bank liquidity event. In the case of such an event, the DGFBS would provide the list of depositors to the *agent bank*. Then the DGFBS would provide the *agent bank* with 50 percent of the payment due and, if necessary, has the legal authority to sell T-bills for the remaining balance.[43] This provision of the law has never actually been used. Currently, there is no legitimate secondary securities market and it would be difficult to imagine smooth capital markets transactions taking place.

The draft new law would ensure funding to the DGFBS. Thus, if the required payments were greater than the cash on hand available to the DGFBS, the Ministry of Finance would provide a loan to the DGFBS in order to make timely payments to depositors. Furthermore, the NBM may provide liquidity assistance to the DGFBS in emergency situations for a maximum of three months, given that it is fully guaranteed with state securities in the DGFBS portfolio. This would mitigate the risk of having to sell T-bills in an illiquid market environment.

The DGFBS has expressed concern about implementing provisions to the Banking Resolution Fund for 2020. The main problem is that the Bank Recovery and Resolution Law was copy and pasted from the bank resolution law of Romania. This type of "cutting and pasting" has been a recurring theme in regulation of Moldova's financial sector as regulators rush to implement new rules that have been recommended or required by international organizations. In this case, the issue is that the new legislation does not take into account the local context and market realities. The DGFBS has requested support in implementing the regulations for the new law.

National SME Agency (ODIMM). A non-profit public entity operating under the coordination of the Ministry of Economy and Infrastructure, ODIMM was established in 2001 and started operating in 2007. It currently supports entrepreneurs and SMEs with a number of resources.

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[42] Law on Guaranteeing Deposits of Individuals in the Banking System, no. 575 of December 26, 2003.
[43] This process is drawn from this assessment's consultation with DGFBS. The Law on Guaranteeing Deposits of Individuals in the Banking System states that payments can be done directly by DGFBS or through the agent bank.

ODIMM focuses on providing informational tools for entrepreneurs and SMEs to establish and grow their businesses. Ultimately, ODIMM aims to train these growing businesses in order to reach a level where they can become bank clients and access finance. In order to facilitate local access to finance, ODIMM has a credit guarantee tool. According to ODIMM, its main stakeholders and resource providers are the European Union and the World Bank, so many of its activities align with the mandates and initiatives of those entities.

ODIMM's credit guarantee operates in a manner similar to USAID's Development Credit Authority (DCA) guarantee. The ODIMM credit guarantee is typically 50 percent pari passu on the principal only. The guarantee typically acts as a collateral substitute for banks to mitigate risk. ODIMM used to require banks to wait for 90-day NPLs (non-performing loans) before calling on the guarantee but have recently changed this process to accommodate bank demands. Now the ODIMM guarantee pays immediately on any missed payments. Another difference from the DCA is that ODIMM does not conduct due diligence on the bank it guarantees as long as the bank is licensed and under NBM regulations. Where USAID DCA is backed by the full faith and credit of the United States Treasury, ODIMM administers a fund with a cap of MDL 140 million through 2018.[44]

Central Securities Depository (CSD). Established by the NBM, the CSD has three core mandates:

> 1. Registration of securities. Currently all securities are registered by the NCFM. This transition may take a few years to move all registrations from the NCFM to the CSD. The CSD will ultimately handle all registered securities in the equity and fixed income markets, including any new issuance in the future. The CSD will also take over all information technology (IT) related to registrations.
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> 2. Settlements. The settlement process will facilitate all transactions (movements of securities). When a security trades from one entity to another, the security will move from one account to the other. That exchange will then need to ensure that the security settles into the new account once money is matched. The CSD has invested in advanced technology to ensure the settlement of transactions.
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> 3. Account holding (registry keeping). As referenced above, for any transaction to be complete, there must be an account assigned for each trade. The CSD will keep the registry for all accounts that can transact in the capital markets. For an investor to have an account to buy and sell securities, the investor must open one on the CSD to allow for the holding of stocks or bonds.

The Moldova Structural Reform Program is in the process of facilitating the development of the CSD website to help bring transparency to the market, as well as to enhance the information system to carry out online transactions with securities. Following this work, the CSD will need help with potential procedures on how to participate in the market through the new website. This work will require market expertise to ensure proper education on the capital markets,

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[44] Interview with ODIMM, June 2018.

transactions, and liquidity. The CSD has the opportunity to be the primary organization to engage key market participants and facilitators to work with USAID to establish the foundation and procedures for the first primary bond issuance in the capital markets. Part of this engagement should focus on bond market literacy including the pricing and trading of bonds in the secondary markets.

SUPPORTING INSTITUTIONS

Banking Sector. As noted in this report, banks must maintain a required reserve of 40 percent of local currency deposits. These short-term liabilities primarily consist of deposits. The foreign currency reserve requirement is 14 percent. While this over-liquidity helps stabilize the currency and lowers banks' balance sheet risk, it also tightens economic activity and stems growth.

KEY SUPPORTING INSTITUTIONS

- Insurance sector
- Leasing sector
- Credit bureaus
- Savings & Credit Associations
- Prime Minister's Economic Council
    - Capital markets
    - Equity market

There remains a chronically high level of doubt among Moldova citizens as to the credibility of the banking system. This is no surprise as not even one individual has stood trial for the illicit actions taken by the three banks. It is safe to say that perceived risk in the banking system remains high.

Not only is the risk and credibility of banks at issue with the population, the dramatic decrease in lending has also added to the frustration people have when dealing with banks. In fairness, banks have had a tremendous amount of regulation thrown at them. Not only is their reserve requirement high relative to most banking sectors around the world, commercial banks are also hurriedly working toward complying with Basel III requirements. Basel imposes a high level of Know Your Customer (KYC) processes. This, along with a focus on risk-based lending protocol over asset-based lending, have put banks on the defensive and has significally reduced banks' willingness to lend. In addition, banks face more amorphous risks such as the ever-changing political environment which can dramatically swing financial system requirements at any given moment. Banks seriously dislike unquantifiable risk and typically wait on the sideline until the outcome is known. The combination of these barriers to lending, combined with the fact that the NBM requires banks to use only "*official reports*" and report all "*affiliated parties*," leads to potential borrowers—who are unwilling to disclose certain incomes or partners—to be wary of the real economy and gravtiate to what professionals in Moldova refer to as the "Informal Economy."

Moldovan citizens are not the only group that remains cautious about the banking sector. Most multilateral organizations are wary of the stability and integrity of banks. As such, there has been a reduction in the type of transactional support that typically shares in or provides guarantees for the risk of certain bank activities. One example is the *letter of credit* (L/C) guarantees previously provided by multilateral development finance institutions. According to one large Moldovan bank, the European Bank for Reconstruction and Development (EBRD) and the International Finance Corporation (IFC) traditionally helped with trade facilitation by providing L/C guarantees confirming that banks did not need cash collateral, thus making the cost of the L/C much more attractive. The 2014 bank fraud paused those operations and they are still not back in place today. Additionally, due to the overall increase in country risk, trade alliances with foreign banks have ceased. The new country risk requires L/Cs to have guarantees by foreign banks. Without these guarantees and/or alliances in place, trade financing for banks requires cash collateral. To make matters worse, the discrepancy between internal cash collateral procedures for local banks and the related procedures of foreign banks results in requirements that mean local banks must post even greater sums as collateral.

All is not lost with the banks in Moldova. The EBRD recently sent a positive signal to the market by joining wth Banca Transilvania in an investment in Victoriabank. In the new arrangement, Banca Transilvania acquired 39.2 percent of the shares of Victoriabank, while the EBRD increased its stake in Victoriabank to 27.5 percent. This investment signals an improving financial system and banking sector. While there is more to evaluate and improve, it is a hopeful sign that the system is changing for the better. Another strong indication of strengthening is substantial bank interest in supporting and participating in the new issuance of bonds in the capital markets. This bears emphasis: every bank we interviewed expressed interest, and in some cases strong interest, in developing a local Moldovan bond market.

Insurance Sector.[45] Moldova's insurance sector consists of both *compulsory* insurance and *secondary* or non-mandatory insurance. Compulsory insurance covers damages done to external parties caused by the insurance carrier but does not cover the insurance holder for personal damages. Conversely, secondary insurance covers the insurance carrier for personal damages but not external damages.

The largest segment of the insurance market is for automotive insurance. There are two types of compulsory auto insurance called Motor Third-Party Liability insurance (MTPL). The first covers in-country (domestic) claims for external parties who were in an accident with the person who has the insurance policy. The second covers international travel for drivers who wish to travel outside the country; it is referred to as "green card insurance." Again, both of these are mandatory, required by the government, with tariff provisions set by the NCFM. On the other hand, secondary auto insurance or "CASCO" (casualty and collision) insurance, is not required and insurance providers set prices according to their own internal metrics. This type of insurance is more variable because it heavily depends on driver history and is generally much more expensive than MTPL. For this reason, CASCO insurance represents a much smaller share of the insurance market.

There have been many attempts to liberalize MTPL over the years and they have experienced continued delays. Now, due to requirements in the EU-Moldova Association Agreement, the NCFM is making a real effort to liberalize this market by July 2019.

There are many factors to consider with the prospect of liberalization, some good and some bad. The primary benefit of a liberalized market is that it promotes a freer market and reduces costs to

[45] Due to the forthcoming World Bank report on Moldova's insurance sector, this report only briefly discusses the main points. At this writing (mid-July 2018) the World Bank report appears to be substantially complete but it has not been released to the public and none of the stakeholders—the Bank, Ministry of Economy and Infrastructure, or the NCFM—are willing to release a preliminary copy. The Moldova Structural Reform Program aims to access to the report from the NCFM as soon as possible so that USAID can have a more thorough assessment of the sector.

the consumer. In the medium term of about three years, the market could see benefits such as insurance providers understanding the risks better; improving their pricing; and engaging in more efficient competition. On the other hand, there are several risks to be aware of. On the consumer side, there is concern that liberalization may be accompanied by increased uncertainty for claimants who must wait long to be paid, or who may not even be paid at all. On the provider and regulator side, providers should be aware of what happened in Romania when it liberalized its insurance market (see Case Study: Romania). There were two large bankruptcies because the companies sold insurance at rates lower than appropriate given the market risks. As a result, the companies did not have enough capital on hand once claims were made. Apparently, these companies thought they would have more volume (and more capital) to cover the below-market pricing. This is a big risk for regulators to be aware of and try to prevent in Moldova. Given the risk and the history, it may be advisable for the NCFM to consider a *minimum* price for this new market in order to avoid undercutting the market and consequent lack of payment. Further research would be needed for this, but the time in which to conduct such research is growing short.

Overall, the insurance sector—from agriculture to construction—is weak, with the exception of a couple of international providers. The main problems stem from poor governance, lack of shareholder transparency, and improper risk management that leads to undercapitalization. Anecdotal evidence suggests that in some cases, intentional non-payment may also be an issue. All of this is due to a lack of oversight and enforcement in the insurance sector. This all leads to a lack of trust in the insurance market and little demand for individuals and SMEs to pay for insurance. The high premiums and history of non-payment on claims has led to a fragmented, inefficient, and ineffective sector.

Leasing Sector. Leasing is a nascent and struggling sector in Moldova. The leasing model uses a nontraditional structure and does not mirror the structure of a traditional lease transaction. The market primarily consists of automotive (car or truck) leases, in the form of a leaseback agreement. This sector struggles to work with and inform the legal system, particularly regarding proper taxation of its financial products. Leasing is a newer market for Moldova; the business is more complex and involves more significant administrative costs and logistical processes. The legal status is not clear (regulation is still a work in progress), which adds to the difficulties leasing companies face when trying to operate in this local market. Some leasing companies blame the "copy and paste" nature of the relevant EU regulation as well as the lack of local context—a theme that is evident in other markets as well.

In many cases, the MFIs have a more conducive business environment. Administrative burdens are fewer, they are usually able to claim collateral without much difficultu, the tax situation has been clarified, and there are fewer logistical challenges. This may be why some leasing companies have left Moldova and more may follow. According to one leasing company interviewed during this assessment, "Leasing needs to evolve before it is restricted so much that the sector dies."

Credit Bureaus. Credit bureaus are relatively new to Moldova's financial system. The first credit bureau ("Biroul de Credit" or "Credit Bureau") was established in 2008, but only fully opened in 2011. The second credit bureau started its activity as "Infodebit," collecting only negative information. From February 2017, it was registered as Biroul Istoriilor de Credit "Infodebit Credit

Report." The majority shareholder of Infodebit appears to be Veaceslav Mîrza, a local IT entrepreneur.

The two bureaus have different characteristics and there is a significant membership divide between the two. The shareholders of the first ("Credit Bureau") are all commercial banks plus two non-banking institutions. Credit Bureau therefore has substantial support from many of the sector's proponents. Banks and the Bankers Association are significant advocates of requiring membership in the Credit Bureau and there is a push for regulation to enforce such a rule[46]. Considering there is a membership fee associated with the credit bureaus, there is a possible conflict of interest as banks are also shareholders of the Credit Bureau. Meanwhile, Infodebit Credit Bureau appears to be the preferred vender of microfinance institutions.

There are also other differences between the two bureaus. For one, Credit Bureau has a larger database. It has access to nearly all bank credit data and close to 30 percent of MFI data. It also has direct access to tax information about individuals' income, which can be provided to banks and NBFI members if the borrowers permit. On the other hand, Infodebit Credit Bureau mainly has MFIs as members and it has no bank support. However, Infodebit charges about 10 percent of what Credit Bureau charges and, according to one technologically advanced MFI, has a much better integrated IT system that provides instant access to information and gives data that can be downloaded instantly. This is in contrast to Credit Bureau, which provides a static PDF file for each individual account request. It is understandable that MFIs that make a larger number of smaller loans would find PDF files for each borrower cumbersome and inefficient.

Parliament recently approved a proposed amendment to article 6(2) of the Law on Credit Bureaus which would require MFIs to belong to at least one of the credit bureaus in Moldova. There is still confusion as to what the ultimate legislation will propose and if it will favor banks or require information from certain sources but not others. Additionally, a 2017 amendment to the Law on Credit Bureaus[47] requires reciprocal data exchange between credit bureaus to be in force beginning on August 5, 2018. At this writing (mid July) it is unclear whether this will take effect in the time required by the law, but full sharing of information between the two credit bureaus is certainly advisable, with competition on prices and services allowed.

Savings and Credit Associations. Savings and Credit Associations (SCAs) were established starting in 1998, based on the mutual responsibility (and joint liability) of their members. There were 279 SCAs as of the end of 2017. Traditionally, SCAs operated in localized rural areas, providing loans to and accept savings only from their members, in localized rural areas. However, in recent years, regulations have forced SCAs into the mainstream economy where they must compete with more traditional institutions such as banks.

For example, the NCFM is considering bringing SCA deposits into the Deposit Guarantee Fund. The rationale for requiring guarantees on deposits is two-fold: (1) the NCFM excluded "citizens" from the name of the SCAs; and (2) the NCFM has also significantly enlarged the geographical coverage for SCAs activities, allowing them to open branches in different regions. The NCFM

[46] "Membership in *which* Credit Bureau?" is an open question.
[47] Law on Credits Bureaus, no. 122-XVI, May 29, 2008.

argues that this has increased systemic risk within the subsector. Apparently there have already been at least two examples of SCAs that set up organizations that only took deposits and then became insolvent. The defrauding of consumers and lack of enforcement leads to the perpetuation of negative sentiment in the industry. SCAs oppose the NCFM proposal, and note that they (the SCAs) already are required to post 10 percent of deposits into a central liquidity fund. The DGFBS also opposes the NCFM's proposed change. It thinks guaranteeing SCAs does not fit the DGFBS model because of the members' mutual and joint liability.

Moreover, SCAs must pay a regulatory/supervisory tax to the NCFM; for 2018 the tax rate is 0.7 percent, 0.8 percent, or 1.0 percent, depending on total assets per annum.

Prime Minister's Economic Council. The Prime Minister's Economic Council (PMEC) does not have any direct oversight function or legal responsibilities concerning the financial sector. However, it is mentioned here because the current PMEC has the ear of the prime minister and also has, at this time, a positive reputation within the financial sector. The PMEC could thus be a possible partner for reform efforts in the financial sector, although this may depend on the current political situation.

Capital Markets. The Moldova capital markets consist of both the equity (stocks) market and the fixed income (bonds) market. The equity market represents the buying and selling of ownership shares in a company, while the fixed income market represents the buying and selling of debt instruments. When a stock or bond is sold to investors in the market, it issued in the primary market. If that stock or bond security changes hands from one investor to another, then it trades in the secondary market. Currently, the National Commission for Financial Markets oversees and regulates all of the capital markets (primary and secondary).

Equity market. During the privatization of Moldovan companies, almost all citizens became shareholders and received stock certificates. Massive privatization of state-owned enterprises resulted in the emergence of a large number of open-ended Joint Stock Companies (JSCs) on the market. Many of them are only formally, from the legal point of view, open-ended JSCs, while in reality, in the economic sense, they are closed companies. Most of these JSCs do not pursue the goal of classical open societies: attracting additional financing through the mechanisms of the securities market.

In 2015, a new law on capital markets entered into force. However, it is important to understand both how the domestic market was organized prior to that change, as well as certain changes due to the new law. The key points are as follows:

- Trading of securities was organized by the Stock Exchange of Moldova (SEM), which has two listing levels: (1) the regulated market, which sets higher requirements for JSCs and their securities and (2) the Multilateral Trading Facility (MTF) market, with less requirements to JSCs and their securities.
- Since 2015, Public Interest Entities (PIE) have had to register in the regulated market, and other JSCs can register in the MTF market. The stocks listed on the MTF exchange are stocks of JSCs that prefer to avoid the greater restrictions and higher level of transparency required in the regulated market.

- There is also a third market: the over-the-counter (OTC) market, which has its own, separate set of regulations. Transactions in the OTC market are made directly between the parties to the transaction, without the participation of brokers. This market is less certain, as the registrants have the right to register the transactions as concluded, without ensuring that payments have been made.
- Pursuant to the legislation that went into effect in 2015:
  (i) the sale or purchase of securities issued by PIE may be carried out in the OTC market if the cumulative volume of such transactions does not exceed 1 percent of the total number of securities of a given class issued by the issuer; and
  (ii) the sale or purchase of securities admitted to the MTF may be registered by the registry and the central depository when the cumulative volume does not exceed 10 percent of the total number of securities of a given class issued by the issuer.

Due to the undeveloped nature of the equity market, it is very difficult to envision a reason why a private company would want to list its shares in the market. Instead, if a company needed to raise equity capital, it would likely first seek private equity capital. In the event that a company had the rare desire to go to the public market, it would do an initial public offering (IPO) in another country. A recent, well-publicized example of this was Purcari, a prominent local wine producer with a successful export business, which did its IPO in Romania.

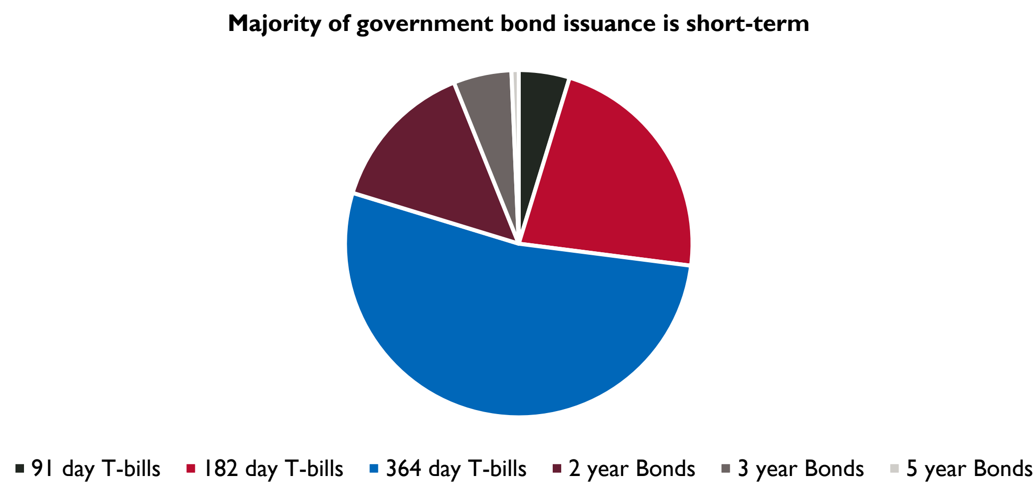
The details of Purcari's IPO are interesting and relevant. Purcari did not originally wish to go public, but its existing private equity investor had an exit horizon and by charter the investor had to sell after 7–8 years of participation. As a result, the best path was for Purcari to seek equity investors internationally. Initially, Purcari tried to find strategic investors and researched some offers. This was done under the guidance of Raiffeisen Bank, an international investment bank. Raiffeisen gave Purcari advice and encouraged them to look for international capital on non-Moldovan capital markets. Since there was no precedent for an IPO in Moldova and local banks are not in position to hold available shares, the most appropriate path was to issue the IPO in Bucharest. The Romanian market is still relatively small and large investors are still reluctant to participate in it. However, "small" is better than "nonexistent," and upon review it appeared that the market would be big enough to support Purcari's IPO. The size of the issuance was approximately USD $50 million, representing 49 percent of its shares. The IPO was successful and Purcari is now a publicly traded company . . . in Romania.

Fixed income market. The fixed income market is underdeveloped and lacks certain important frameworks and processes. Currently, the only bonds in the capital markets are government securities. The Ministry of Finance (MoF) issues bonds through an auction process that occurs outside of the equities markets. Banks that have Primary Dealer status are the only entities allowed to participate in these auctions, and banks are primarily the only investors (or holders) of government bonds. Other than international funds, institutional investors are not engaged in the fixed income market. There is no liquidity in the markets and no true secondary trading exists. Unsurprisingly, there is a substantial lack of capital market literacy concerning the secondary market and the trading, pricing, and settling of fixed income securities. According to banks consulted during this assessment, the only "trading" conducted in the secondary markets consists of transactions based on pre-agreed terms in order to fill the requirements set forth by the NBM.

In reality, these banks are not active traders and almost all fixed income securities are held to maturity.[48]

Most government securities issued in the primary market are short-term maturities with 79.7 percent having maturities of between 3 months and 1 year (figure 5). Another 19.6 percent have maturities of 2–3 years, while the recently introduced 5-year note represents less than 1 percent of government bond issuances. The Ministry of Finance issued a 5-year note in March and April 2018.[49] This is Moldova's longest dated maturity for bonds in the capital markets. The 5-year bonds were apparently oversubscribed, which typically indicates greater demand. However, in discussions for this report, banks said that there is not a strong appetite for longer dated securities beyond five years due to the uncertainty of Moldova's interest rate environment. The greatest appetite by banks is for the 14-day central bank deposit notes that offer 6.5 percent interest.[50]

Figure 5. Government Bond Issuances



Source: Government of Moldova, Ministry of Finance, *Central Government Debt Management Monthly Bulletin*, April 2018.

On the positive side, Moldova does have a bond market with the infrastructure to allow for the issuance of new bonds and the necessary laws are in place to support such activities. What is lacking is a framework and process for companies and municipalities to issue in the market. While there has never been a bond issuance other than of state securities, there has been appetite to do so in the past. Ten years ago, there was a strong interest in developing a bond market and an increasing likelihood that Moldova would see its first-ever bond issuance. At that time, there were

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[48] Regulation on Placement and Redemption of State Securities in Book-Entry Form, Approved by the DCA of the NBM, no. 96, May 17, 2013, available at http://bnm.md/en/content/regulation-placement-and-redemption-state-securities-book-entry-form-approved-dca-nbm-no-96.
[49] Ministry of Finance of the Republic of Moldova, April 2018 data.
[50] According to multiple bank interviews with the Treasury departments, May-June 2018.

many supporting actors, including regulators and banks. Unfortunately, the global economic crisis of 2008/2009 struck, and interest dropped dramatically.

One issue that was raised repeatedly by multiple stakeholders in the course of the research for this report was the need for pension reform in order to establish institutional investors. In most developing countries, pension funds are normally key players in the capital markets. This is not currently the case in Moldova.

That said, the timing appears to be good for setting up the framework and developing a path for a private entity or municipality to issue bonds. The banks hold the view that the bond market, rather than the stock market, appears to be more promising. This is, of course, a self-interested position (banks are more likely to be directly involved in bond issuances than in IPOs), but it also appears to be accurate. The NCFM also is looking for support in developing Moldova's capital markets and suggested piloting an issuance with the Chisinau municipality. The multilateral institutions also support this idea, and told members of the research team for this assessment that this was the "right direction to push as munis [municipal bonds] are more credible." The multilateral institutions also suggested there is a lack of focus on and support for the capital markets, and they said that work developing those markets would be highly impactful.

The Central Securities Depository can settle all stock exchange and bond transactions. In order to see a successful development of the capital markets and pilot a bond issuance, USAID would be best situated by focusing on the CSD as the key partner to work with to engage the various relevant parties, including regulators, banks, and others.

CASE STUDY: ROMANIA

Romania's Financial Regulatory Agency (ASF) is the body responsible for regulating the financial markets in Romania. The capital market in Romania is now aligned with the EU regulatory framework. The main regulatory challenges to sector development include high trading fees, inconsistent enforcement of corporate governance rules, and overall low liquidity.

The only remaining state-owned banks in Romania are the National Savings Bank (CEC) and EximBank, with 8.3 percent of the market. Otherwise, there are 37 banks and credit cooperative national unions, of which the largest five combined have 58 percent market share.

The Bucharest Stock Exchange (BVB) allows for trading in corporate, municipal, and international bonds, and has a market designated for SMEs and start-ups (AeRO). Treasury bonds were issued in U.S. dollars starting in 1998, but since 2006, all bonds have been issued in euros or local currency. Romania began issuing bonds much later than the rest of Europe due to late adoption in 1998 of a key regulation that allowed local administrations to use the capital market for borrowing funds. The first municipal bond was issued in 2001 by Predeal (PRD03) and Mangalia (MNG03) with a total value of €0.6 million. Within 5 years (by 2006), €19 million in municipal bonds had been issued. The market grew rapidly because on one hand these bonds offered superior rates of return compared to those offered by the monetary market, while on the other hand they also resulted in lower borrowing costs for municipalities compared to bank lending.

The first corporate bond was issued in 2003 for €1.3 million, and the market quickly exploded to €159 million in 2006. (Romania is unusual among European countries in that the municipal bonds are not as well traded as corporate bonds.)

Overall, the market in Romania is underdeveloped with low liquidity. Key factors are the lack of rating in the Romanian market and the lack of a yield curve. Additionally, a few years after the initial bond issuances, banks began to offer better credit conditions to municipalities in reaction to the competitive bond market.

The securities market is regulated by the Ministry of Public Finance (MPF) and managed by the National Bank of Romania (NBR). NBR is the sole depository for all government securities issues. It also organizes and conducts investment activities and sets norms for the secondary market for securities, in coordination with the MPF and according to the terms of its own statute.

POLITICAL ECONOMY

Uneven Regulatory Environment. The dominant political class still has enormous sway over Moldova's regulatory environment. They are positioned to have first access to new opportunities because much high-level business activity in Moldova still relies on patronage and influence networks that often act as barriers to entry for new entrepreneurs or "unconnected" Moldovans. Challenging these embedded systems of patronage requires a robust regulatory framework in tandem with enforceable implementation of regulations to ensure greater participation by a wide range of business owners. The ability of microenterprises or even SMEs to operate without political connections and resources to pay bribes is rare; large businesses either have direct access or, if foreign, face fewer hurdles because government leaders act as chaperones trying to attract foreign capital. Old systems of patronage trump modern regulations within the Government of Moldova.

Parliamentarians are not viewed as defenders of the SME sector. One respondent stated that this was because few, if any, members of Parliament come from the SME sector. If officials continue to be the beneficiaries of rent-seeking by powerful elites, progress toward a more open and prosperous market is difficult to envision.

Business Support Organizations. The strategy for SME development is highly politicized and can depend on personal interests of individual politicians and government counterparts doing favors, rather than following state-oriented strategic development; this remains a predominate theme. While ODIMM, the MIEPO,[51] and the Chamber of Commerce and Industry provide useful support to SMEs (e.g., financing, technical assistance, and other services) these institutions are hampered by inefficient and outdated bureaucratic systems that slow down SME growth. For example, despite the creation of a "single window" for registering businesses, some complain that there are still no clear and easy guidelines for starting a business.[52] This is because certain laws are not clearly written; and when the laws are translated into different languages, the meanings often change creating further confusion.

Role of government and the upcoming elections. The majority of stakeholders who were interviewed as part of MSRP's early political economy review remarked that government was still seen primarily as a "regulator and gate keeper" rather than an ally of SMEs. Government was viewed as mainly awarding (tax) privileges to bigger businesses as its main interest is generating revenue rather than enabling SME growth. This creates perverse incentives that influence market dynamics and often put new entrepreneurs at an unfair disadvantage.

An additional factor is the upcoming elections. At the time of writing this report (early July 2018), elections are expected within about six months, probably in the period from November 2018 to March 2019. The elections are already having an effect on the attitudes and priorities of government stakeholders. Elected and appointed officials are distracted and looking for quick,

[51] The Moldova Investment and Export Promotion Organization is a public institution coordinating policy implementation for competitiveness, export promotion and investment attraction in Moldova.
[52] This view was challenged by about half of the SME respondents who said that it wasn't difficult to start a business.

high-profile "wins" rather than focusing on longer-term policy and administrative changes that will not show results until after the elections.

Yet another complication is that, at the moment, the current Moldovan government is in a state of partial confrontation with the European Union because of the recent mayoral election in Chisinau. A number of reforms that were conditionalities for European assistance may not necessarily pass now, or at least not on the originally planned schedule.

Rule of Law. There is a strong perception among Moldovan SMEs—and, indeed, individuals and most business generally—that they should avoid taking disputes to court if possible. One commentator said that in general, "Judges are overwhelmed; many are corrupt; clerks are making many of the decisions." This point is supported by the *Doing Business Report 2018*, which noted that "corruption and a lack of trust in the justice systems [are] major impediments to doing business in Moldova."

RECOMMENDATIONS

Capital markets framework and process

The extensive review conducted for this assessment indicates that there is a promising opportunity for USAID support to make a real difference. A successful bond issuance, whether by a private entity or a municipality, could have a significant, positive impact on Moldova's economic growth, financial health, and international credibility.

As noted above, the necessary legal infrastructure for the issuance of new bonds is already in place. What is needed now is to put in place an implementing framework and process for companies and municipalities to issue in the market.

In order to accomplish this, there will need to be collaborative efforts by many stakeholders, including the CSD. USAID could help by organizing, collaborating, and providing technical expertise for everything from legal structure to capital markets training for government, banks, companies, and individuals. Specific actions could include:

- Based on the existing capital markets legislation, develop a framework for issuance of the bonds, which should include the implementing institutions (such as the NCFM and the CSD) and supporting institutions (such as banks, international financial institutions).
- Describe the whole process: detailing the step-by-step procedures needed for the issuance, settlement, and secondary trading of the bonds.
- Describe and analyze the types and features of possible bond issuance structures in Moldova, including the following:
    - Municipal or corporate bonds,
    - Seniority of bonds and collateral, and
    - Maturity, coupon and associated duration.
- Conduct a local market analysis for future municipal and/or corporate bond issuances.

Capital markets pilot bond issuance

Additionally, the NCFM has indicated that it would be great if there were support for developing the capital markets and suggested piloting an issuance with the Chisinau municipality. The multilateral institutions support this idea as well, and told the research team that this was the "right direction to push as municipalities are more credible than corporates." They also suggested there is a lack of focus on and support for the capital markets and that work developing those markets would be highly impactful.

Bond issuance with Chisinau municipality. It would be beneficial to add to the recommendations listed above a concrete project in the form of a pilot bond issuance with a municipality. Chisinau is by far the largest municipality in the country and would therefore be the logical starting point. While the capital markets framework is a priority and a reality, a pilot issuance could add to the momentum and provide something tangible to incentivize key stakeholders and potential investors. There would need to be further research on the viability of a Chisinau bond, but initial discussions point to a viable path forward. One thing to consider is the political environment and how that may affect timing. Regardless, the work required to support this path would stand the test of time. Specific steps could include:

- A USAID high level meeting with the (acting) mayor of Chisinau to reach an agreement in principle on the issuance of municipal bonds.
- Developing a memorandum of understanding and an action plan with Chisinau municipality
- The action plan should, at minimum, contain the following main measures:
    - Determining and agreeing on a plan that lays out in detail the steps that will be taken in the process of issuing the bonds
    - Approval of the project by Chisinau Municipal Council
    - An investment plan for the selected implementation plan for the bond issuance
    - An analysis of the municipal budget structure, dynamics, and forecasting in order to determine borrowing capacity
- Identify the appropriate features based on the market dynamics and the needs and realties of the borrower, including determining the following:
    - The type of bond: revenue bonds, general obligation bonds, or Chisinau balance sheet; and
    - Maturity, coupon, and collateral
- Identify potential risk mitigation tools
- Identify bilateral and/or multilateral support
- Review of municipality finances, particularly of medium-term cash flow
- Obtain an institutional credit rating
- Obtain all authorizations required for the issuance of the bonds by law and regulations
- Prepare the prospectus, which should explain the amount, purpose, and structure of the bond issuance
- Conduct investor outreach by organizing a roadshow to generate demand for the bond issuance

Bond issuance with a private entity. A bond issuance with a private entity could also be possible. If a suitable partner could be found, it would offer some advantages: less political uncertainty, and a partner that would probably be more flexible and more able to move rapidly. However, there are also several negatives. A private company would need to be convinced not to go to Romania or elsewhere. The level of trust in a private company is likely to be lower; in interviews, banks expressed much more interest and enthusiasm in municipal bonds than in private ones. Interest rates are likely to be higher, making this less attractive as a proof-of-concept activity. Taken overall, this alternative is worth investigating, but at this time the municipal bond appears more promising.

MFI sector analysis

A deeper analysis of the MFI market is warranted, including a full mapping of how regulation can affect MFIs going forward. The NCFM simply does not have the resources to do this, so it would have to fall to a donor.

The focus should be on very specific details regarding interest rates, fees, disclosure rules, penalties, and various structures. The analysis should cover quantitative risks of foreign currency borrowing and lending specific to the sector and the likely over-indebtedness of MFI consumers. Ultimately, a better fundamental understanding of the different types of MFIs in Moldova, how they operate, and who they target is important. The analysis should also use quantitative data that can truly inform the opportunity cost of consumers using certain MFIs versus bank loans. This should include the cost of taxes versus the cost of finance.

Consumer financial literacy training

In Moldova today, there is a significant lag in financial literacy for individuals and SMEs. USAID could focus on either MFI or bank clients, although both would benefit for different reasons. MFI borrowers are most at risk due to the high cost of financing. These consumers would benefit by understanding the all-in cost of borrowing and what other options they may have. Bank clients would benefit from learning the new lending practices by banks. With the added regulation and Basel III requirements for banks, clients need to be better positioned for access to finance. Existing bank clients are confused by the new rules and question why they can no longer have access to resources they had for years. Specific steps could include:

- Work with relevant parties (mainly ODIMM and the Chamber of Commerce and Industry) to identify the critical literacy issues for consumers, especially for SME, to access financing
- Develop and deliver a literacy training program with a focus on SMEs

Bank Training – Basel III

In addition to training for consumer financial literacy, banks would also benefit from learning how to implement new risk-based lending procedures. Historically, banks were focused on asset-based financing and collateral more than risk calibration and credit quality. While banks are certainly capable of shifting focus to align with Basel III, the industry would benefit by learning how to implement these practices to actually build their loan portfolios and reengage SMEs to facilitate access to finance. The Bankers Association has the platform to work with USAID to facilitate bank training.

Surprisingly, no other donor is committed to this activity at this time. It would seem a natural area of interest for the IMF and/or the EU, but neither has any activity related to Basel III training. This is an important activity and some donor should be moving forward with it. Possible activities might include:

- Work with the Bankers Association, Moldovan Bankers' League, and the NBM to identify what elements are missing in the existing and potential training support to banks regarding Basel III implementation
- Develop and deliver a bank training program on Basel III