



ACCESS TO FINANCE CONSTRAINTS ANALYSIS STUDY AND ACTION PLAN

July 2017



This Study was funded by the
SUSTAINABLE DEVELOPMENT ACCOUNT MOLDOVA

This Study was developed by
Ion Tornea, Individual Consultant

Acknowledgements

This document was prepared by Ion Tornea in the frame of the Contract for provision of individual consultant services related to analysis of constraints of businesses in access to finance in Moldova and development of an action. This contract was financed by the Public Institution “Sustainable Development Account Moldova” (SDA Moldova). The document was reviewed by the SDA Moldova and exposed to public consultations.

The Consultant would like to thank Sergiu Luchita (Access to Finance Activity Lead, SDA Moldova) for a thorough review of the document, formulation of valuable suggestions and editing assistance, as well as other SDA Moldova representatives for their important inputs and support in elaboration of the document, preparation and delivery of public presentations. Also, special thanks to representatives of private and financial sector, public institutions and donor community for their opinions/suggestions during interviews and feedback upon public consultations.

Disclaimer:

This document has been produced with the financial support of the Sustainable Development Account (SDA) Moldova. The views expressed herein are those of the author and can in no way be taken to reflect the official opinion of the Sustainable Development Account (SDA) Moldova or of the Government of the Republic of Moldova.

Copyright Statement:

© IP „Fondul de Dezvoltare Durabilă Moldova” (Sustainable Development Account Moldova), 2017.

Integral or partial reproduction of this document is authorized, providing that clear and exact reference to the source has been made.

Contents

LIST OF ACRONYMS	5
EXECUTIVE SUMMARY	6
PART 1. ACCESS TO FINANCE CONSTRAINTS ANALYSIS STUDY	12
1. INTRODUCTION	13
2. PRIVATE SECTOR CONSTRAINTS.....	15
2.1. Private Sector Overview	15
2.2. Access to Financial Services	26
2.3. Access to Finance in Agriculture	33
2.4. Findings / Summary of Market Failures	39
3. CREDIT INSTITUTIONS CONSTRAINTS TO FINANCE.....	42
3.1 Bank Sector.....	42
3.2 Microfinance Sector	54
3.3 Leasing Sector	59
3.4. Findings / Summary of constraints.....	63
4. REGULATORY FRAMEWORK AND FINANCIAL INFRASTRUCTURE	66
4.1 Regulatory Framework.....	66
4.2 Financial Infrastructure	73
4.3 Findings / Impact on Access to Finance	80
5 ACCESS TO FINANCE REFORMS	83
5.1 Implemented and Failed/Delayed Reform Efforts	83
5.2 On-going Reforms Aimed at Facilitation of Access to Finance	88
5.3 Current Development Partners' Reform Efforts	92
5.4 Key Findings.....	104
6 CONCLUSIONS / SUMMARY OF CONSTRAINTS	109
BIBLIOGRAPHY.....	114
ANNEXES	118
LIST OF INTERVIEWEES.....	124
PART 2. ACTION PLAN	125

List of figures

Figure 1: Contribution of expenditure elements to GDP, and GDP evolution, %	16
Figure 2: Evolution of exports, remittances and their share in GDP, 2000-2016, %	17
Figure 3: The number of registered companies, sales and profits, 2005-2015.....	19
Figure 4: Share of SMEs in the total no. of companies, employment and sales	20
Figure 5: Average annual growth rates by size of company (2006-2015)	21
Figure 6: Distribution of indicators by companies' ownership and size, 2006 vs. 2014	22
Figure 7: Distribution of the number of companies, sales and profits by regions.....	22
Figure 8: Business/economic intensity in Moldova by rayons, 2015, %	23
Figure 9: Domestic credit provided by financial sector in 2016 vs. 2004, % of GDP	27
Figure 10: Depth of financial sector in Moldova by components, % of GDP	28
Figure 11: Percentage of firms with a bank loan/line of credit	29
Figure 12: Percentage of loans requiring collateral and value of collateral	30
Figure 13: Percentage of investments financed by banks and internally	31
Figure 14: Percentage of firms using banks to finance working capital and.....	32
Figure 15: Real interest rate vs. gross profit margins, demand for bank loans (right axis) and evolution of investments (left axis) in Moldova, 2005-2015*	33
Figure 16: Share of agriculture loans in bank portfolios, 2016	34
Figure 17: Evolution of sales and profits in agriculture vs. total per economy	38
Figure 18: Profit margins in agriculture vs. profit margins per economy, 2005-2015.....	39
Figure 19: Financial depth of the banking sector	42
Figure 20: Government bonds (GB) sold and effective interest rate for GB	44
Figure 21: Market share by the value of assets of top-5 banks	45
Figure 22: Bank market shares by no. of outstanding loans/loan amounts as of 31.12.15	46
Figure 23: New loans extended (left) and deposits attracted (right) in 2015 by maturity.....	52
Figure 24: Evolution of NPL ratio in the banking sector, %	53
Figure 25: Market share of the biggest MFOs (as % of total lending portfolio).....	55
Figure 26: MFO and SCA sectors evolution	56
Figure 27: Sector distribution of loans by MFO (left) and SCA sectors (right).....	57
Figure 28: Official development assistance statistics (as of 2015)	94

List of tables

Table 1: Sector distribution of sales and profits by regions, 2014, %	24
Table 2: Financial access and outreach, 2015	29
Table 3: Assessment of mitigation risk practices used by banks for agricultural loans.....	35
Table 4: Structure of collateral in the banking sector as of 31.12.15	48
Table 5: Prudential norms of regulatory authorities for lending institutions in Moldova.....	71
Table 6: Provisioning standards for different lending institutions	72
Table 7: Specific objectives for the AF in Moldova 2020 Strategy	83

List of annexes

Annex 1: Constraints to doing business in Moldova according to international surveys	118
Annex 2: Growth rates of enterprises by size.....	119
Annex 3: Transactions with agricultural land in Moldova.....	120
Annex 4: Progress in the implementation of RPRA in the financial sector	121
Annex 5: Main on-going official development assistance programmes relevant to the AF ..	123

LIST OF ACRONYMS

AA	Association Agreement between the EU and Moldova
AF	Access to Finance
CE	Central Europe
CEE	Central & Eastern Europe
CIS	Community of Independent States
CHB	Credit History Bureau(-s)
CLD	Credit Line Directorate
DCFTA	Deep and Comprehensive Free Trade Area
DGFBS	Deposit Guarantee Fund in the Banking System
ECA	Europe & Central Asia
EU	European Union
FDI	Foreign Direct Investments
FSAP	Financial Stability Assessment Program
GD	Government Decision
GDP	Gross Domestic Product
GoM	Government of Moldova
GoMB	Government of Moldova Bonds
IFAD	International Fund for Agricultural Development
IFI	International Financial Institution
IMF	International Monetary Fund
MARDE	Ministry of Agriculture, Regional Development and Environment
MDL	Moldovan Leu
MEI	Ministry of Economy and Infrastructure
MF	Ministry of Finance
MFO	Microfinance Organization
MFS	Microfinance Sector
MIEPO	Moldovan Investment and Export Promotion Organization
NBM	National Bank of Moldova
NBS	National Bureau of Statistics
NCFM	National Commission for Financial Markets
NCFS	National Committee for Financial Stability
NBCO	Non-Bank Credit Organizations
NPL	Non-Performing Loans
ODIMM	Organization for Development of Small and Medium Enterprises of Moldova
PIU	Project Implementation Unit
RM	Republic of Moldova
RICM	Roadmap for Increasing Competitiveness of Moldova
RPRA	Roadmap for Priority Reforms Agenda
SCA	Saving and Credit Associations
SME	Micro, Small and Medium Enterprises
SEE	South-Eastern Europe
VAT	Value-Added Tax
WB	World Bank

EXECUTIVE SUMMARY

Access to finance (AF) is the result of a complex interplay of different factors, both endogenous (internal) and exogenous (external) to the financial sector, the right kinds of financial infrastructure, and a sound legal and regulatory framework. Endogenous factors influence access to finance in two ways: (i) through different financial infrastructure elements, such as credit bureaus, payment and securities settlement systems, deposit and loan guaranteeing mechanisms, collateral registries, crises resolution settlements, as well as through the legal and regulatory framework to allow the proper functioning of the financial markets and of the various financial infrastructure elements; and (ii) through the practices of the various financial institutions themselves (banks, microfinance organizations, leasing, etc.). In their turn, exogenous factors influence access to finance through the macroeconomic environment in which the businesses and financial institutions operate; business and investment climate that determine economic intensity and development of enterprises; the level of economic integrity, affecting balanced regional development, availability of infrastructure and efficiency of institutions; quality of judiciary to ensure adequate law enforcement. Not lastly, the access to finance is influenced by the speed and quality of reforms to get all these elements on track. The present Study provides an analysis of all these elements in Moldova to identify the main constraints in AF.

Private sector constraints to AF

The economic growth in Moldova is volatile and lethargic given the unstable macroeconomic environment (most notably interest and exchange rates), open character of the economy, limited diversification of exports and non-stimulating business environment. These translate into frequent external shocks, unstable demand and increased costs that reduce companies' revenues and earnings. Internal output is limited by reduced competitiveness of local produce, restrained and stagnant production capacities. GDP growth relies primarily on private consumption fueled by remittances, which exposes the economy to vulnerabilities, among which falling remittances that reduce internal consumption, resulting in lower revenues/earnings for companies and shrinking demand for credit.

Deficiencies in the business environment (corruption, inefficient courts, political and policy instability, bureaucratic/inefficient institutions, burdensome regulations etc.) don't allow for the rapid expansion of business activities and for compensation of the negative influences from the above mentioned constraints. High rate of shadow economy also distorts competition, negatively affects revenues/earnings by legal operating businesses and limits expansion of financial/lending products. The number of companies has grown over the years, however, the size of businesses tend to remain small. Small businesses do not grow into medium-sized companies, and the reason apparently lies in worsening of business environment for medium businesses (takeovers, poor investment protection, law enforcement and burdensome regulatory framework). Performance of big companies has been higher, fueled primarily by FDI; however, their further expansion is limited by the prevailingly unattractive investment climate. Also, business activity in Moldova is highly concentrated geographically, with the bulk of businesses in Chisinau. Weak economic intensity in regions reduces incentives for lenders to expand geographical outreach.

Constraints mentioned above determine a shortage of bankable firms. AF is being further constrained by limited financial management and planning abilities of businesses. These are insufficiently supported by available training and support services for growing companies, integration of firms into value chains (VC), availability of special VC lending products and accommodated risk evaluation practices of lenders. Although comparable with countries with similar level of development, real interest rates are high in comparison with profits earned by companies. High interest rates restrain firms from making investments and expand business operations, diminishing in the meantime the demand for credit.

AF for agricultural companies is limited, on top of constraints mentioned above, by the high risk perception of lenders associated with agriculture. This translates into fewer loans issued to the sector in comparison to other sectors, higher loan interest rates and more strenuous collateral requirements. Performance of agricultural companies has been more volatile and unpredictable as compared to the rest of the economy. At the same time, earnings in agriculture have been higher. However, inappropriate risk evaluation models coupled with lack or insufficiently developed facilitating tools (attractive loan guaranties schemes, crop and warehouse receipts, etc.) limit the expansion of credit to the sector. Also, the ability of farmers to secure financing by pledging land is limited due to slow evolution of the land market. Coupled with low real estate prices in the regions and lack of liquid secondary markets for a large part of pledged agricultural equipment, it constraints significantly the availability of financing in agriculture.

Credit institutions constraints to AF

Banking sector

The conditions of the banking sector worsened considerably in the last years, limiting significantly the AF for the bank clients. Bank intermediation is limited by the lack of trust in banks, shallow economic activity and rudimentary stage of development of the banking sector. High interest rates for GB and erratic exchange rates allow banks to easily earn hefty profits, creating little incentive for them to meet the needs of smaller business, develop financial products or improve lending practices. The banking sector is extremely concentrated, with the largest 3 banks accounting for 80% of all loans by number. High bank concentration also excludes most of micro and small companies from the area of interest of banks. In comparison with countries in the region, the Moldovan banking sector has a low level of strategic FDI. This limits not only competition, but also implementation of new technologies, more advanced expertise, products and healthy lending and banking practices. Ownership and corporate governance problems determined donors to exclude the largest banks from their funding programs, which substantially limited the access to long term and cheaper financing for about 80% of bank borrowers.

Collateral evaluation and lending practices based on high or very high collateral to loan ratios by banks translate into inability of businesses to obtain enough credit. Time, administrative costs and resource consuming efforts needed to put together all documents required by creditors is also an important constraint to AF. Banks usually manage to avoid risks instead of managing risks to maximize profits. This is both a result of rigid regulations, inadequate risk evaluation practices and, occasionally, ultra-conservator behavior of banks. Consequently, banks often over-estimate risks by using worst case scenarios, compounding independent risks and failing to calculate off-setting risk factors. This also results in strenuous collateral requirements and higher loan interest rates.

Banks are limited in their ability to extend long term loans both by the regulator's rules and the shortage of long term resources. Most of deposits with banks (92%) are short term (up to 1 year). The narrow institutional investor base and under development of the capital and insurance markets limits the availability of longer term resources. Volatility of the macroeconomic environment and small coverage limit by the DGFBS (currently, 6,000 MDL; 20,000 MDL since 01.01.2018) also limit long term deposits with banks. Complex and lengthy loan application formalities by banks hamper the ability of companies to plan for financing and meet agreed schedules that also incur additional costs to them. High NPL rates of banks don't allow for decreasing of funding costs, reduce their operational efficiency and hamper reallocation of resources for new investments.

Microfinance sector

Despite its relatively fast growth, the microfinance sector (MFS) doesn't represent yet a viable alternative to bank lending for businesses and particularly for agricultural companies.

Estimative, 83% of all MFO and 53% of SCA lending is for individual sector. Agriculture makes up 8% and 42% of the overall MFO and SCA loan portfolios, which in their turn are only 10.9% and respectively 1.5% of the overall bank loan portfolio. At the same time, business loans are concentrated mainly in few big MFOs. The bias toward consumer and mortgage loans of the MFS seems to be determined the higher risk perceived in relation to business lending and easier creditor rights enforcement in relation with individuals. Even if MFOs and SCAs are faster and more flexible in lending to microenterprises than banks, they are limited in their ability to offer a more complete range of services (payments, letter of credits, cards, etc.) which prevents their expansion into the corporate sector.

MFOs and SCAs are also more limited than banks in their ability to provide long term financing for business. MFOs are not allowed to collect deposits, relying mainly on lines of credit from their founders and IFIs, which in their turn are rarely longer than 3-5 years. As for the SCAs, only those holding category B and C (still non-existent) license may collect deposits; however these are predominantly short time MFO and SCA loans are more expensive (by 30-50%) than bank loans, which also limit their expanding. This comes from higher administrative and operational costs, as well as from the more expansive resource base given the inaccessibility of deposits for the MFOs and many SCAs, lower capitalization than banks and respectively, higher reliance on borrowings from other institutional lenders. In case of MFOs, most of resources are also in foreign currencies, which places additional significant costs on clients.

Leasing sector

Statistically, leasing is the third financing option in Moldova after banking and MFS. However, 88% of leasing is concentrated in vehicles. Expansion of leasing on other market segments (particularly, on agricultural equipment) is limited primarily by the absence of liquid secondary markets for such assets. As in the case of banks and MFS, leasing is predominantly short term (up to 3 years) and medium term (3 to 5 years) given the shortage of longer term resources. Regional outreach is also very concentrated, with 75% of the overall leasing portfolio in Chisinau, given stronger demand and closeness to active secondary markets. Deficit of resources at low cost and prevalence of funding in foreign currencies also makes leasing expensive. The bias towards vehicle leasing is determined also by unfavorable VAT regime for leasing of machines and equipment. Also, concessional credit lines that banks benefit from development partners allow clients to purchase goods and equipment exempted from VAT, which makes acquisition of the same items in leasing be less attractive. Furthermore, the Law on subsidies in agriculture doesn't create a level playing field for leasing companies as compared with other creditors. The regime for deduction of provisions from the tax base and for the enforcement of claims also doesn't create a playing level field for leasing companies as compared with other credit institutions.

Regulatory framework and financial infrastructure

Regulatory framework

The Moldovan banking norms are in line with, and in certain aspects, is even stricter than, the Basel I prudential norms, given more volatile and unstable business environment. However, serious constraints limiting the powers of NBM and NCFM to effectively regulate and supervise both bank and non-bank financial markets, including ownership and corporate governance, have been revealed by the recent banking crisis resulting in failure of 3 banks (BEM, Banca Sociala and Unibank). The legal and regulatory framework of the bank and non-bank sectors is undergoing now significant changes, most of them meant at ensuring stability of the financial sector. Amendments are guided primarily by the IMF recommendations. Most of the immediate recommendations relating to restoring and strengthening the powers of regulators have already been adopted, however concerns remain in relation to bank ownership transparency and implementation of improved corporate governance regulations in banks. A law on recovery and resolution of banks has been adopted

recently and put already in practice; however establishment of all effective tools for recovery and resolution of banks will last until 2024. The Memorandum of Economic and Financial Policies with the IMF concluded on November 07, 2016 provides for a new 3-year reform agenda aimed at further strengthening the regulatory and supervision environment for financial institutions to ensure long time financial stability.

MFOs, in contrast to banks, are not yet regulated. Except for provisioning norms for tax purposes, there are no prudential regulations. The liberal framework seems to have favored rapid expansion of the sector. The lack of regulation and supervision seems to have resulted in certain circumstances in disloyal lending practices toward customers. A draft law on NBCO provides for a greater degree of regulation and supervision of the sector by the NCFM, including introduction of prudential norms and supervision fee. However, it provides for certain risks that might translate into increase of loan products' prices and elimination of small and medium MFOs from the market.

In contrast to MFOs, the SCA sector is closely regulated and supervised by the NCFM due to B- and C-licensed SCAs' right to accept savings deposit from members. The legal and regulatory framework has been amended, especially since 2007 and after the 2009 crisis, including setting-up of prudential and non-prudential rules, SCA support and stabilization mechanisms etc. However, its implementation is often difficult, especially in relation with the smallest SCAs.

Similarly, the leasing sector is neither regulated nor supervised yet. As in the case of MFOs, this seems to have facilitated the rapid growth of the sector. Another draft law amending the Law on leasing No.59/2005 provides for regulation and supervision of leasing companies by the NCFM, however, as in case of MFO, these will be limited and raise no special concerns from sector participants, except for introduction of supervision fee.

Financial infrastructure

The first CHB has been operating since 2011. However, its effectiveness is constrained by a number of bottlenecks, among which is limited sectorial coverage and small number of products delivered to creditors. Initiatives to oblige MFOs and insurance companies to connect to the CHB have been developed with support from the International Finance Corporation, but failed to be adopted so far reportedly because of opposition from smaller MFOs on grounds of high internal interconnection costs and fear that the CHB disclosed information may be used by competitors to take over their clients.

AF is further constrained by the lack of effective loan guarantee mechanisms. The only currently functioning loan guarantee fund (LGF of ODIMM) failed to bring a systemic impact on the AF because of limited capitalization and conceptual deficiencies related to services provided: non-recognition by the NBM of guarantees for provisioning purposes, exclusion of MFO, SCA and leasing companies from the guaranteeing schemes, and incertitude as for the readiness of the ODIMM to pay against the issued guarantee. AF seems also to be hampered by the low coverage level of deposit guarantees by the DGFBS. The actual threshold of only 6,000 MDL is too small to spur confidence in banks and favor more savings by population, and particularly long term savings. Its increasing up to 20,000 MDL starting from 01.01.2018 is also not enough to add too much to this confidence.

Significant changes have been made in the last years to the legal and regulatory framework for creditor rights and insolvency regime. However, despite improvements, their effective implementation remains weak. The use of movable collateral by banks is limited not only by the absence of liquid markets for movable goods, but also by the lack of mechanisms to ensure integrity of the movable collateral, as well as difficulties in collateral registration. Enforcing claims by lenders in court is hampered by numerous existing possibilities for debtors to delay and challenge the process, even in cases of simplified procedures (execution

titles). Also, lenders complain about arbitrariness of justice either because of low qualification of judges, or, apparently, for corruption reasons.

Access to finance reforms

Implemented and failed/delayed reforms

Facilitating AF is among objectives of the main policy documents of the country. However, impact of the envisaged actions is often difficult to assess, either because there are no quantifiable impact/result indicators set or because the respective actions are very loosely defined. Existing strategies and plans are focused mainly on activities and processes rather than results. Also, the progress in implementation of many actions is very slow.

The internal determination to implement reforms seems to be quite low. A large body of reforms in the AF, particularly those for the ensuring of stability in the financial sector, origins in the recommendations of development partners, however their implementation has been delayed. After the recent banking crisis, implementation of reforms in financial sector has been the result of conditionality set by most of development partners to resume external financing of the RM. In 2016, the Parliament adopted 2 main law packages intended to strengthen the NBM and NCFM powers in dealing with non-transparency of bank shareholders and quality of corporate governance in banks. However, more efforts are needed (especially, on implementation) to ensure efficient regulation, supervision and stability of financial sector.

The main initiatives to improve AF in agriculture include a draft law on agricultural credit and establishment of a guarantee fund for agricultural loans (promoted by MARDE), as well as 2 programs proposed by MEI to support productive SME from rural areas. These didn't materialize, because of public finance constraints and lack of sufficient argumentation and efficient elaboration of solutions. Introduction of warehouse receipts for grains in 2006 failed to bring positive impact on AF given deficient legal enforcement framework for movable pledges, opaque behavior of businesses and low awareness/weak incentives in using this tool. Another initiative that could have had a significant impact on easing access to affordable and cheap financing by agricultural companies - the Polish €100 million loan – have not translated into reality because of ill-conceived implementation mechanism, disputes among implementing bodies, operational delays and government instability.

The lack of progress in reforming the judiciary represents an extremely serious constraint in implementation of many reforms, including those that might facilitate better AF. The level of corruption in the judiciary is perceived as extremely high, while market participants complaint about absence of impartial and predictable rule of law. This determines lenders to be selective and conservative in taking and evaluating collateral. Even if regulators' powers have been mostly restored and strengthened, risks still persist as far as the judicial system remains vulnerable to corruption and, apparently, versed political and group interests.

On-going reforms

Reform efforts of the NBM have been directed primarily to strengthen the regulatory and supervision environment, improve corporate governance in banks and ensure transparency of ownership structures. Despite significant legal and regulatory changes, there are still big challenges in attaining veritable ownership transparency and better corporate governance in several banks. The NBM also started implementing the standard approach for credit, market and operational risk under Basel III. Basel III norms have the potential to positively impact financial stability of the sector. On the other hand, AF could be significantly constrained by the new, more strenuous capital and liquidity requirements for banks.

The microfinance and leasing sectors are also expected to undergo legislative changes, if the draft law on NBCO and the draft amendments to the Law on leasing No.59/2005 are approved. Both draft laws have been greatly delayed, awaiting approval since 2012. Another

delayed initiative is the draft law on facultative pension funds, designed by the NCFM as part of the AA commitments. The draft law on venture capital funds (VCF) drafted by the MEI represents another reform action, stemming from the AA commitments. However, the biggest constraint to emergence of VCF in Moldova does not seem to be the absence of a dedicated law, but the complex and cumbersome conditions for business activities and limited possibilities for entry and liquidation of investments, which create little incentives for potential venture capital, also the lack of internal systems of institutional investors, underdevelopment of the capital market. For the SCA sector, major changes envisage the establishment of a Savings Guarantee Fund, new services by SCAs, special administration by the NCFM and delegation of certain supervision powers to the central Associations of SCAs, regulation of SCA internal control and risk management.

Development partners' reform efforts

Because of vulnerability of economic growth model, Moldova is relying heavily on assistance from external donors. After 2014, however, development assistance dropped sharply because of diverting of pro-reform agenda, political turmoil, slowdown of reforms and theft in the banking sector. Most of the donors rethought their strategies. Budget support has been stopped completely in 2015-2016. Provision of funds to financial institutions was limited mainly to only 2 subsidiaries of foreign banks and few banks/MFO/leasing companies with foreign ownership. Instead, money has been diverted mostly to public infrastructure projects, direct financing of private sector or reforms in the business environment.

Development partners' efforts address some of the constraints in AF identified in this Study. These envisage support for structural reforms in the business regulatory framework, competitiveness enhancement in agriculture, further strengthening of regulatory framework and financial infrastructure etc. Some of the donor activities may however overlap and there doesn't seem to be sufficient coordination among different donors. Also, the majority of donors seem to prefer establishing their own PIUs. This may lead to less efficient use of available assistance funds in the benefit of the Republic of Moldova, and to less productive coordination of different development assistance programs. At the same time, no effective implementation mechanism of international assistance in AF at the GoM level exists, which have prevented implementation of some projects with potentially high impact on facilitation of AF.

PART 1. ACCESS TO FINANCE CONSTRAINTS ANALYSIS STUDY

1. INTRODUCTION

1. Access to finance (AF) has always been among top challenges for Moldova in busting business activity within the country and propelling economic growth. Notwithstanding recognition by all governments of the importance of the issue and its inclusion among top priorities in the main governmental strategies and programs, AF has been constantly identified by market players, most notably representatives of private sector, as one of the main constraints impeding their development and growth, which is confirmed by the country's standing in international rankings for the ease of AF. Access to finance is the result of a complex interplay of different factors, both endogenous and exogenous to the financial market, of the right kinds of financial infrastructure, sound legal and regulatory framework and right response from governments in form of reforms and corrective actions to remedy inherent market, legal and regulatory dysfunctions. Access to finance is not a problem only for business in Moldova. International specialized literature abounds of studies and researches on the financial gaps. Even if recognized that the respective problem is common to all the economies, including the most developed ones, it is unanimously acknowledged that this obstacle is keener in countries in transition and in developing countries.

2. Among reasons for this situation are more severe weaknesses in the elements influencing AF, less developed financial infrastructure, more deficient legal and regulatory framework and less efficient reform actions. Particularly, financial institutions in less developed countries don't have sufficient incentives to operate in smaller market segments, including SME sector. Entrepreneurs tend to avoid regulations and taxes in the formal sector, operating totally or partially in the informal sector. Also, governments of the respective countries don't always possess sufficient administrative capacities to effectively enforce laws and regulations¹. Numerous donors have been assisting such countries to overcome market and institutional weaknesses. Main economic reforms in Moldova also have been conducted with support from development partners. Since the beginning of the independence, donors committed more than 4.8 billion EUR in external assistance for Moldova. Total disbursements amounted to more than 2.5 billion EUR, in about 2000 activities², including in facilitating AF. Notwithstanding these efforts, AF continues to be cited among most stringent constraints for the development of the private sector in Moldova.

3. In line with the above arguments, part I of the present study intends to offer a clear and comprehensive overview of the current status of access to finance, highlighting direct and indirect constraints, with a dominant focus on agriculture. Furthermore, part II of the Study contains an Action Plan with detailed actions and specific recommendations in the short (1-3 years), medium (3-5 years) and long – run (5+ years) to mitigate existent constraints in AF, key stakeholders to be involved in these actions, with special attention to actions dealing with constraints in agriculture AF.

4. Sectors considered by the AF Study are primarily banking, microfinance and leasing. The Study presents analysis and recommendations in line with terms of reference and feedback from the Sustainable Development Account (SDA) Moldova. Not every paragraph supports a separate argument; often an idea is supported by several paragraphs. According to these, core subjects covered by the 2nd chapter of the study are private sector constraints in AF, with special focus on constraints in agriculture AF. The 3rd chapter deals with credit institutions' constraints in AF (in the banking, microfinance and leasing sectors). The 4th chapter assesses regulatory banking and non-banking framework and financial infrastructure with the aim of identifying potential bottlenecks in these fields. Government and development

¹ Financing Technology Entrepreneurs & SMEs in Developing Countries: Challenges and Opportunities, the WB, 2008.

² <http://amp.gov.md/portal/>, visited on July 14, 2017.

partners' efforts related to policy reforms aimed at facilitation of AF, implemented policy reforms, as well as those failed and on-going reforms are further revealed in the 5th chapter. Each chapter is finalized by "findings" summarizing the main ideas of respective chapter. Chapter 6 makes a summary of conclusions and identified constraints. Finally, part II of the AF Study contains a plan of actions recommended to decision-makers for implementation, which would allow reaching significantly facilitated access to finance, including in agriculture. Conclusions and recommendations of the Study are to be used by SDA Moldova in planning and implementing further activities within its AF component, in coordinating efforts with other donors and mobilizing resources for this scope. Also, conclusion and recommendations of the present Study may serve a starting point for more broad coordinated efforts of the donor community in Moldova under the AF component of development assistance rendered to Moldova. For the convenience of the readers, "Findings" sections, and "Conclusions/Summary of Constraints" chapter and "Executive Summary" summarize the main ideas/arguments supported by separate paragraphs. The AF Study and Action Plan have been developed based on an extensive own research undertaken in June - September 2016, which also included a series of in-depth interviews with AF relevant stakeholders (see "List of interviewees" at the end of Study) and upgraded upon feedback from the SDA Moldova and stakeholders from envisaged sectors as part of an ample public consultations process in May-July 2017. In absence of specialized trust measurements at country level, this Study evaluates constraints in AF predominantly based on identification of market failures and policy deficiencies, as well as data from available research, especially the World Bank database, Enterprise Surveys etc.

2. PRIVATE SECTOR CONSTRAINTS

2.1. Private Sector Overview

Volatile macroeconomic and unfavorable business environment

5. The aggregate indicator that expresses most appropriately the size and role of the private sector in a country's economy is its contribution to GDP. Following independence in 1991, Moldova suffered one of the largest losses of productive capacity among transition economies, with an almost decade long decline by 65% in GDP between 1991 and 1999. The crisis resulted in dramatic worsening of the living conditions and spurred an exodus of the working age population. Moldova entered the path of growth only after 2000, when GDP grew on average almost 4.6% a year by 2016. While this rate of growth may seem quite high, in fact, it is lower than the average growth in peer lower middle income countries according to WB classification, in the same period (5.8%)³. This means that after entering the transition as one of poorest countries in its geographical area and experiencing a decade-long GDP decline, Moldova stagnated for another one-and-half decade even in terms of converging with the relatively poor peer countries⁴. Not surprisingly, it still has the lowest GDP per capita in Europe.

6. Economic growth, inflation and the exchange rate have been highly volatile over the years. Likewise, conditions for doing business, although improved compared to 10-20 years ago, remain unpredictable. Corruption, policy instability, government instability and inefficiency of government bureaucracy are amongst the major problematic factors for conducting business in Moldova, along with access to finance problem, high inflation and inadequate supply of infrastructure and labor force, according to the last two Global Competitiveness Indexes (2016-2017 and 2017-2018). Higher inflation (a reflection of macroeconomic instability), corruption, political instability and inefficient bureaucracy are commonly associated with lower investment and business activity levels, affecting growth in the long term. The last World Bank Enterprise Surveys 2013 also places corruption (1) and political instability (2) ahead of the quality of workforce (3) and access to finance (4) constraints. Substantial outmigration makes the country dependent on workers' remittances which are a major source of external finance and provide an important business for commercial banks and source of funding for small and family businesses. At the same time, migration distorts the local labor market and causes shortages in some occupational categories. Flaws in the business climate are reflected in the overall low position of the country in the international classification for the quality of business environment and competitiveness; currently Moldova ranks #44 in the 2017 Doing Business Report and #89 in the 2017-2018 Global Competitiveness Index. The quality of all dimensions of governance is also well below the average for the peer ECA countries (annex 1). Most important, these affect the intensity of economic activity and the attractiveness of the economy for FDI.

7. A World Bank⁵ study brought quantitative evidence of the adverse impact of poor regulatory and business environment on firms. It concluded that lengthy customs and import licensing procedures have a negative impact on firms' productivity. Each day that companies have to wait to clear customs is associated with a productivity loss of 0.5%. Furthermore, corruption also has an adverse effect on firm performance and productivity. Moldovan firms that used informal payments and gifts to deal with customs procedures and with the courts were between 6-7% less productive than their counterparts. The cost of using bribes to obtain

³ <http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?view=chart>, visited on July 24, 2016.

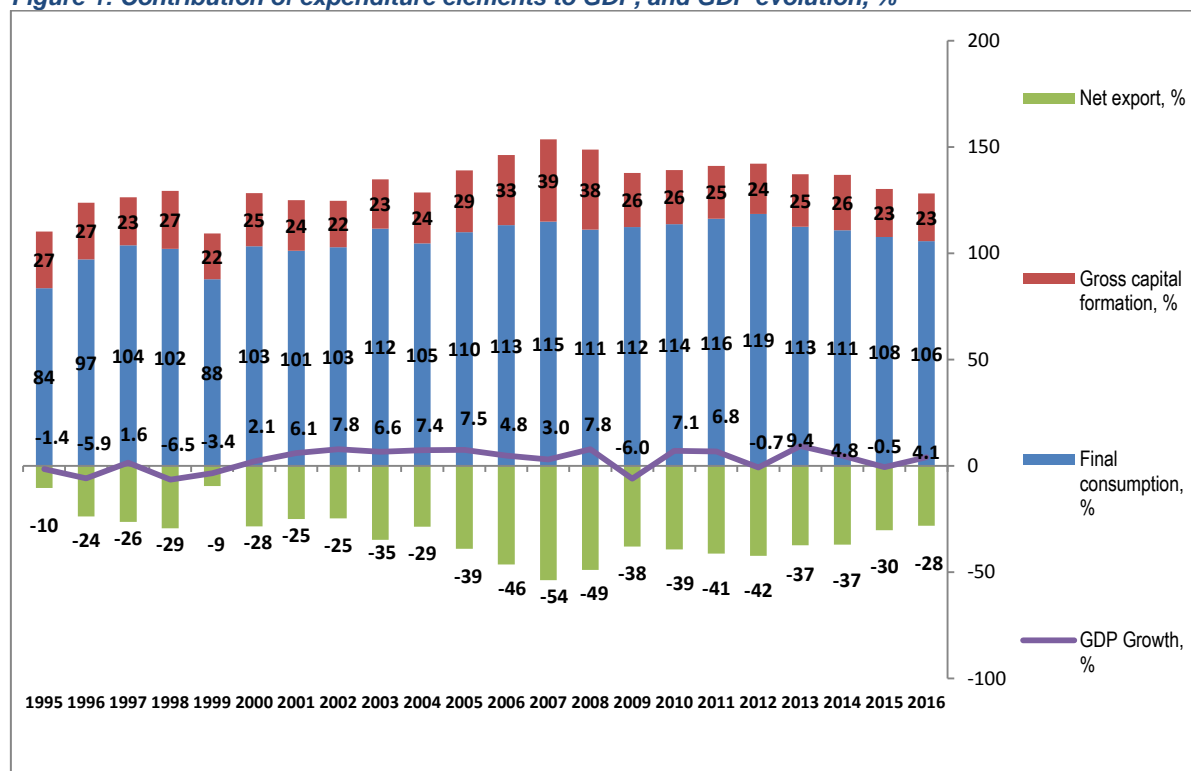
⁴ The National Strategy for Investment Attraction and Export Promotion 2016-2020.

⁵ Moldova Trade Study, the World Bank, December 2015.

business licenses, on the other hand, is also very high. Firms that relied on bribes in their application for business license were 50% less productive than counterparts. Other governance issues, according to the study, such as the functioning of courts and political instability, adversely affect firms' performance. Those Moldovan firms that perceive the functioning of courts as a major obstacle are 15% less productive.

8. Despite its more than double shrinking in size, the agricultural sector still remains one of the most important pillars of the economy - about 12% of the country's GDP and 34% of the employed workforce. The share of agriculture increases substantially (to 17-20%) of the GDP, if to include affiliated food processing. Industry is rather small and narrowly based on the production of low-skilled goods, mostly processed food, textiles and apparel, glass and construction materials. As a share of GDP, industry takes about 15% and all kinds of services - 59% (of which retail and wholesale - 14% and public services - 14%). High volatility of agriculture revenues induced by adverse weather conditions or extremely uneven exports determined substantial profitability drops and reduction in demand for credit (see the section 2.3 "Access to finance in agriculture" below). On the expenditure elements side, the GDP growth after 2000 relied primarily on final consumption, of which about 90% private consumption. Investments had been rather small and shrank further after the regional crises of 2009. They did not return to the pre-crisis level, which indicates that the expansion of domestic production capacity is stagnating (figure 1).

Figure 1: Contribution of expenditure elements to GDP, and GDP evolution, %



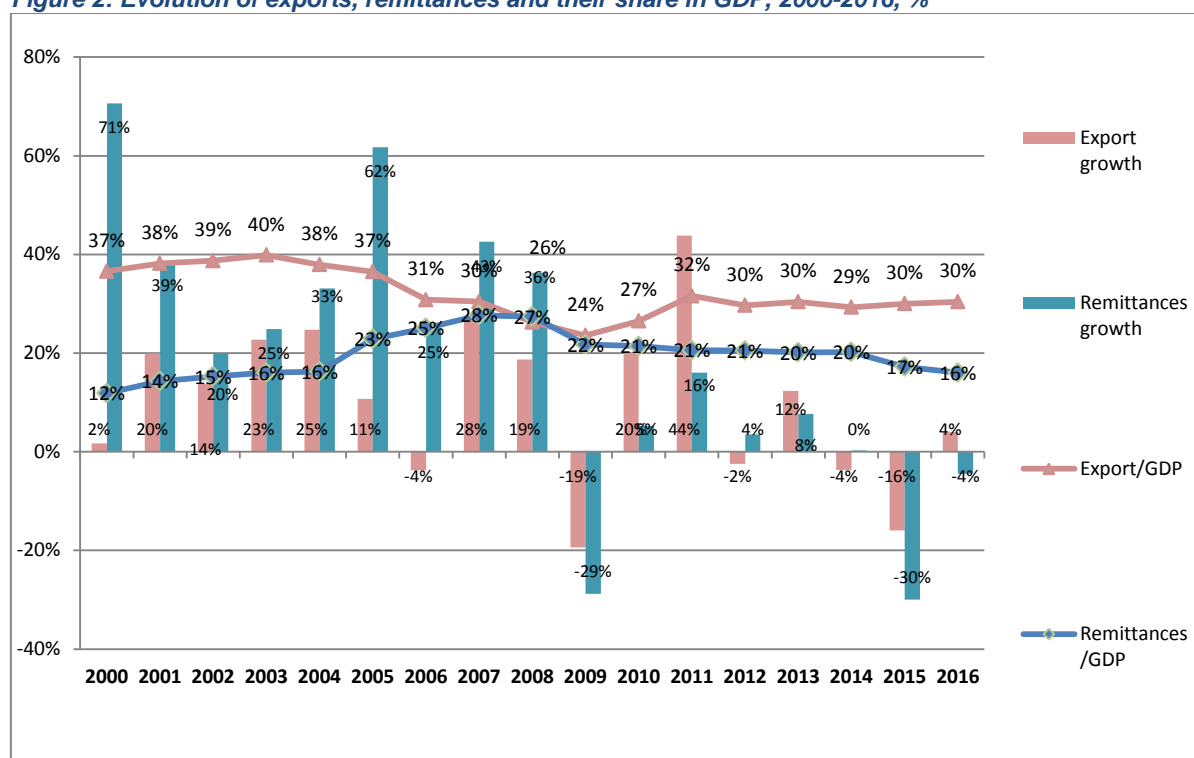
Source: The National Bureau of Statistics (NBS).

9. Economic growth and financial stability in Moldova are strongly dependent on the influx of remittances from labor migrants and the consumption generated by it (remittances from Moldovan workers abroad made up on average 20% of GDP in the last 16 years). There is only limited FDI⁶, alongside with low internal investments. Constrained by limited internal production capacities and an unfavorable business environment, domestic demand has been

⁶ According to the National Strategy for Investment Attraction and Export Promotion 2016-2020, average net inflows of FDI per capita in 2005-2014 was only about USD87, the lowest compared to the countries in the region. Given the scarcity and high costs of domestic capital, such a low level of FDI undermines further the competitiveness and the sustainable development of the country.

satisfied primarily from the imports of goods and services. The country's economy is thus relatively small and open, with imports of goods and services exceeding exports at a ratio of 2:1⁷. This imbalance in economic growth, relying on consumption fueled by remittances, exposes the economy to a series of vulnerabilities, making it unsustainable in the medium and long run without changing the current economic growth model. Fluctuations in remittances and export market conditions have a strong impact on companies' revenues and earnings. This dependency was particularly visible in periods of global/regional financial and economic crisis. Thus, remittances shrank by 29% in 2009, 30% in 2015 and 4% in 2016, on the verge of the global and Russian economic crises, while GDP contracted by 6.0% in 2009 and 0.5% in 2015, affecting companies' performance. Remittances' share in GDP reduced to 16% in 2016, negatively affecting internal demand (Figure 2).

Figure 2: Evolution of exports, remittances and their share in GDP, 2000-2016, %



Source: NBS and World Bank.

10. Companies' reliance on few export markets also makes them vulnerable to changes in demand and trade barriers by partner countries. Russia's share in Moldovan exports accounted for 1/3 in 2005 and dropped to 11% in 2016 mainly because of non-tariff barriers imposed by this country in 2006-2007 and starting with 2013 to Moldovan wine and agri-food products. The same global and regional financial crises in 2009 and 2012 determined export contracting by 19% and 2% correspondingly, followed by further drop in exports in 2014 and 2015 (by 4% and 16%), because of Russia's embargos against Moldovan wine and agri-food, and economic recession of this country in 2015. All these events negatively affected companies' revenues and earnings, diminishing the demand for credit and ability to repay on older loans. Limited competitiveness of Moldovan goods impedes rapid reorientation on other export markets, even after the removal of tariff and non-tariff barriers by the EU in the frame of the AA in September 2014. External shocks and limited demand for domestic goods determined the shrinking of the export to GDP ratio from an average of more than 51% in 2000-2005 to less than 43% from 2014 to 2016⁸.

⁷ According to WB data, Moldova's export to GDP ratio of 43% is in line with the average for ECA countries, while import to GDP ratio (74%) is almost twice higher than that of similar countries from the ECA region.

⁸ WB data on <http://data.worldbank.org/>

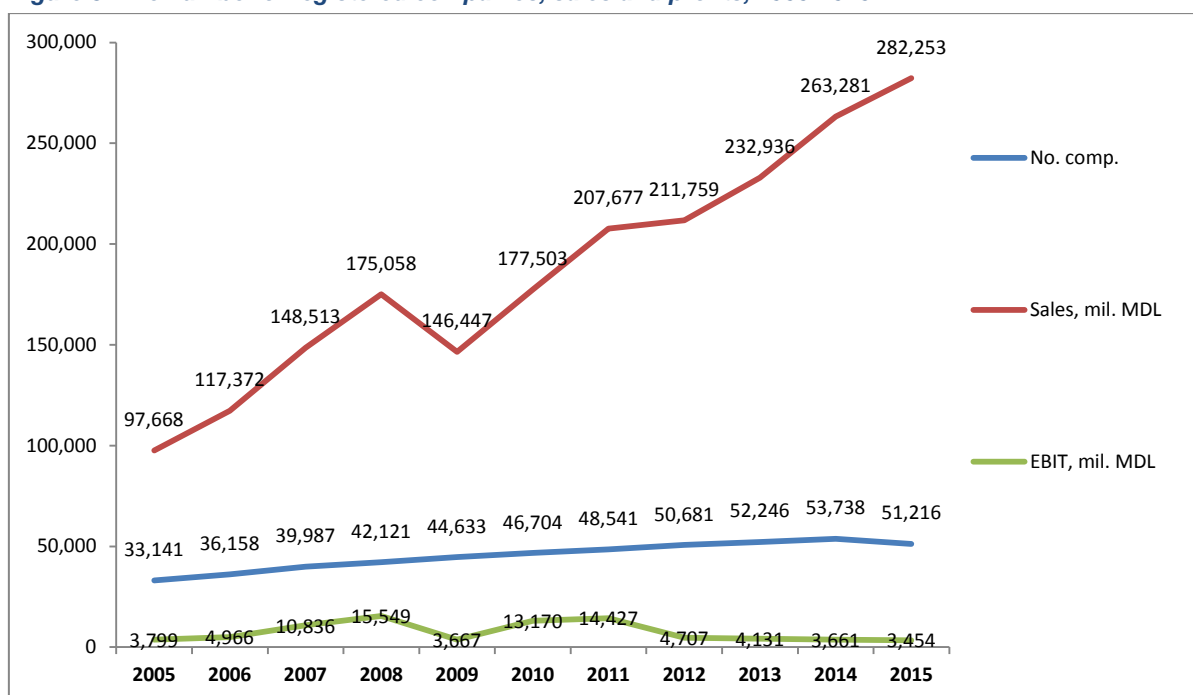
11. The National Development Strategy “Moldova 2020” (hereinafter – NDS) acknowledges the unsustainable character of the current economic growth model. A central aspect of the NDS refers to the necessity of replacing the actual model, based on private consumption fueled by remittances, with a more dynamic one, based on investments and on export oriented sectors. The NDS identified 8 national priorities, among which improving access to finance and enhancing the business climate. NDS acknowledges the lack of trust from companies and population in banks, a feeling which inhibits savings and prevents banks from efficiently performing its main function: financial intermediation. Improving business climate, increasing public investments in physical infrastructure and competitiveness of agribusiness sector, enhancing the quality of education and of the judiciary are other 5 major pillars of the NDS to impel business activity and prosperity of the country. Progress however is very slow or even negative (see on-going reforms chapter). In addition to stagnant investments and decreasing exports, as shown above, there are relatively few companies exporting or export-ready, as showed by a SME segmentation study by the World Bank, despite the fact that Moldova is pursuing “export-oriented” growth⁹.

Adverse enabling environment for SME

12. Although the number of registered companies grew almost constantly over the years (from 33.1 thousand in 2005 to 51.2 thousand in 2015), sales, and especially profits, proved volatile (figure 3). Frequent external shocks reduced companies’ turnover and profits, making long- and even medium-term planning a difficult task to accomplish for business. Also, it should be kept in mind that the actual number of active companies is smaller than the number of registered companies. Thus, from among the registered companies, about 1/3 report no sales. This may also indicate to the high share of the shadow economy (40% of the total economy of the country, according to the UNDP National Human Development Report 2014). Company profits reduced sharply in 2012 (by more than 3 times). Despite the fact that economy recovered in the subsequent years, companies’ earnings remained low for the next 2 consecutive years, in contrast to the similar episode in 2009, when companies’ profits reversed to the pre-crisis levels immediately after the 2009. This situation may testify to the worsening of the operational environment for the companies, increased sensitiveness of business to exchange rate volatility in the situation when MDL depreciated significantly in 2013-2015, as well as difficulties in finding alternative export markets after the close of the Russian market for a large range of agri-food products accounting for about 40% of all exports. While companies’ turnover grew at an average annual rate of 12% from 2005 to 2015, the average gross profit margin was only 4.3%, dropping to a marginal 1.2% in 2015. Data from the NBS suggests that almost half (49%) of the enterprises reported net annual losses in 2010-2015. This percentage is higher for micro and small enterprises: 54% for micro companies and 36% for small ones, in contrast to 33% for medium and big companies.

⁹ The WB “Studiu privind segmentarea IMM” of 2015 estimated that just around 100 companies are export-ready, while 200-300 companies are export-close, from the total population of about 35 thousand active SMEs.

Figure 3: The number of registered companies, sales and profits, 2005-2015



Source: NBS.

13. Inefficiency of regulatory framework, which increases operating costs of businesses and affects companies' profitability and competitiveness, could be another reason why companies don't grow or are growing slowly. According to the Economic Freedom Index in 2017, Moldova ranks 110th out of 180 countries, being placed in the category of countries with predominantly unfree economy¹⁰. The authors of the research note that the persistence of bureaucracy and the lack of transparency often lead to the fact that the costs of creating and operating private companies are high and the environment is burdensome. Rules on labor relations are rigid, non-wage hiring costs are high, and restrictions on working hours remain inflexible. And these are not the only examples of burdensome business rules. Because of the often non-transparent decision-making process that does not comply with the ex-ante regulatory impact assessment rules, the regulatory framework abounds in "harmful" and burdensome business rules.

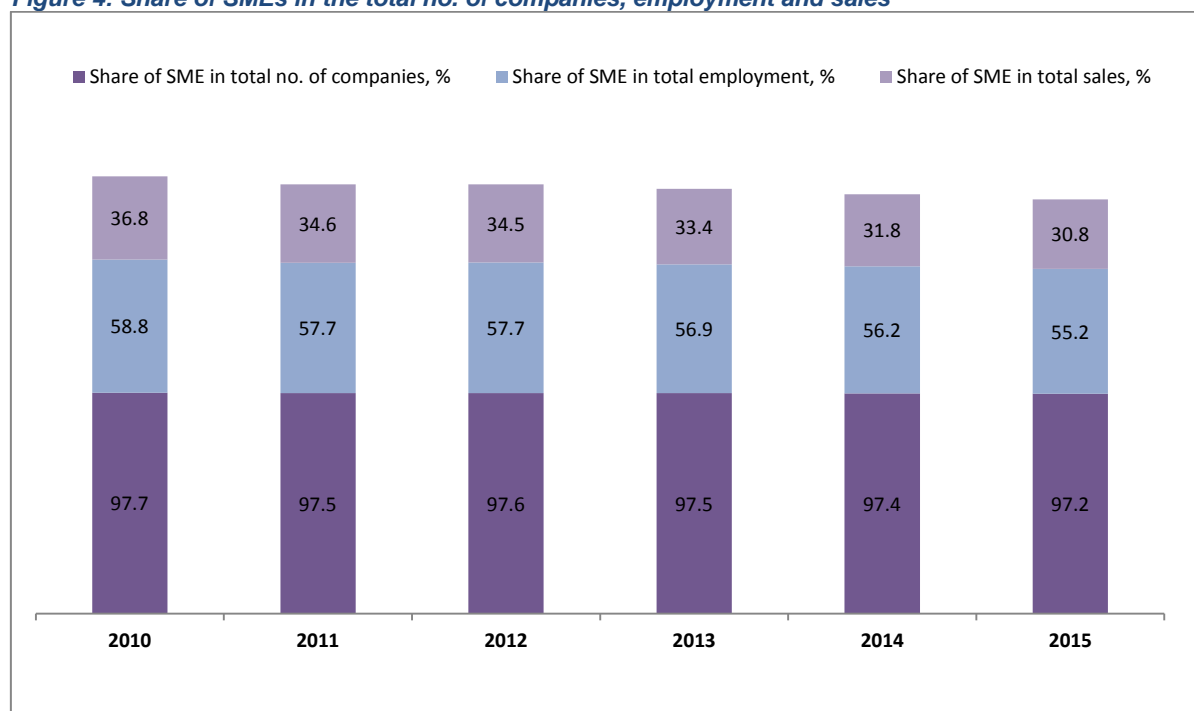
14. Financial needs and available loan products by private sector may differ by ownership, size and type of economic activity. In terms of size, Moldova's economy is dominated by small and medium-sized enterprises (SMEs) that hardly use banks for financing investments except for special SME credit lines¹¹. The share of SME in the total number of enterprises stayed constantly above 97% in the last 6 years (figure 4). Yet their contribution to the overall employment and turnover declined: 55% in 2015 vs. 59% in 2010 for the employment, and 31% in 2015 vs. 37% in 2010 for turnover. The fact that the share of SME in the overall employment and turnover declined, while the share in the total number of companies remained constant is an indicator of the worsening of the business and operational environment for SMEs. By ownership, 89% of the total number of registered companies in Moldova are private local, 5% are foreign owned, 4% - mix property (foreign and local) and 2% - public property. Private local companies contribute also 60% to the total employment and sales, foreign companies – 8% and 15% accordingly, public companies – 24% and 10%. However, interviews with stakeholders suggest that foreign investors do not rely on local

¹⁰ Index of Economic Freedom 2017, Heritage Foundation

¹¹ Gábor Hunya, Jan Mládek and Josef Pöschl: Private Sector and Financial Markets Development in the Republic of Moldova, the Vienna Institute for International Economic Studies (WIIW), 2008.

financing; they finance investments from abroad, through retained profits or directly from IFIs.

Figure 4: Share of SMEs in the total no. of companies, employment and sales

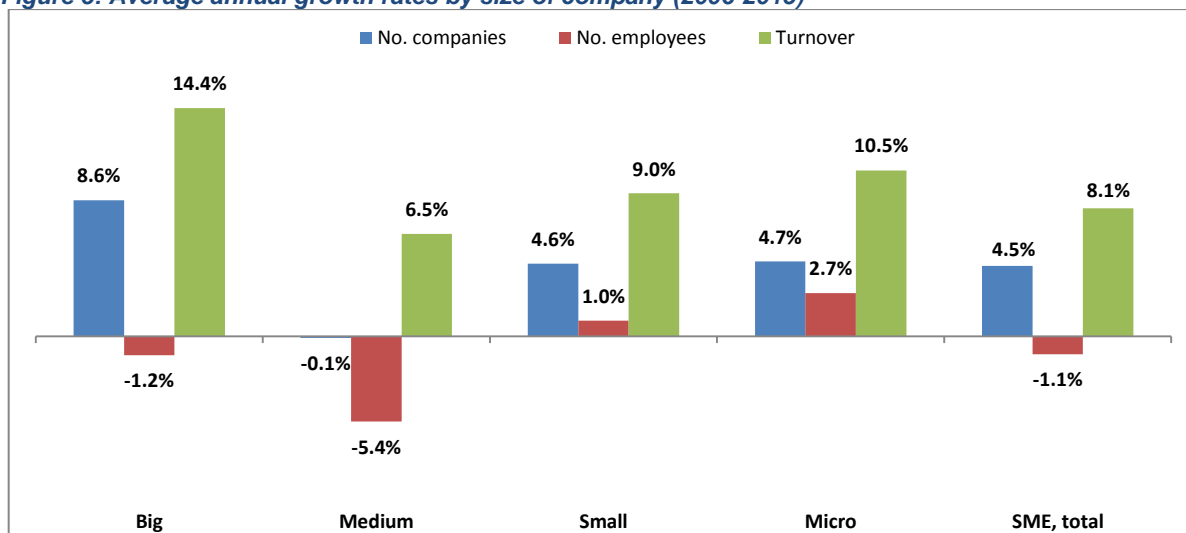


Source: NBS.

15. The reason for the declining share of SMEs in the total employment and turnover seem to lie in persisting barriers to growth – official statistical data show that small companies do not grow into medium companies. Company growth seems to stop at the level of small companies. Indeed, micro companies grew in number on average by almost 5% a year in the period 2006-2015, by 2.7% in terms of employment and by 10.5% as turnover, and this growth translated into growth of small companies on average by 4.6% annually in number, by 1.0% in employment and by 9.0% in turnover (figure 5). At the same time, medium companies dropped on average by 0.1% yearly by number and 5.4% as share in total employment, and grew only as share in total turnover (by 6.5%). Big companies displayed the fastest growth: by 8.6% as share in the total number of companies and by 14.4% in total turnover. The drop in the total number of employees by big companies seems to be determined by higher productivity gains. The main driver for big companies' growth by number and turnover apparently are FDI (see the paragraph below). The reason behind medium companies' deadlock seems to be fear of takeovers. Businessmen prefer to split their operation into several small enterprises to protect the business against takeovers¹². For the yearly evolution of the above indicators by company size please refer to annex 2.

¹² As reported by stakeholders during interviews.

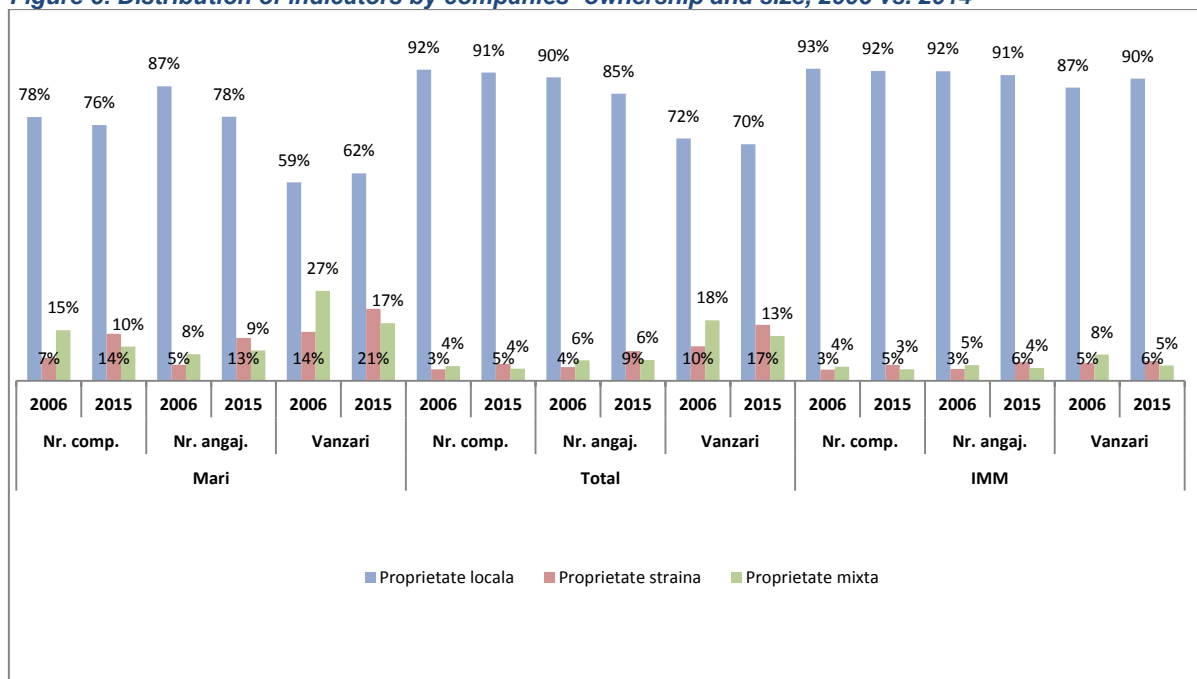
Figure 5: Average annual growth rates by size of company (2006-2015)



Source: NBS.

16. Even if low in international comparison, FDI seem to play an important and continuously increasing role in Moldova's economy. Big companies with FDI are increasing their share faster than the rest of the companies. From 2006 to 2015 the share of foreign owned companies in the total number of companies increased from 3% to 5%, from 4% to 9% in total employment and from 10% to 17% in the overall turnover. The share of big foreign owned companies increased in the same period from 7% to 14% in the total no. of big companies, from 5% to 13% in the total employment by big companies and from 14% to 21% in overall big companies' turnover. Foreign owned SMEs grew at a slower pace: from 3% to 5% as number of companies, from 3% to 6% as contribution to employment and from 5% to 6% as share in turnover (figure 6). Medium foreign owned companies seem not to be affected by the standstill disease: their share in the total number of medium companies tripled in the same period from 3% to 9%, doubled as contribution to employment (from 4% to 8%) and grew from 6% to 7% as share in the overall medium companies' turnover. As witnessed by some of the interlocutors, there seem to be two distinct operation environments for foreign and local companies: foreign companies enjoy better rule of law and investor protection than local companies. And the reason is not better legal provisions for FDI: legislation doesn't differentiate between local and foreign businesses, but poorer law enforcement and legal protection in relation to local companies. Foreign companies are protected against adverse actions of authorities or judiciary by the potential resonances among diplomatic circles and international organization representative offices in Moldova. Local medium sized companies are less protected against adverse regulatory or judiciary adverse actions.

Figure 6: Distribution of indicators by companies' ownership and size, 2006 vs. 2014

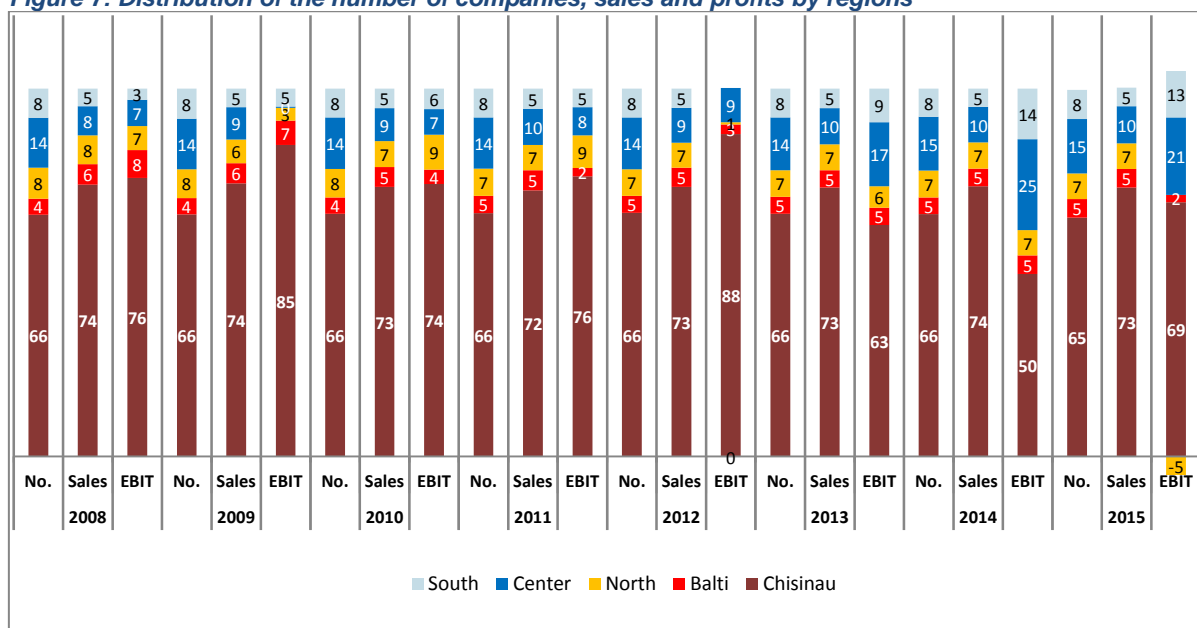


Source: NBS.

Weak business activity in the regions

17. Another important issue for the business conditions in Moldova is high regional concentration. Approximately 65% of all companies are located in the capital city of Chisinau (figure 7). There are about 42 companies per 1000 inhabitants in Chisinau versus just 6 companies per 1000 inhabitants outside Chisinau. Their annual turnover accounts for 73% of the overall business turnover, disproportionately higher than the contribution to the total number of registered companies, indicating to higher sales and larger businesses located in Chisinau. Companies residing in Chisinau generate also 69% of the total earnings before income tax. This share increased significantly in slow down periods (ex. 2009 and 2012), indicating to higher sensitivity to economic shocks and lower productivity of businesses outside Chisinau. Weak economic activity in the regions reduces incentives for lenders to expand geographical outreach, limiting the availability of financial services into the regions (see access to financial services section below).

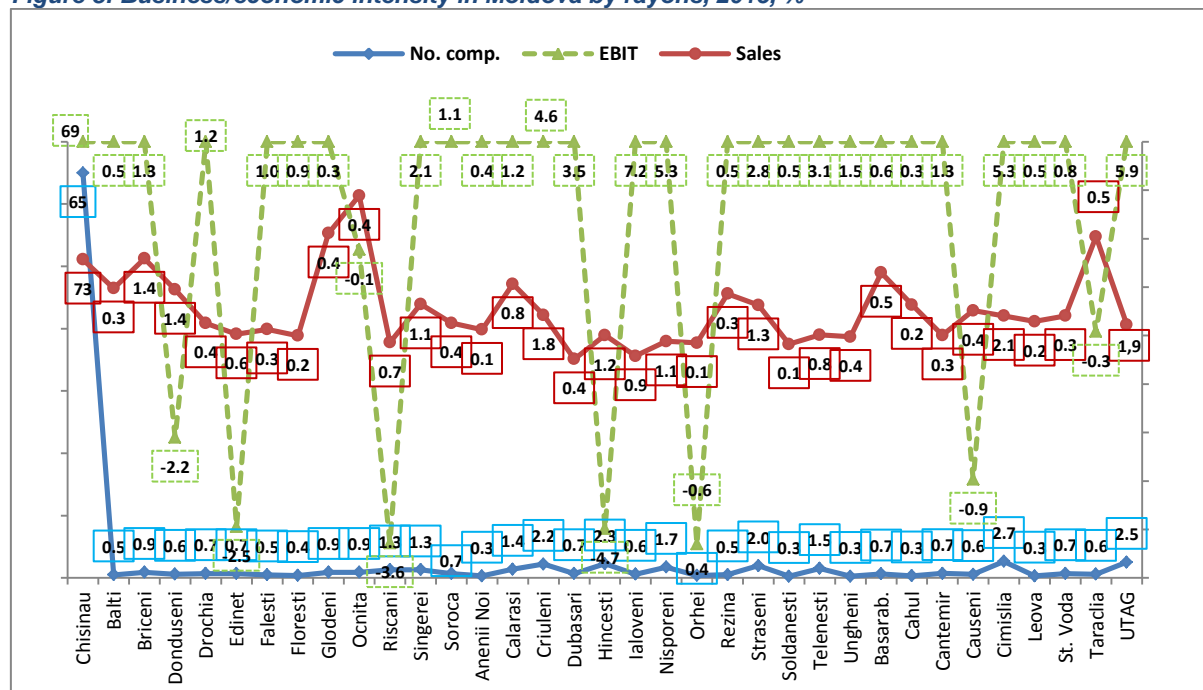
Figure 7: Distribution of the number of companies, sales and profits by regions



Source: NBS.

18. Regional disparities in the intensity of business activity are even more evident when analyzing distribution of the above indicators on the level of districts (rayons). Economic growth and business activity tend to concentrate in Chisinau and to a smaller degree in the second largest city, Balti. Compared to the more developed European countries, Moldova displays a very pronounced economic and business polarization in its capital city, where only one quarter of the total population lives. Other cities/rayons represent only small isles of significantly less intense economic and business life. Very few of them account for more than 1% of the total number of companies, overall turnover or total profit earned (figure 8). The reasons behind this situation lie in the low level of economic integration of the country's localities. The main instruments of the economic integration are strong and efficient institutions, developed and available infrastructure, and incentives for the attraction of economic activities in more deprived zones.

Figure 8: Business/economic intensity in Moldova by rayons, 2015, %



Source: NBS.

19. High concentration of economic activity relates not only to its geographical dimension, but also is true in respect to sector agglomeration. Almost half (47%) of all companies' sales and 70% of all profits originated in 2014 in the retail and wholesale sector (table 1). Although agriculture and fishing accounted for only 4% of all turnover per economy in 2014, they generated 25% of all profits, however these are highly volatile (see below section 2.3 "Access to finance in agriculture"). Except for the agriculture, Chisinau concentrates from almost 60% to 97% of overall turnover in all of the remaining sectors. Nearly all financial activities are converged in Chisinau (97% by sales). This may indicate indirectly to a gap in the provision of financial services in localities outside the municipality of Chisinau. However, this hypothesis is difficult to verify in absence of specialized tools for measuring financial gaps and access to financial services. About 92% of sales related to real estate transactions and services rendered to business are located in Chisinau, which also may indicate on the lack of logistical and support services for businesses outside Chisinau. Agriculture activities are prevalent in the North (without Balti) and almost equally concentrated in the Center and South parts of the country.

Table 1: Sector distribution of sales and profits by regions, 2014, %

Sector	Total ²		Chisinau ³		Balti ³		North ³		Center ³		South ³	
	Sales	EBIT	Sales	EBIT	Sales	EBIT	Sales	EBIT	Sales	EBIT	Sales	EBIT
Total	100%	100%	74%	50%	5%	5%	7%	7%	10%	25%	5%	14%
Agriculture, fishing	4%	25%	12%	-17%	1%	1%	40%	51%	24%	32%	23%	34%
Mining and manufacturing	16%	32%	58%	86%	9%	6%	10%	-12%	15%	14%	7%	6%
Energy	7%	-89%	78%	90%	9%	4%	6%	2%	4%	2%	3%	3%
Construction	5%	21%	77%	74%	3%	3%	4%	6%	11%	14%	4%	4%
Retail and Wholesale	47%	70%	78%	75%	4%	6%	5%	3%	9%	14%	4%	2%
Hotels & Restaurants	1%	0%	85%	955%	4%	-124%	4%	-234%	5%	-373%	2%	-125%
Transport & Communication	9%	16%	85%	100%	2%	3%	5%	-14%	6%	11%	2%	-1%
Financial activities	3%	15%	97%	71%	0%	1%	1%	1%	0%	2%	1%	25%
Real estate, services to business	4%	11%	92%	105%	3%	7%	1%	-10%	4%	1%	1%	-3%
Public services ¹	3%	-1%	69%	72%	6%	-43%	8%	48%	11%	43%	7%	-20%

Source: NBS.

Notes:

¹ Public services include public administration; education services; health and social assistance; other collective, social and personal services.

² As share in total per economy.

³ As share per respective sector.

Deficiencies in financial planning and low integration into value chains

20. Shortage of “bankable” firms (or low quality of projects submitted for financing) is one of the main reasons invoked by bankers for the limited expansion of credit. Although described in words, there is no statistical evidence of this widespread perceived constraint, i.e. no data is available on the number of rejected loan application, reasons for denial, etc. Also, no data is available on the percentage of firms that went bankrupt, including because of the lack of financing. At the same time, this kind of information is indispensable for the identification and addressing of constraints in financing for the private sector. The vast majority of interviewed stakeholders mentioned “low financial or planning abilities” and low quality of financial reports as one of the main constraints on the demand side. Insufficient financial management and planning abilities aggravates information asymmetry, inherent in every lender-debtor relationship. Information asymmetry leads mainly to two problems. First, lenders cannot differentiate adequately between “high quality” and “low quality” companies and projects (the “adverse selection” problem). In that case, price variables (i.e. interest rates) do not work as a screening device in Moldova. Banks tend to turn down applications for riskier projects; instead of raising the price for such projects – both because of poor risk evaluation practices and rigid regulations (see risk management practices by banks in the next chapter). Second, once the lenders have supplied the funding, they may not be able to assess whether the enterprise is utilizing the funds in an appropriate way (the “moral hazard” problem). In order to mitigate these problems, lenders often adopt precautionary measures, such as requiring that financing be collateralized in excess, affecting firms’ productivity, or they may simply turn down the request for financing (“credit rationing”). A recent study by the World Bank concluded that high collateral requirements are associated with lower total factor productivity (TFP) levels. More precisely, a 1% increase in the required collateral decreases productivity by 0.5%¹³.

21. “Adverse selection” and “moral hazard” problems relate not only to limited ability of businesses to convincingly articulate business ideas and financial plans, but also to the unwillingness of many entrepreneurs, especially small ones, to “waste time” in dealing with often rigid lending terms of financial institutions¹⁴. Informational asymmetries tend to pose

¹³ Moldova Trade Study Overview, the World Bank, December 2015.

¹⁴ Financing Technology Entrepreneurs & SMEs in Developing Countries: Challenges and Opportunities, the WB, 2008.

more severe problems for SMEs, than for larger business. This is because the information that SME can provide to external lenders (in the form of financial accounts, business plans, feasibility studies, etc.) often lacks the necessary detail and rigor. This problem is often aggravated by the low level of education of small entrepreneurs, who may not be in the position to adequately articulate their case. The information supplied to bankers and other lenders by small businesses is often not fully accurate and realistic, and opaque behavior often prevails. Under these conditions, external financiers tend to adopt a very cautious attitude towards SME, reduce the amount of financing sought, increase collateral requirements, or even refuse financing.

22. Asymmetric information could be overcome by increasing financial literacy and financial management skills, improving financial infrastructure, using special purpose products, such as value chain (VC) financing, or by accommodating risk evaluation practices to include information from the VC by lenders (see below the section 2.3 “Access to finance in agriculture”). VC lending techniques are being developed based on strategic alliances between larger suppliers/buyers and small enterprises, or through working capital based on warehouse receipts. In Moldova, however, VC financing is not yet developed¹⁵. This is because Moldovan firms are not well-integrated into VC. Most of Moldova’s produce is exported by small wholesalers to lower-value markets and competes at the lower end of these markets. Consequently, profit margins earned are very low. Cooperation and collaboration among producers is not a very used practice, except for cases when donors offer special incentives (grants) for groups of producers. Moldovan companies still have a limited understanding of the benefits of collaboration with VC partners, and tend to see them as competitors rather than potential partners. The lack of collaboration prevents producers from reaching economies of scale and determines increased production and transaction costs, which together with limited use of modern production techniques make them less competitive on export and internal markets and lowers profitability.

23. On the other hand, firms that are better integrated in global VC enjoy productivity gains. Firms that are export-oriented and show productivity premium when compared to others in the same country, same sector, and of the same size. The productivity premium is even higher for foreign firms: foreign-owned entities have a 17% higher TFP than domestic firms. Size matters too, with larger companies enjoying a premium over smaller ones¹⁶. Limited integration of Moldovan firms in the international VC also reduces the potential for knowledge transfer and capacity building in the country that FDI bring along, preventing local companies from benefiting of more productivity gains and profitability. Countries that succeeded in qualitatively transforming their economies (Ireland, Czech Republic, Hungary, etc.) were also the ones that achieved close integration and linkages between local companies and foreign investors/multinationals. These also succeeded in building up efficient institutional structures to support local companies and attract significant FDI (see box 1). In contrast, the facilitator role of MIEPO in attracting FDI has been quite limited until recently (until the new organizational structure was adopted and its reorganization in 2016) and has not allowed for quantitative and qualitative boost in attraction of FDI. In its turn, ODIMM has developed and is being implementing several successful support programs for businesses. However, these programs are limited in size and as impact on the entire economy, while their primary focus is small companies and start-ups. Medium companies, in turn, remain outside the existing institutional support schemes. At the same time, growing companies can demonstrate a better productivity growth on every MDL invested in support services, but they often need more services of this type to affirm on the market, integrate into international VC.

¹⁵ Republic of Moldova: Enterprise Access to Finance, Background Note, the World Bank, 2013.

¹⁶ Moldova Trade Study Overview, the World Bank, December 2015.

Box 1. IDA Ireland and Enterprise Ireland: Established in the late 1960s IDA Ireland has become over the years one of the most successful investment promotion agency (IPA) worldwide with support from successive Irish governments and all political parties. It employs approx. 250 people and has an extensive network of overseas offices. IDA Ireland has been provided with the mandate, legislation and resources to attract FDI and become a major contributor to the national development strategy and goals. It has developed the culture and experience that have allowed it to become a highly successful IPA with a government strategy backed by competitive incentives. IDA initially dealt with domestic (SMEs, export and business development) and FDI companies. Today it deals only with FDI companies, while a sister agency, Enterprise Ireland, is responsible for supporting Irish companies with more than 700 employees. The two agencies work with FDI companies, Irish suppliers and SMEs to promote linkages among them, rooting FDI in the country and supporting local SME to benefit from productivity gains associated with closer linkages with FDI companies.

CzechInvest: Established in 1992, CzechInvest provides services and development programmes that contribute to attracting FDI and to developing Czech companies. In 2004 the agency was merged with CzechIndustry and SME Development Agency. The agency has a network of 8 foreign offices and 13 regional offices within the country. It has 243 employees, out of which 1/3 works in FDI promotion, while the rest - in supporting local SMEs. Early during its operation CzechInvest realized that availability of local suppliers able to meet foreign investors' requirements is an important attraction factor for FDI and one of the determinants of the quality of investment climate. In 1999 it designed a Supplier Development Program modeled on Irish and Scottish experience (later replicated also in Serbia). Nowadays, CzechInvest provides through its Sourcing Department targeted services to foreign investors including identification of suitable potential Czech suppliers, a "market screen" service (comparison of suppliers by number of employees, turnover and other predefined filters), arrangements of meetings with potential suppliers, identification of local partners and suppliers forums at which foreign companies can communicate with local suppliers and exhibit the required products; local suppliers have the opportunity to familiarize themselves with the products, their use and requirements for components.

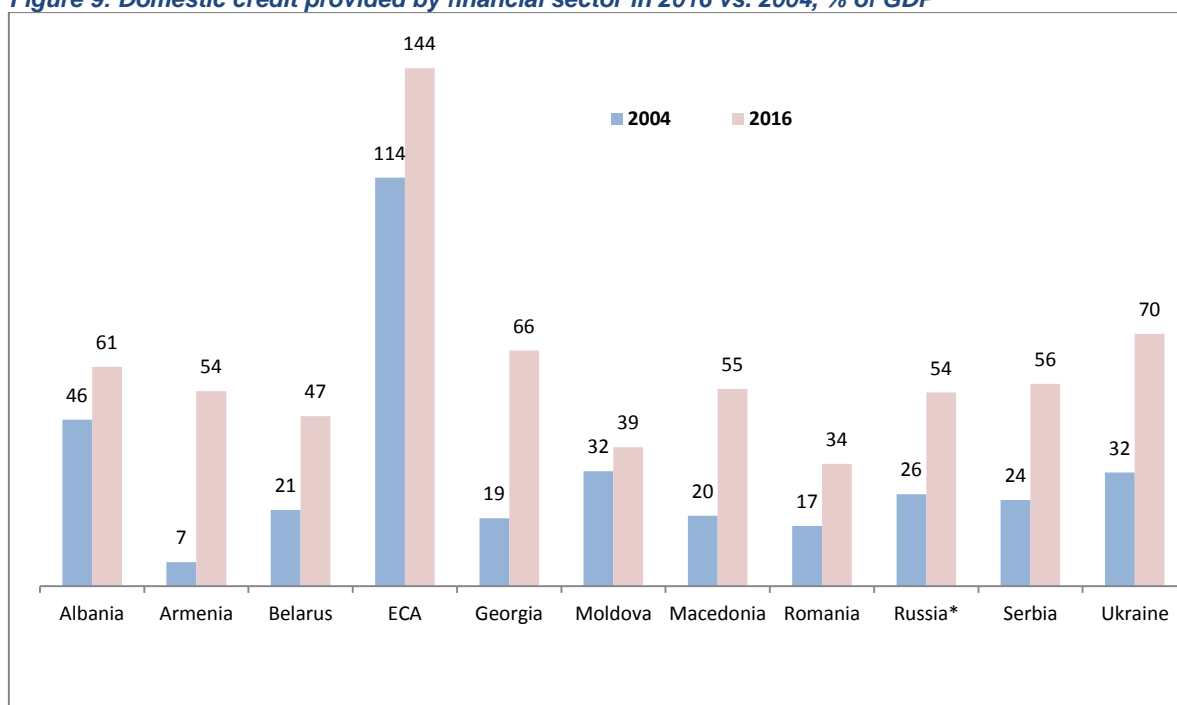
2.2. Access to Financial Services

24. One of the causes of deficiencies in the development of the private sector results from limited access to financing¹⁷. The Republic of Moldova has the lowest levels of domestic credit provided by the financial sector (figure 9). However, more important is the fact that Moldova has the slowest growth rate among countries in the region. From 2004 to 2016 financial depth index in Moldova grew only by 21%, while in ECA countries it grew on average by 27%, Armenia by 713%, Macedonia by 180%, Georgia by 247%, Albania by 32%, etc. Even Romania, which still has a lower financial depth index, surpassed Moldova by the speed of growth of the respective index, which was 104% from 2004 to 2016. It is quite obvious that without serious progress in increasing access to credit, in few years Moldova will increase the negative gap compared to countries in the region. Limited access to finance has also affected the capacity of the private sector to create jobs and, in general, to contribute more to the economic growth¹⁸. This issue is even more acute in the case of SMEs, given the informational asymmetry problems discussed above.

¹⁷ Human Development Report 2014, UNDP.

¹⁸ The National Strategy for Investment Attraction and Export Promotion 2016-2020.

Figure 9: Domestic credit provided by financial sector in 2016 vs. 2004, % of GDP



Source: The World Bank; *- data are for 2004 and 2015

25. The European Commission described a financing gap as “a situation where firms that would merit financing cannot get it due to market imperfections”¹⁹. Accordingly, the identification of a market weakness can be seen as an indication that a financing gap exists. Direct tools for measuring potential existing financial gaps in Moldova are missing; therefore the majority of studies in this area are based on identification of market/policy weaknesses. However, as past studies noted, a number of demand-side surveys have been conducted by donors in the past, but these are not comparable over time, are based on different sub-segments of the private sector and do not go sufficiently in depth on the funding sources and concrete needs of businesses²⁰. In the EU, the European Central Bank (ECB) performs regularly a survey focused on credit availability to enterprises by size. Moreover, for the justification of public policy interventions in the EU, access to finance market assessments are frequently conducted, as the so called “ex-ante assessments” have become mandatory under the new Common Provisions Regulation²¹. The lack of data in Moldova not only prevents from identifying existing gaps/constraints, but also makes difficult to assess the effectiveness of reform measures in this area.

26. Financial sector in Moldova is dominated by the banking sector, which represents the main external financing option for the private sector, despite existence of some alternatives on the local financial market, notably in form of MFOs, SCA and leasing companies. Factoring, risk and investment capital are only beginning to emerge and their contribution is still negligible. As shown in figure 10 below, the depth of the bank sector (share of bank credits in GDP) grew continuously after the recovery from the 2009 crises though 2013 to 42.2%. Even after the banking crises of 2014-2015, banks remained the main source for financing in Moldova, even though depth index substantially dropped (36.8% in 2014, 31.3% in 2015 and 25.8% in 2016). In contrast, the depth of the MFO sector increased only marginally from 2.2% in 2014 to 2.4% in 2015 and 2,8% in 2016 in spite of the space left by the shrinking bank lending. At the same time, SCAs lending share in GDP stood constantly at 0.4% in 2014, 2015 and 2016, while the share of leasing decreased after 2013 to 1.0% in 2014 and

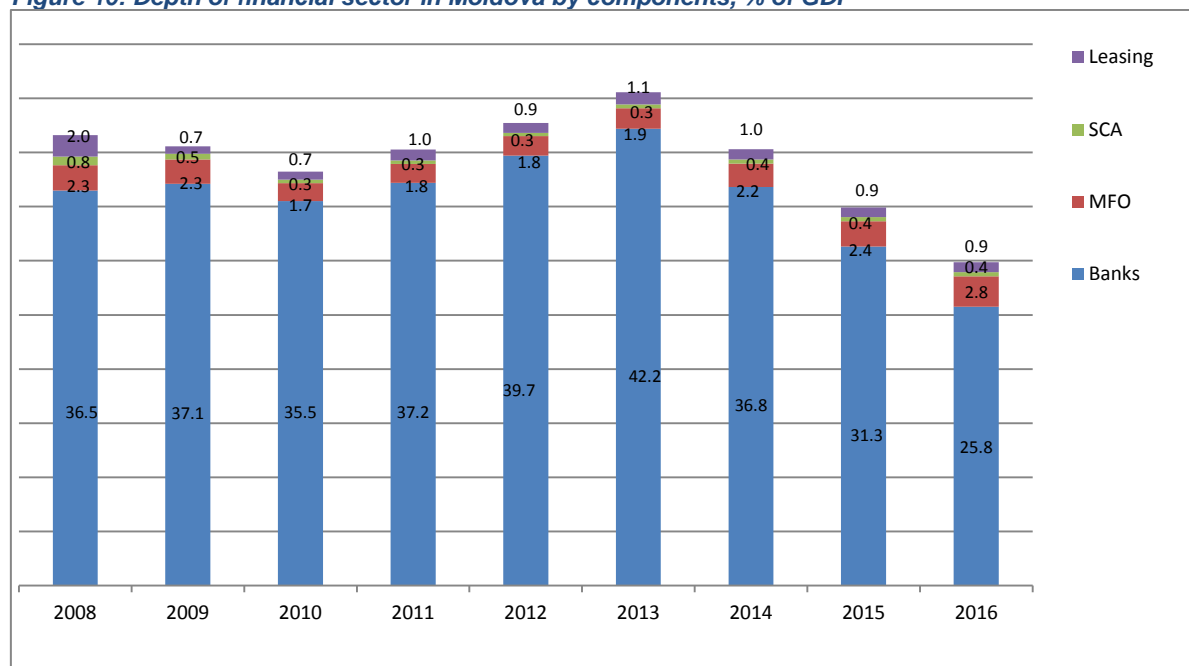
¹⁹Best practices of public support for early-stage equity finance, DG Enterprise and Industry, September 2005.

²⁰Republic of Moldova Enterprise Access to Finance/Background Notice, the World Bank, 2013.

²¹Regulation no 1303/2013 of the European Parliament and of the Council of 17 December 2013.

0.9% in 2015 and 2016. The limited depth of the microfinance and leasing sectors, as well as their slow evolution points out to growth difficulties encountered by the MFOs, SCAs and leasing companies. Especially, SCAs witnessed a stalling dynamic through 2013, after the sharp decline in 2009.

Figure 10: Depth of financial sector in Moldova by components, % of GDP



Source: NBS, NBM, WB and own calculations.

27. Moldova's financial sector services outreach in regional comparison is quite low. The affirmation in paragraph 11 above about the lack of trust from companies and population in banks is confirmed by the standing of Moldova in international rankings for access and outreach to financial services. The number of depositors per 1,000 adults (747 in 2015, table 2) is higher only to the average for the lower and lower middle income countries, by WB classification, but is lower compared to countries in the region (Estonia, Latvia, Ukraine, Georgia). By number of borrowers from commercial banks per 1,000 adults (50), Moldova is below the average for the peer country group (63) and far behind countries of the region (Macedonia – 338, Romania - 215, Georgia – 680, Albania – 147, Latvia – 368, etc.). Also, by number of commercial bank branches and number of automated teller machines per 100 thousand adults Moldova is ahead only to low income and some lower middle income countries, but is again far behind countries of comparison in Eastern and South-Eastern Europe.

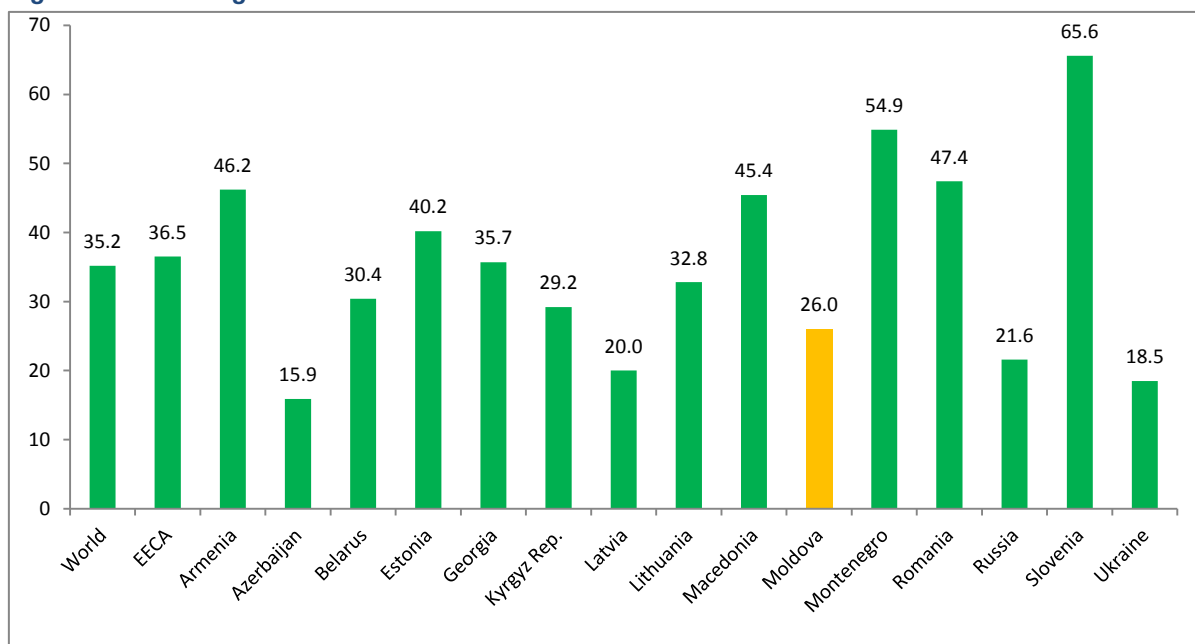
Table 2: Financial access and outreach, 2015

Country	Depositors with commercial banks per 1,000 adults	Borrowers from commercial banks per 1,000 adults	Commercial bank branches per 100,000 adults	Automated teller machines per 100,000 adults
Albania	N/A*	147	21,93	35,1
Estonia	2,097	526	11,17	72,76
Georgia	1,240	680	31,92	69,6
Latvia	1,323	368	18	62,86
Macedonia	N/A	338	24,74	60,77
Moldova	747	50	10,02	32,49
Romania	N/A	215	28,69	68,59
Ukraine	1,814	N/A	0,56	86,69
Uzbekistan	887	58	37,23	10,48
Lower income	121	N/A	2,94	4,39
Lower middle income	518	63	8,32	19,71

Source: World Development Indicators, the World Bank.

* Not available data.

28. Surprisingly, but the last Enterprise Surveys 2013 of the World Bank points that only 7.2% of firms in Moldova indicated access to finance as a major constraint. This is quite low in comparison with other countries (the world's average is 26.6% and ECA average is 17.2%). However, identification of financial gaps is rather subjective, while accurate measurement is even impossible²². The next paragraphs will try to assess the existence of such gaps, making an international comparison of the most important indicators of the access to loans. The first one is the percentage of firms with a bank loan/line of credit. According to the same data from the WB Enterprise Surveys, only slightly more than a quarter of all firms in Moldova have a loan or line of credit with a bank (figure 11). This is less than in the majority of countries in the region, except for Azerbaijan, Latvia, Russia and Ukraine, and below the world's and EECA's average.

Figure 11: Percentage of firms with a bank loan/line of credit

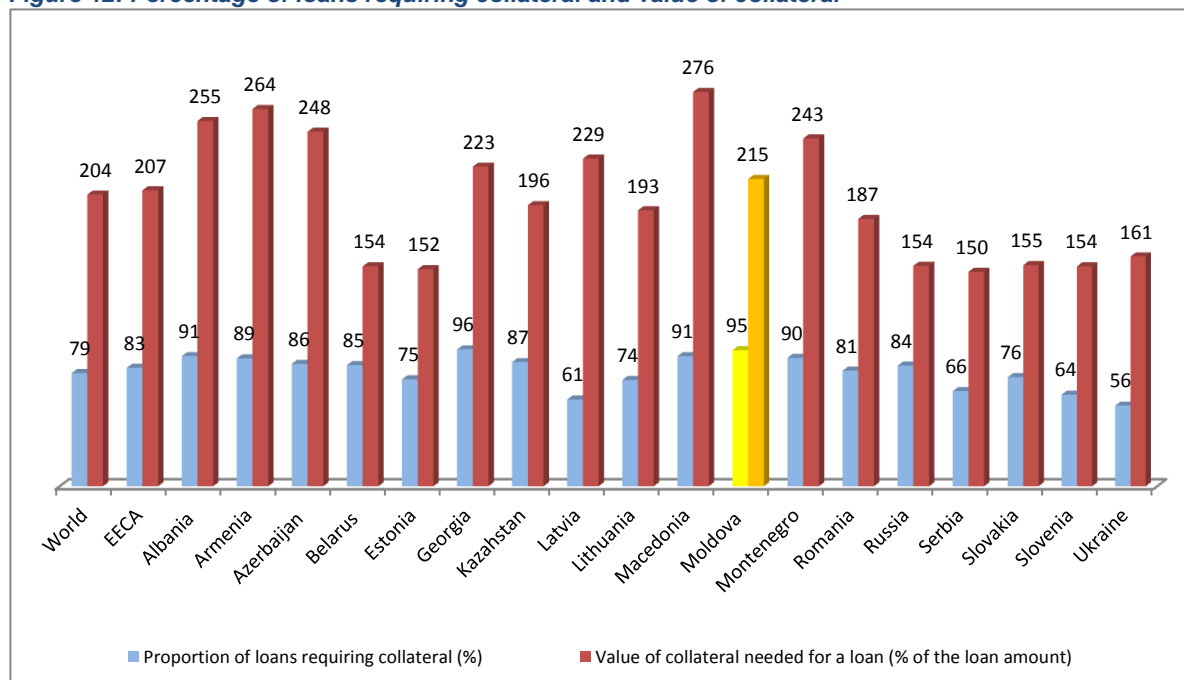
Source: The Enterprise Surveys, WB, 2013.

²² Helmut Kraemer-Eis, Frank Lang: Guidelines for SME Access to Finance Market Assessment, the European Investment Fund, 2014.

29. However, these data don't automatically imply that there is a gap in financing. The same surveys reveal that more than 63% of Moldovan firms don't need a loan. This is more than the world's (46.1%) or EECA's average (51.1%), and well above the majority of countries in the region. Again, this could not by all means imply that firms in Moldova have sufficient internal financial recourses to finance their operations and investments. Rather, it could reflect a lack of trust in banks (including in revealing to them financial information), high costs associated with getting loans from banks (interest rates and fees, formalities associated with collateral evaluation and registration, etc.), discordant offer from banks in terms of loan products, and/or maturities, or a lack of sufficient financial literacy from entrepreneurs. Only companies in Latvia from countries in the region showed more reticence in accessing loans or lines of credits from banks (78.6%).

30. Lack of collateral or too high requirements from banks and other lending institutions for the value of collateral needed to secure a loan is one of the most frequently invoked, by entrepreneurs, constraint for the access to finance. On average, Moldovan banks require a collateral coverage level of 215% of the loan amount. This is slightly higher than the world's and EECA's average (204% and 207% accordingly), and higher than most countries in Eastern and South-eastern Europe. From among the 17 compared countries in figure 12, only 7 had higher requirement in respect to the value of collateral, mainly from the ex-USSR or ex-Yugoslav geographical area. However, in most East-European countries that became members of the EU, collateral requirements are lower. At the same time Moldova, together with Georgia, are absolute leaders in the region for the proportion of loans requiring collateral. This indicator for Moldova was 95%, and for Georgia 96% in 2013. The world's average for it in the same period was 79%, and the EECA average - 83%. All other countries had smaller proportion of loans requiring collateral (56% - Ukraine, 61% - Latvia and 66% - Serbia, 91% - Albania and Macedonia, 90% - Montenegro, 89% - Armenia and 86% - Azerbaijan).

Figure 12: Percentage of loans requiring collateral and value of collateral



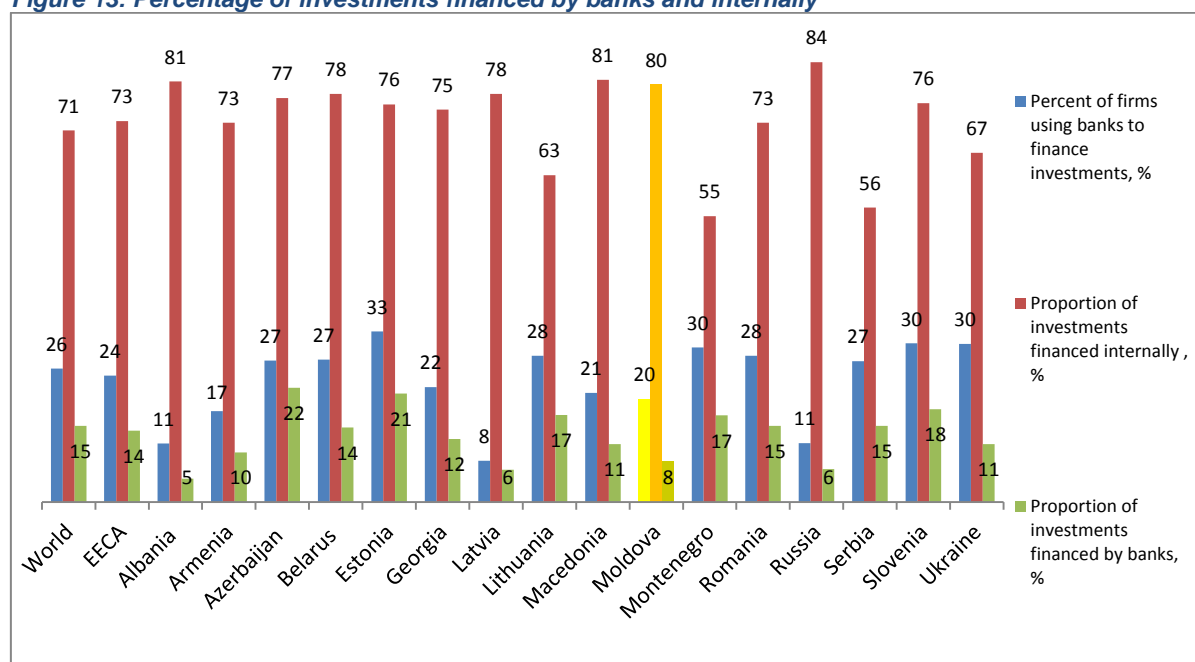
Source: The Enterprise Surveys, WB, 2013.

31. This may reflect institutional, legal and enforcement deficiencies, as well as insufficiently developed information infrastructure in less advanced transition countries, which altogether exacerbate information asymmetries between lenders and entrepreneurs. For example, insufficiently developed legal systems prevent the development of certain financing instruments, including the use of various types of collateral as a risk-mitigating element. Even when adequate legislation is available, there are often problems with enforcement

(functioning of the cadaster and registers of movable assets, lengthy procedures for registration of mortgages and pledges, procedures for ascertaining the status of certain assets, cases of corruption and inefficient courts, lack of effective mechanisms for collecting and exchanging information on credit history, payment performance, etc.)²³.

32. According to the same WB Enterprise Surveys 2013, companies from Moldova have one of the highest rates of investments financed from own money (80%). Only firms from Russia (84%), Macedonia (81%) and Albania (81%) from among East-European countries have higher rates of investments financed internally. For comparison, the world's average is 71%, and EECA countries' average – 73%. At the same time, only 20% of Moldovan companies turned to banks for financing their investments. Only in Latvia (8%), Russia, Albania (11% each) and Armenia (19%), from among East-European countries, this rate was lower. The world average for this indicator was 26%, while EECA's average -24%. As for the proportion of investments financed by banks (8%), Moldova surpasses only 3 East-European countries: Albania (5%), Latvia and Russia (6% each) (figure 13). A study of the private sector and financial market in Moldova conducted in 2008 concluded that the most visible reason for the very low share of investments financed by bank credits is the high interest rate both in local and foreign currencies. Credits have always been expensive nominally and there is no reliable inflation and exchange rate forecast, while the monetary policy itself drives up interest rates. The risk of long-term credit is therefore high and its cost accordingly²⁴. Other reasons, according to the same study, are the overall lack of trust from businesses and cumbersome lending procedures. It concluded that companies restrain from disclosing financial data to outsiders, even to banks and are reluctant to present detailed business plans complying with banking rules.

Figure 13: Percentage of investments financed by banks and internally



Source: The Enterprise Surveys, WB, 2013.

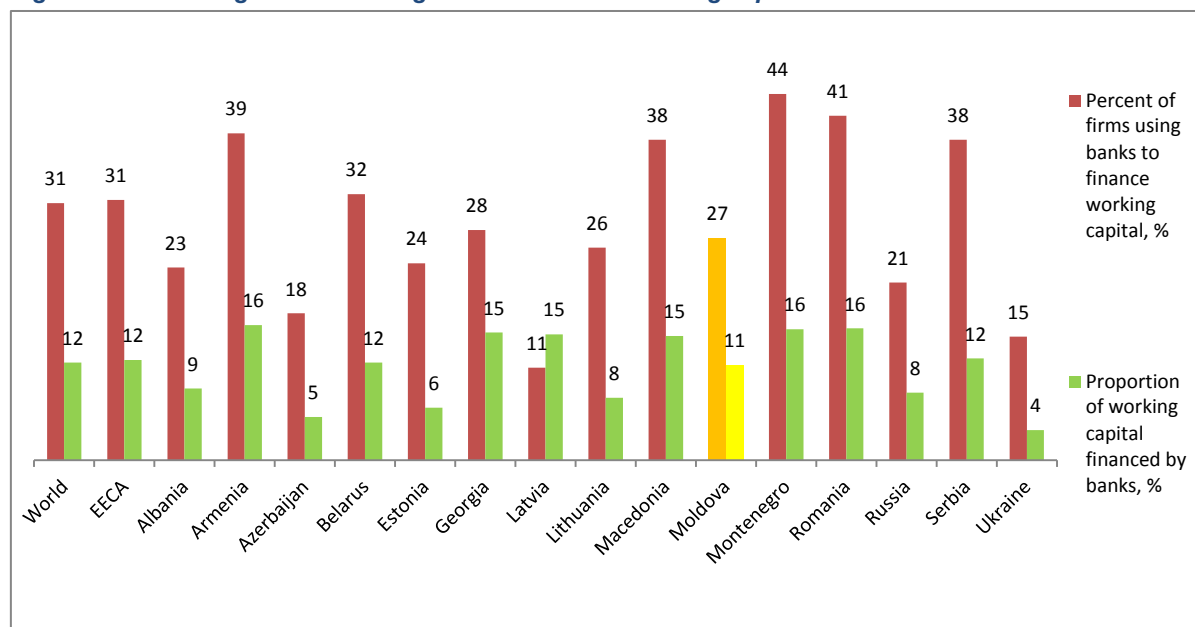
33. In respect to the percentage of firms using banks to finance working capital (27%), Moldova performs below the world's and EECA's average (31%). Moldova's performance is also below that of most countries in the region (figure 14). At the same time, banks in Moldova finance only 11% of the working capital of firms. This level is close to the world and EECA's average (12%); however, as in the case of the percentage of firms using banks to

²³ Financing Technology Entrepreneurs & SMEs in Developing Countries: Challenges and Opportunities, the WB, 2008

²⁴ Gábor Hunya, Jan Mládek and Josef Pöschl: Private Sector and Financial Markets Development in the Republic of Moldova, the Vienna Institute for International Economic Studies (WIIW), 2008.

finance investments, it is lower than that of the majority of countries in the region. While using international comparison for assessing possible gaps in the access to finance proves to be useful, it is not exhaustive and cannot reveal the real extent of the gap, causes behind it and financing needs of companies. Regular specialized measurements should be established for this scope. However, such a comparison helps understand if there are potential gaps and where such gaps persist.

Figure 14: Percentage of firms using banks to finance working capital and



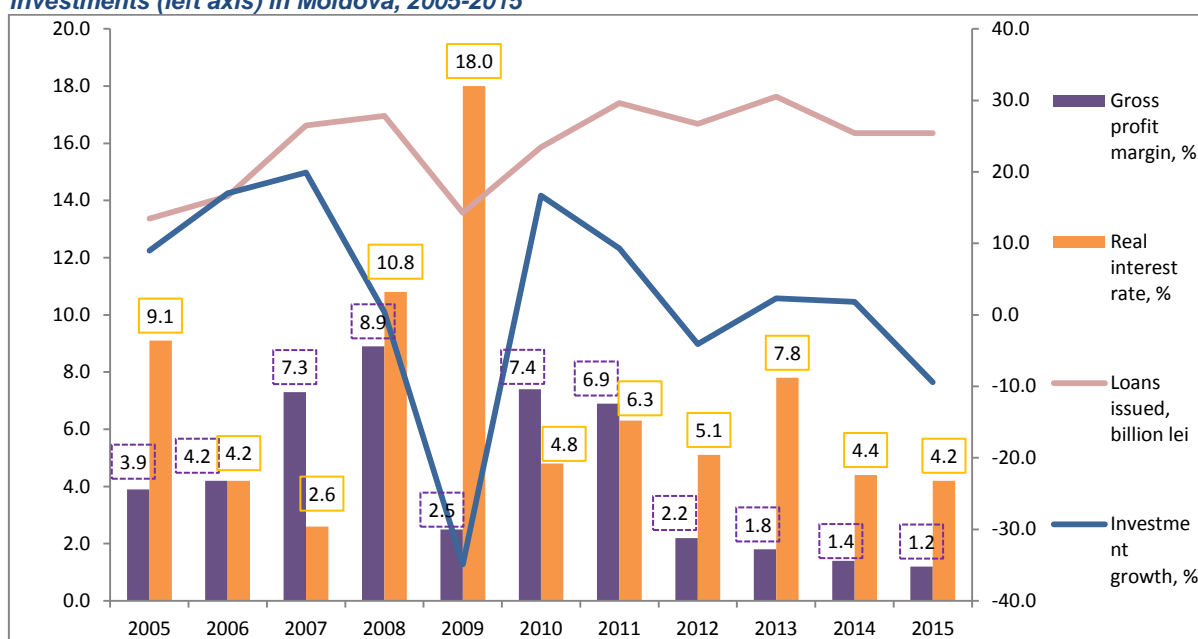
Source: The Enterprise Surveys, WB, 2013.

34. As already stated, one of the main reasons (and by many interviewed stakeholders, this is also the central reason) behind poor access to finance in Moldova are high interest rates. From an international perspective, high interest rates seem also to be the major constraint in AF. The EBRD BEEPS survey for 2013-2014 showed that 48% of respondents in transition countries indicated high interest rates as the main constraint for credit²⁵. In international comparison, real interest rate in Moldova is comparable to countries at similar level of development²⁶; however it is much higher than in developed or more advanced transition countries. Real interest rates diminish profitability of companies, and in an ideal economic model these have to be lower than the gross profit margin to make taking loans economically grounded. Although there is not a perfect correlation between these two variables in a real economic system, generally a drop in the real interest rate resulted in higher profit margins for Moldovan companies and triggered an increase in demand for bank credit, sometimes with a small lag in time (figure 15). In contrast, in years in which real interest rate was higher than the gross profit margin, demand for loans dropped (again, this might take place with a small lag in time, determined by the adjustment of nominal interest rates for loans). Also, increase in real interest rates had a discouraging effect on investments in fixed assets, and vice versa, investment growth generally followed the falling trend of interest rate (as in the case of demand for credit, there is a time lag in some years determined by adjustments or influences of other factors).

²⁵ EBRD transition report 2015-2016.

²⁶ See World Bank data on real interest rates comparison internationally at <http://data.worldbank.org>.

Figure 15: Real interest rate vs. gross profit margins, demand for bank loans (right axis) and evolution of investments (left axis) in Moldova, 2005-2015*



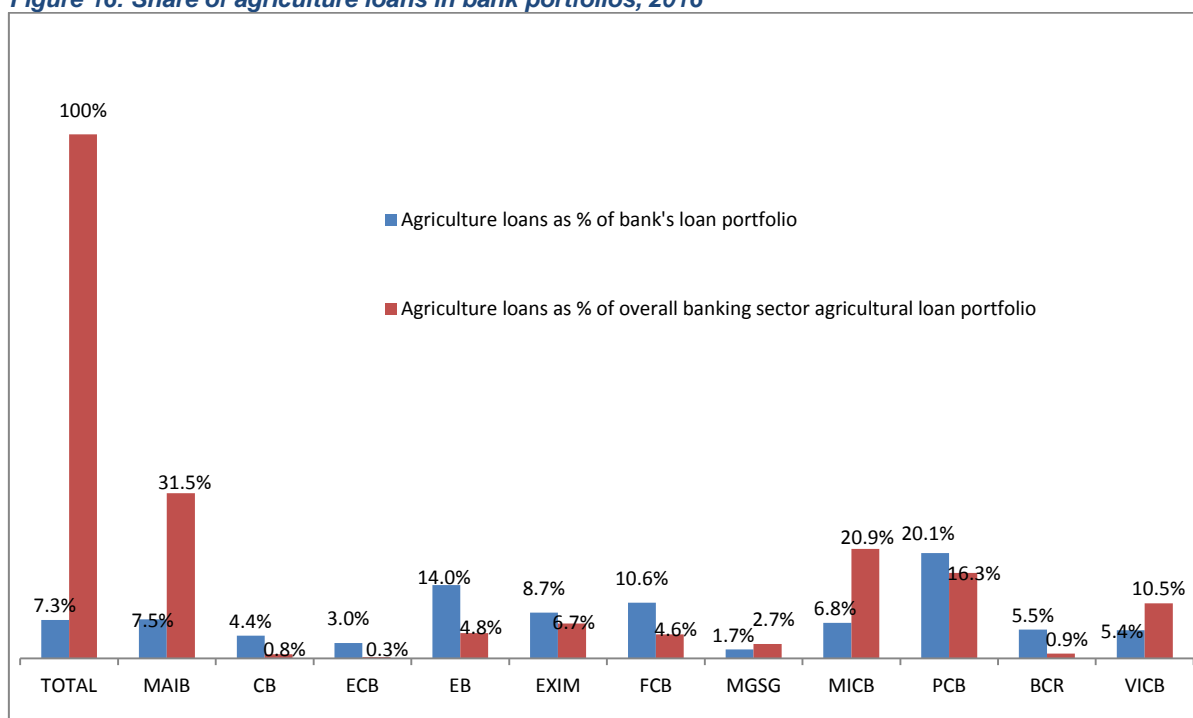
Source: NBM, NBS and World Bank.

* Data for loans issued in 2014 are *de-facto* for 2015, as the respective indicator for 2014 was seriously distorted by the interconnected and virtual lending among the 3 failed banks (Banca de Economii, Banca Sociala and Unibank).

2.3. Access to Finance in Agriculture

35. Bank loans are the main financing option for agribusiness companies, in line with the overall patterns in Moldova. As already discussed in the section 2.2 "Access to Financial Services" above, the availability of data for assessing potential gaps in financing to private sector is a problem. In the absence of direct measuring, one can only make estimations based on indirect assessment. While contributing directly 12% to the GDP and accounting for 25% of all earnings before income tax and more than 40% of the country's exports, agriculture accounts for only 7.3% of the total bank loan portfolio (figure 16). In absolute terms, this is about 2.5 billion MDL, out of the total loan portfolio of 34.8 billion MDL in 2016. It is obvious that the existing financial gap in agriculture lending is not covered by other components of the financial sector. As it will be argued further, agriculture lending makes up only 7.9% of the MFO lending portfolio or about 300 million MDL, and 41.7% of SCAs loan portfolio (almost 218 million MDL). Leasing doesn't seem to be an important financing alternative for agriculture companies. Total equipment leasing portfolio was only 88.5 million MDL in 2015 and this refers to all types of equipment, of which agriculture one is only a small portion.

Figure 16: Share of agriculture loans in bank portfolios, 2016



Source: NBM.

36. As discussed further, banks and MFOs consider agriculture risky, and adopt conservative stances in lending to agriculture. From among the 11 banks, only 3 have more significant individual exposure to agriculture: ProCredit Bank (PCB) – 20.1%, Energbank (EB) – 14.0% and Fincombank (FCB) – 10.6%. All the rest have less than 10%, including the biggest 3 banks – Moldova-Agroindbank (MAIB) – 7.5%, Moldindconbank (MICB) – 6.8% and Victoriabank (VICB) – 5.4%. Compared to the overall bank sector agricultural loan portfolio, the largest agriculture loan exposures however have the biggest 2 banks: MAIB (31.5%) and MICB (20.9%), followed by PCB (16.3%), VICB (10.5%) and Eximbank (EXIM) – 6.7%. The biggest 3 banks hold together almost 2/3 of the total agricultural loan portfolio of the banking sector.

37. Banks in Moldova are universal/not specialized in agriculture or other sectors lending. Therefore they tend to overestimate agricultural lending risk (see table 3 below and bank sector constraints to finance further), resulting in high collateral requirements and limited allocation of credit to the agricultural sector. All 11 commercial banks (as shown in figure 16 above) make agribusiness loans. Banks with large branch networks are usually more active in lending to agriculture and agribusiness. Agribusiness loans (agricultural and food industry loans) by banks grew at a more rapid pace, than the overall loan portfolio. Thus, according to the NBM, total loan portfolio by banks in Moldova grew by 66% from 2007 to 2015, while agriculture & food industry loan portfolio of all banks increased in the same period by 1108%²⁷. Consequently, as a percentage of all loans, agriculture & food industry loans increased in the same period from 14% to 17%.

38. In spite of the overall growth of lending to the agribusiness sector in the last decade, it largely continues to be underfinanced. Almost one third of the financing necessary in the agri-food sector is covered by bank loans, one quarter – by supplier credit, 3% - by state subventions. The situation improved considerably in 2012-2013, when bank loans increased by 50% each year, and the financing gap dropped from 50% to 35%, but continues to remain

²⁷ Comparison with data before 2012 is possible only for agriculture & food industry loans, as no separate statistics for agricultural loans before 2012 existed.

quite big²⁸. Also, interviews with stakeholders from the sector revealed systemic deficiencies in lending to agriculture (see the section 3.1 "Bank sector" and other sections of the Study below). Among these, high effective interest rates (18%-19% annually), conservative collateral requirements (demand of collateral in excess, under-evaluation of collateral by banks), combined with insufficiently developed special tools for access to credit (loan guarantee funds, warehouse receipts, subsidizing of interest rates, etc.) lack of sufficient long term financing from internal resources (investment loans are usually granted for a period of up to 3 years, in exceptional cases up to 5 years, which is inadequate for financing of perennial plantations or post-harvesting equipment/facilities (cold storages), etc. Longer term financing is generally available from donor funding programs, which are quite limited in scale though (see next chapter).

Table 3: Assessment of mitigation risk practices used by banks for agricultural loans

Risk Type	Usual ways to Reduce Risks	Status
"Expected Loss" Risks	Probability of Default and Loss Upon Default risks/Basel terms	
<i>Probability of Default</i>		
Low management skills and weak business plans	Frequent use of business plans by banks and customers to monitor borrower status	Limited use (mostly formal use)
Borrower payment histories	Credit Bureau	Used, but coverage is low
	Experience with customers	Limited use
	Verification from Value Chain (VC)	Limited use
	Credit Bureau (CB) credit scores showing non-bank debt	Not used/CB not providing scores
	Know value chain terms of lending and member credit histories	Limited/No use
Unreliable financial statements	Credit Bureau scores	Not used/CB not providing scores
	Estimate income from bank accounts	Used
	Use assets accumulated to estimate past income	Limited use
	Estimate from partial receipt records	Limited use
	Tax filings in high tax compliance environments	Limited use
Identification of Strong borrowers	Value Chain information - timing of payments within the VC	Limited/No use
	Industry studies of financial ratios by sector	Not used
	Risk rating models quantifying financials, efficiency, quality of product, and competitor status.	Limited use
'Capital' budgeting	Before approving an investment loan, review forecasts of profit changes from investment to validate the decision Review item and price choices with borrower	Limited use
Quantify risk information	Triage applicants initially	Not used
	Measure all risks by risk category	Limited/No use
	Assign scores by risk type	Limited use
	Weight importance of categories	Not used
	Calculate the "yes/no" loan decision	Not used
	Calculate a higher price for higher risk	Not used
<i>Loss Upon Default</i>		
Inadequate funds from liquidation of assets by	Monitor loans frequently Consult with borrower early on operating & liquidation decisions	Limited use
Inadequate funds from liquidation of assets by bank	Monitor liquidation markets and trends. If possible add collateral later	Limited use
	Lower collateral coverage when debt service coverage is high meaning borrower cash flow is generous	Not used
	Use stress scenarios to get realistic forecasts of debt service coverage	Not used
	Know VC players to know quality of accounts receivable, inventory stocks of supplies, work in progress and finished production	Limited use

²⁸ These estimates were made by the National Strategy for Agricultural and Rural Development 2014-2020.

'Unexpected Loss' Risks	External risks and losses due to correlations (connected or overlapping risk factors)	
Weather	Borrowers diversify their sources of income or banks require more assurances	Limited use
	Crop Insurance	Limited use
	Partial forward sales of crops	Not used
	Producers avoid mandatory crop delivery contracts; processors and packagers reduce fixed costs & have other suppliers for poor crop	Limited/No use
Market disruptions	Banks measure borrower vulnerability and may require use of contracts, insurance, or diversification to reduce risks	Limited use

Source: Janet Buresh and Ion Tornea: Expanding Issuance of Loans to Agriculture and Agribusiness in Moldova, CNFA, 2007, adapted.

39. A study of the constraints to AF conducted in 2009 concluded that total investment requirements for on-farm HVA equipment and post-harvest infrastructure and equipment would have been between USD 350-400 million by 2015, which was well in excess of the availability of funding in Moldova to meet this need²⁹. At the same time, the National Strategy for Agricultural and Rural development 2014-2020 estimated that annual needed investments in agriculture would gradually grow from 4 billion MDL in 2004 to more than 7 billion MDL in 2020. Taking in account that respective calculations were made at an exchange rate of 16.5 MDL for 1 Euro, but the actual exchange rate increased to 21-22 MDL for 1 Euro, one could estimate that figures for future investment estimates have to be multiplied at least by one third. The Strategy identified 3 main solutions for improving the access of farmers to loans: (i) creation of a functional framework for the secured transaction with goods (guarantee funds, warehouse receipts); (ii) stimulation of land market, to transform the land in a more attractive asset for banks, as well as (iii) reduction of agricultural risks (by mitigating and insuring risks in agriculture).

40. An analysis of constraint to FDI by United Nations Conference on Trade and Development (UNCTAD) in 2013 concluded that the most important obstacle to more investment in agribusiness in Moldova is the limited supply capacity of the country. This limited supply capacity is related to the current production structure (fragmented parcels) and uncertainties about land titles. Moldovan agribusiness faces also enormous challenges in terms of adjusting to the requirements of the international market in labeling, packaging, traceability and following sanitary and phytosanitary standards³⁰. Presently, about 83% of agricultural lands are privately owned. Agricultural production is performed by 35,545 limited liability companies (LLC), holding 754.2 thousand ha (37% of all agriculture land), 351,268 peasant farms (PF) with 515,6 thousand ha (25.3% of agriculture land), 2709 agriculture cooperatives with 87.6 thousand ha (4.3% of agri land), 152 joint-stock companies holding 29.2 thousand ha (1.4% of agri land). At the same time, 799850 individual owners (households) have 239.7 thousand ha of agriculture land, mostly by-house plots (1.8% of total). The rest is held by state agriculture enterprises – 179.1 thousand ha (8.8% of total), other state and local public authorities' land (7.7%), other private land – 3.7% of total agriculture land. Thus, family-type farms work about 37% of agriculture land, while other about 50-55% is managed by corporate agricultural enterprises. At the same time, corporate enterprises had a share of only 42% in the total agricultural production in 2016, PFs - 19%, while 39% of agriculture output was produced by individual households. However, the high share of households in the total agricultural production is due particularly to the important share of animal production (about 71% of the total animal production). These figures point out to the low productivity of corporate agricultural enterprises.

41. Agricultural land is one of the most important assets for farmers and corporate agricultural enterprises. However, the land value is depressed by the current land parceling

²⁹ Constraints to Agriculture Finance in Moldova, draft report, MCC, 2009.

³⁰ Republic of Moldova investment policy review, UNCTAD, 2013.

and the lack of a liquid and transparent land market. About 36% of all PFs hold land plots less than 1 ha, while 57% – from 1 to 5 ha. The average size of agricultural land plots held by individual owners is 0.30 ha, while the average size of agricultural land by LLC (Limited Liability Companies) is 21.2 ha. The ability of LLC to pledge land is limited by the fact that more than 85% of the land operated by them is leased. Evolution of the land market is slow, both in terms of consolidation and efficient use. The main constraints of agricultural land market differ little from the initial stages of post-privatization in the late '90s: the size of land plots is small, the market is not attractive for commercial transactions, information about the demand and supply and transactions with land is missing, agricultural enterprises and farmers lack the necessary capital for technological upgrade and modernization, the institutional structures in agriculture lack adequate capacities, competitiveness of existing agricultural entities is limited, prices for agricultural land plots is well below the average for the countries in the region, the share of eroded, saline and alkaline plots is high³¹.

42. Given the weak attractiveness of land for potential buyers, agricultural land plot prices are currently very low. The correlation between potential buyers and de facto sellers is 1:2.8. As a consequence, even if market prices are increasing (annex 2), they still remain below the economic value of the agri land and small in comparison to countries in the region. The estimated number of transactions with land plots (totaling 15653 ha) in 2014 was 23282, with the average price of 19851 MDL per 1 ha. The average size of one plot sold was 0.67 ha, while the surface of agri land sold in 2014 is estimated to be only 0.79% of total agricultural land. Even if compared to 2000 the number of transactions increased about 2.5 times, from 2000 to 2014 less than 12% of all agricultural land in the country has changed hands through sales³². Reasons for this slow development include low prices for land, especially in villages located far from urban centers, complicated procedures and high fees for land transactions. Another negative factor is migration of rural population abroad, leaving their plots uncultivated with no possibility to legitimately pass these plots to other users either by sale or lease³³. At the same time there are big regional differences in prices. If the average price for 1 ha of agricultural land in Chisinau was 118060 MDL in 2014, in Taraclia, Rezina and Causeni the price for 1 ha ranged from 8136 to 9478 MDL, or 12.5-14.5 times lower³⁴. The total amount of land sales in 2014 was slightly more than 310 million MDL.

43. The lack of sufficiently large and developed secondary market for most part of the collateral that agricultural companies and farmers can offer to banks/credit institutions as security for loans also impedes expansion of credit to agriculture. Given the underdevelopment state of the land market, this limits the ability of agribusinesses to pledge assets in exchange for financing. It is especially difficult to assign values to some agribusiness equipment because it is special-use equipment and has both illiquid markets and few buyers. As it will be argued further, lenders have a high risk perception of agricultural businesses, and this makes them more strenuous in evaluating collateral and imposing high coverage rates. As it will be described further, the lack of secondary markets for equipment and machinery is also an impediment for development of operational leasing, and the few attempts to start operational leasing operations in Moldova failed to materialize of this reason (see section 3.3 "Leasing sector"). Real estate prices in the regions are also considerably lower than in Chisinau. This makes the development of alternative tools for guaranteeing of loans to agribusiness (loan guarantee funds, warehouse receipts and crop certificates, etc.) an especially actual issue for Moldova.

44. Although sales and earnings of agricultural companies grew substantially over the years, they proved to be highly volatile. Total sales of the sector decreased in 2009 and 2012,

³¹ Viorel Chivriga, *Evoluția pieței funciare agricole în Republica Moldova*, IDIS Viitorul, 2009.

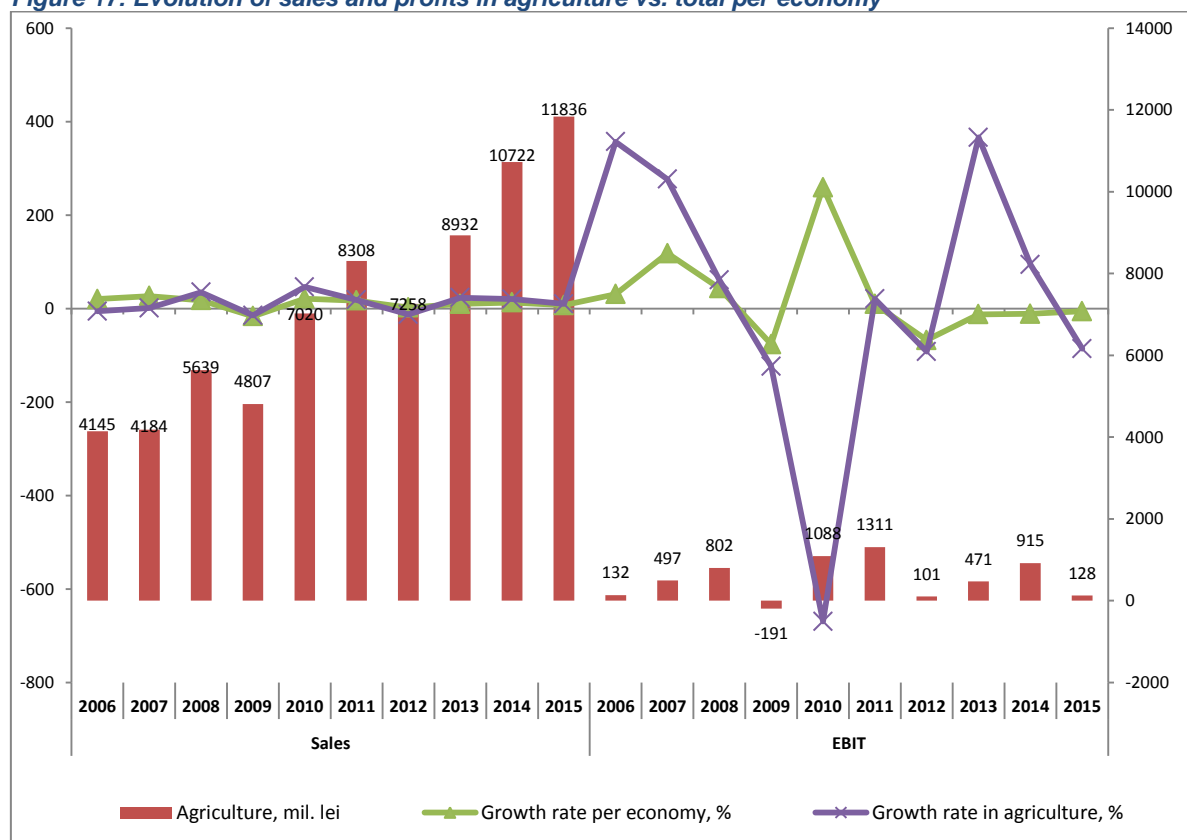
³² Tudor Bjura, *Piața funciară autohtonă: dimensiuni actuale și tendințe de dezvoltare*, INCE.

³³ Constraints to Agriculture Finance in Moldova, draft report, MCC, 2009.

³⁴ Tudor Bjura, *Piața funciară autohtonă: dimensiuni actuale și tendințe de dezvoltare*, INCE.

impacted by the economic slowdown induced by the global financial and European sovereign crises. Profits followed the same pattern, but proved to be more inflexible in reverting to the pre-crises levels, especially after 2012. After the more than 10-fold decrease in profits in 2012, the sector was able to regain until 2014 only 70% of its profitability in 2011, however profitability crashed again in 2015. The recovery of the sector, together with the entire economy, has been severely affected by the Russian bans on Moldovan wines and agri-food exports after 2013, the negative evolution of prices on the EU market after the introduction of bans by Russia against imports of agricultural produce from the EU and depreciation of MDL, that substantially reduced profits of agricultural producers. While sales dynamic was more or less in line with the pattern displayed by other sectors, profits in the agriculture sector proved to be a lot more volatile (figure 17). Even if the total evolution from 2006 to 2015 for both sales and profits in agriculture corresponds to the one displayed by the economy in general, the amplitude of fluctuations within the same period was incomparable higher for the agriculture.

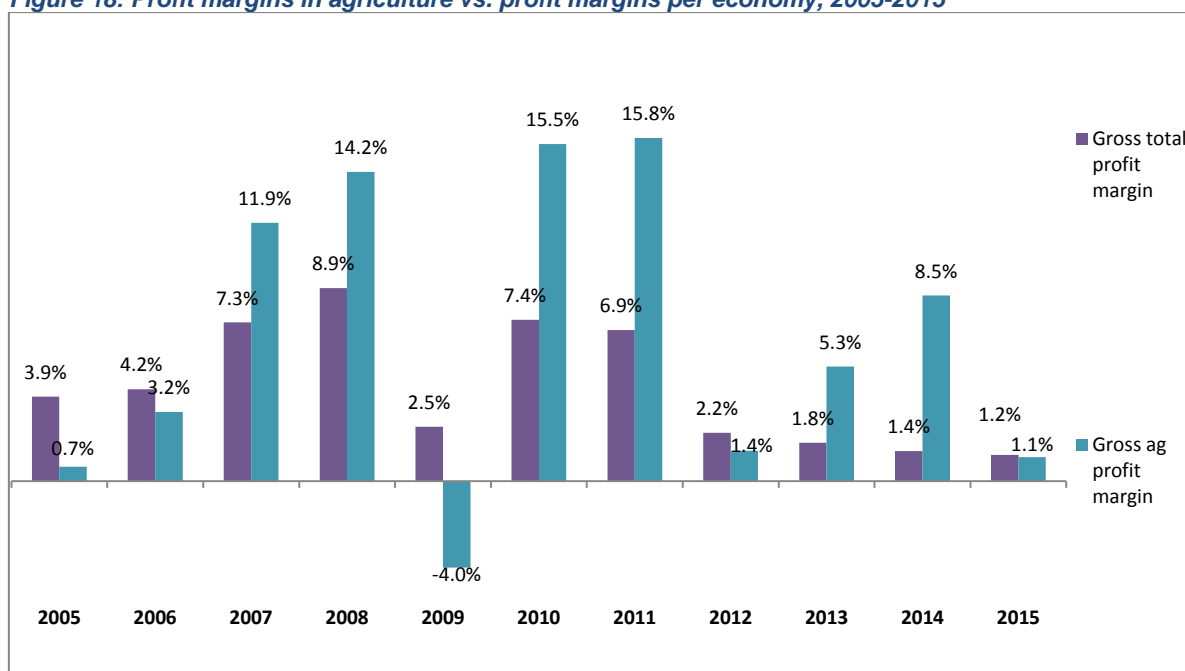
Figure 17: Evolution of sales and profits in agriculture vs. total per economy



Source: NBS.

45. As a result of volatile macroeconomic conditions, decreasing demand/prices and barriers on main export markets, driven by evolutions described in section 2.1 “Private Sector Overview” of this chapter, the profit margin in agriculture is well below its levels in 2010-2011 and even lower than that displayed in the most affected by drought year – 2007. In 2012 profit margin in agriculture was only 1.4%, following the drought and economic slowdown induced by the regional economic crises. It increased further to 5.3% in 2013 and to 8.5% in 2014, but dropped again in 2015 to only 1.1%. Adding to this the increased interest rates for loans in the same periods, the ability of agricultural businesses to access new loans and repay on older ones has been severely affected, as has been the inclination to invest, which will affect further growth. Except 2012 and 2015, the profit margins in other sectors have been even lower than in agriculture, although less volatile. More grave is that these are decreasing continuously since 2010, from 7.4% to a mere 1.2% in 2015, 6 times less than in 2010 (figure 18).

Figure 18: Profit margins in agriculture vs. profit margins per economy, 2005-2015



Source: NBS.

2.4. Findings / Summary of Market Failures

46. The identification of constraints in the access to financing for the private sector in Moldova is affected by the lack of specialized studies and measurements. No studies are available about financing needs of companies in Moldova, funding by sources, as well as no data on failure incidence of companies, rejection rates of financing application, etc. Indirect conclusion one can make based on identification of market failures, as well as based on international comparison with peer countries. Conclusions from such a research have been verified and completed with in-depth interviews with stakeholders from the private and financial sectors. Bullet points below summarize main conclusions of the research conducted for the identification of constraints in the access to finance on the demand (private sector) side:

- The economic growth in Moldova is volatile and lethargic, given the unstable macroeconomic environment (most notably interest and exchange rates), heavy reliance on imports, limited diversification of exports and non-stimulating business environment. On background of open character of economy, the low diversification of exports exposes it to frequent external shocks (economic slowdowns and trade barriers in main export countries) that reduce companies' revenues and earnings. Internal output is limited by reduced competitiveness of local produce, restrained and stagnant production capacities.
- GDP growth relies primarily on private consumption fueled by remittances, which exposes the economy to a series of vulnerabilities, among which decreasing of money inflows from worker migrants and shortage of workforce in certain sectors. Falling remittances reduce internal consumption, resulting in lower revenues and earnings for companies, as well as shrinking the demand for credit. The imbalance due to the excess of exports by imports makes the economy unsustainable in the medium and long term, unless the current model of economic development is changed.
- Deficiencies in the business environment (corruption, inefficient courts, political and economic policy instability, bureaucratic/inefficient institutions and customs formalities, etc.) don't allow for the rapid expansion of business activities and for

compensation of the negative influences from the above constraints. High rate of shadow economy also distorts competition, negatively affects revenues/earnings by legally operating businesses and limits expansion of financial/lending products.

- The number of companies has grown over the years, however, the size of businesses tend to remain small. Small businesses do not grow into medium-sized companies, and the reason apparently lies in worsening of the business environment for medium businesses (fear of business takeovers, poor investment protection (especially those local) and law enforcement). At the same time, due to the low transparency and neglect of the regulatory impact analysis of legal acts, the regulatory framework is a burdensome one, which significantly increases the costs of companies, affecting their profitability and competitiveness. The performance of big companies has been higher, fueled primarily by FDI; however their further expansion is limited by the prevailingly unattractive investment climate that restrains more significant FDI inflows.
- Business activity in Moldova is highly concentrated geographically and by sector, with the bulk of businesses in Chisinau or involved in commerce. Meanwhile, regions and other sectors represent small isles of low intense economic and business life. Regional and sectoral disparities are stimulated further by insufficient economic integration of country's localities and non-stimulating business environment, economic integration meaning strong and efficient institutions, developed and available infrastructure, and incentives for economic activities in the regions. Weak economic intensity in regions and other sectors reduces incentives for lenders to expand geographical outreach and sector diversification, limiting the availability of financial services in the regions other sectors, and concentrating them in Chisinau or in commerce activities.
- Volatile macroeconomic environment and frequent shocks make long- and even medium-term planning a difficult task for business. The respective constraint is further amplified by the shortage of bankable firms because of the tendency to operate 'in the shadow' or because of limited financial management and planning abilities of those operating in the legal field, intensifying the inherent information asymmetry problem between lenders and borrowers.
- Information asymmetry is little helped by available training and support services for growing companies, by integration of firms into value chains, by availability of special VC lending products and accommodated risk evaluation practices by lenders. There is limited awareness by firms of the benefits of collaboration within VC. Also, there is low integration of Moldovan companies into international VC and insufficient linkages with FDI companies, little supported by existing internal institutional structures for FDI promotion and SME development.
- Scarce data is available on the access to finance in Moldova. Specialized studies and measurements are missing, impeding the evaluation of existing financial gaps, exact financing needs of companies, the quality of reform actions in the field and assessment of the effectiveness of implemented reform measures. International comparison with peer countries shows limited outreach of financial services, including lower than the average for the region percentage of firms with bank loans/lines of credit, higher than in most countries of the region collateral requirements by banks, higher investment rates financed internally by firms in Moldova and respective lower proportion of investments and working capital financed by banks.
- Real interest rates, although comparable with countries at similar level of development, are high in comparison with profits earned by companies. These were

more than 3 times higher than the gross profit per economy in the last year of available data (2015). High interest rates (compared to available profitability) restrain firms from making investments and expand business operations, diminishing the demand for credit.

- Access to finance for agricultural companies is limited by the high risk perception by lenders associated with agriculture. This translates into fewer loans issued to the sector, in comparison to other sectors and to its role in the economy, higher interest rates and more strenuous collateral requirements that make loans by agricultural companies less accessible. It is true that performance of agricultural companies has been more volatile and unpredictable as compared to the rest of the economy. At the same time, earnings have been higher. All banks seem to make agricultural loans, however the more active are those with larger branch networks and that have developed appropriate risk evaluation models.
- In general, banks tend to overestimate agricultural risks and do not use appropriate risk evaluation and mitigation techniques. A large portion of loans to agricultural companies are extended thanks to available donor funding programs that offer lower interest rates and longer maturities. However, inappropriate risk evaluation models coupled with lack or insufficiently developed facilitating tools (functional loan guaranties schemes, crop and warehouse receipts, etc.) limit the expansion of credit to the sector.
- Evolution of the land market is slow, both in terms of efficient use and commercial attractiveness. Land market has little evolved from the initial stages of post privatization in the late '90s. The size of land plots is small, the productivity is low, information about transactions is not ready available, while procedures for registration of transactions are complicated and fees - high. As consequence, the share of uncultivated agricultural land, which normally would have been sold, is high. Because of the above constraints, the average share of agricultural land sold in the last years is only 0.65%, which means that each agricultural land plot lot will change hands once in 154 years. All this traduces into low market prices for land. Consequently, the ability of farmers to secure financing by pledging land is limited.
- The underdevelopment of the land market is further aggravated by low real estate prices in the regions and lack of liquid secondary markets for a large part of the agricultural equipment. This makes lenders more strenuous in evaluating collateral and inclines them to impose high coverage rates, constraining significantly the availability of financing in agriculture. The respective issues make the quest of alternative tools for the guaranteeing of loans to agribusiness (loan guarantee funds, warehouse and crop receipts, etc.) especially actual for Moldova.

3. CREDIT INSTITUTIONS CONSTRAINTS TO FINANCE

3.1 Bank Sector

47. The banking sector represents the main component of the financial market in Moldova and the major source of financing for business, as evidenced in the previous chapter. Moldova has maintained a two-tier banking system since 1993, consisting of the National Bank of Moldova and 11 commercial banks, as of end 2016. The Moldovan banking system was considered to be one of the strongest among the CIS-7 countries until 2008³⁵. However since then the condition of the banking sector worsened considerable. One bank failed in 2009, on the back of the global financial crises. Another failed in 2012, coincidentally, or not, on the wave of internal corporate governance problems and economic slowdown triggered by the European sovereign debt problem, emphasizing once more the vulnerability of the Moldovan economy to external shocks. But the most intense turmoil the Moldovan banking system underwent in 2014-2015, when 3 banks (Banca de Economii (BEM), Banca Sociala (BS) and Unibank (UB) crashed as result of fraudulent lending and corporate governance problems. These negative events only revealed dormant problems that started to appear in the banking system in 2005-2006, associated with raider attacks on banks and increased opacity of the ownership, supported by wider integrity and independency problems in the judiciary.

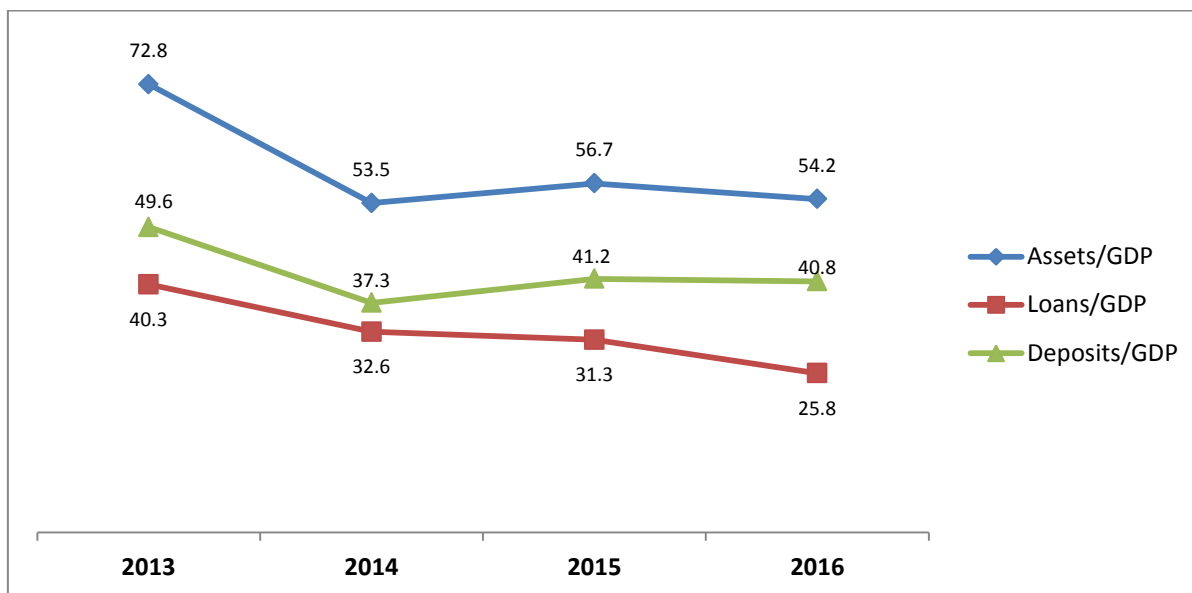
Low level of bank intermediation

48. The assets of the 11 operating commercial banks account to about 54% of the GDP, which is substantially lower compared to countries in the region. For example, in 2016 the average bank asset to GDP ratio in the South East European (SEE) countries was 77%, 90% in the Eastern European (EE) countries and 100% in the Central European (CE) countries³⁶. In Moldova, the bank assets to GDP ratio declined sharply in 2014, after the bankruptcy of the 3 scammed banks. Deposits as compared to GDP followed the same path, declining from about 50% in 2013 to only 37% in 2014, reflecting a loss of confidence in banks from population and business. However, the tendency reverted in 2015 and 2016, albeit not to previous levels (41%). Total bank loan portfolio to GDP also decreased, with the single difference that the fall continued also in 2015 and 2016, down to 31% and 26% correspondingly, on the wave of the declining demand for credit, stemming from fading economic activity and worsened macroeconomic conditions (figure 19). This level of bank intermediation is significantly lower than that of the neighboring countries. In 2016 the average loan-to-GDP ratio in the CE countries was about 54%, 48% in the EE region and almost 45% in the SEE countries.

Figure 19: Financial depth of the banking sector

³⁵ The CIS-7 term was mostly used by IMF at the beginning of 2000, with reference to 7 countries within the CIS at that time: Armenia, Azerbaijan, Georgia, the Kyrgyz Republic, Moldova, Tajikistan, and Uzbekistan.

³⁶ CEE Banking Sector Report, Raiffeisen Research, June 2017.



Source: NBM.

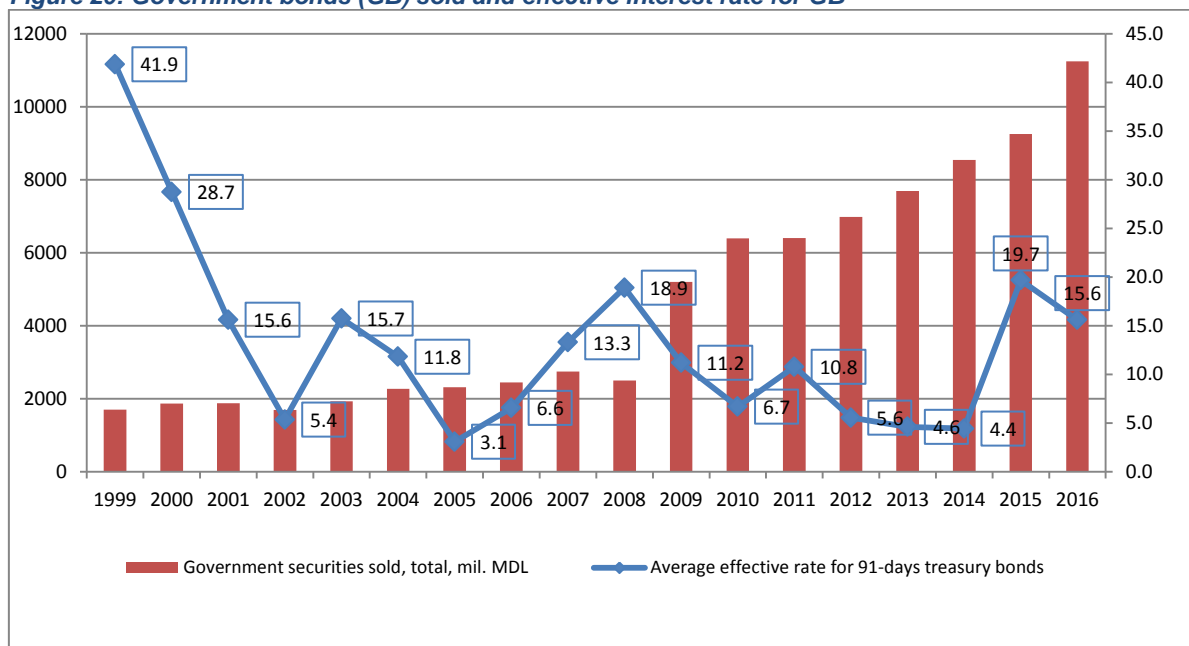
49. Low bank intermediation is rather a reflection of the rudimentary stage of the banking system development, than a constraint per se for the access to financing in Moldova. The underdevelopment of the banking sector is exacerbated by legal and institutional factors. Both demand and supply side constraints, as well as exogenous factors limit rapid development of the sector and its transformation into an efficient intermediary mechanism channeling savings into the economy. First, Moldova as many other developing countries still has a concentrated and uncompetitive banking sector. This is partially the result of restrictive regulations, partly the consequence of unattractive environment for foreign investments in the banking sector and sluggish business activity. Secondly, banks' governance, risk and lending practices evolve very slowly in such an environment. Thirdly, the lack of alternatives to bank deposits for saving/investment, coupled with low financial literacy and culture, mistrust in banks and poor outreach of financial services in rural areas prevent the placement of savings from population in business. These are directed, mainly, into consumption or into the residential real estate sector. Given the underdevelopment of the capital market (almost 2% of GDP), there are practically no other channels through which savings (fueled mostly by remittances) can go into the real sector of the economy. Restrictive regulations (see further regulatory framework chapter), high concentration and lack of alternatives for savings and financing reinforce the tendency to adopt conservative lending policies or to charge high interest rates. If banks can thrive with a stable pool of well-established clients, they have no real incentive to improve operational efficiency, the range of financial products — and, in particular, no incentive to go down the market, to meet the needs of small businesses³⁷.

50. The same is true if banks can make hefty profits simply by buying government debt, as was frequently the case starting with 2009. The GoM increased substantially the supply of government bonds to finance budget deficits (figure 21, right axe). At times of rising inflation, the NBM also increased the basic interest rate. This also led to growth of the effective interest rate for government bonds, allowing banks to make profits by simply buying governmental bonds and holding them up to their maturity (figure 20, right axe). This phenomenon often results in the “crowding out” of small-scale lending. Growing spread on government bonds and interest rate on required reserves of banks with the NBM increased profitability of banks and reduced their incentive to expand into new market segments and search for new clients. The same, even if not more, is true for high volatility of exchange rates. Sharp fluctuations of foreign currencies exchange rates to MDL allow banks to make substantial profits. Thus, in

³⁷ Financing Technology Entrepreneurs & SMEs in Developing Countries: Challenges and Opportunities, the World Bank InfoDev Program.

2016 profits from exchange rate differences accounted for 62% of the total net profit of the banking sector, in 2015 – 90%, in 2014 – 106%, in 2013 – 60% and in 2012 – 121%³⁸.

Figure 20: Government bonds (GB) sold and effective interest rate for GB



Source: NBM.

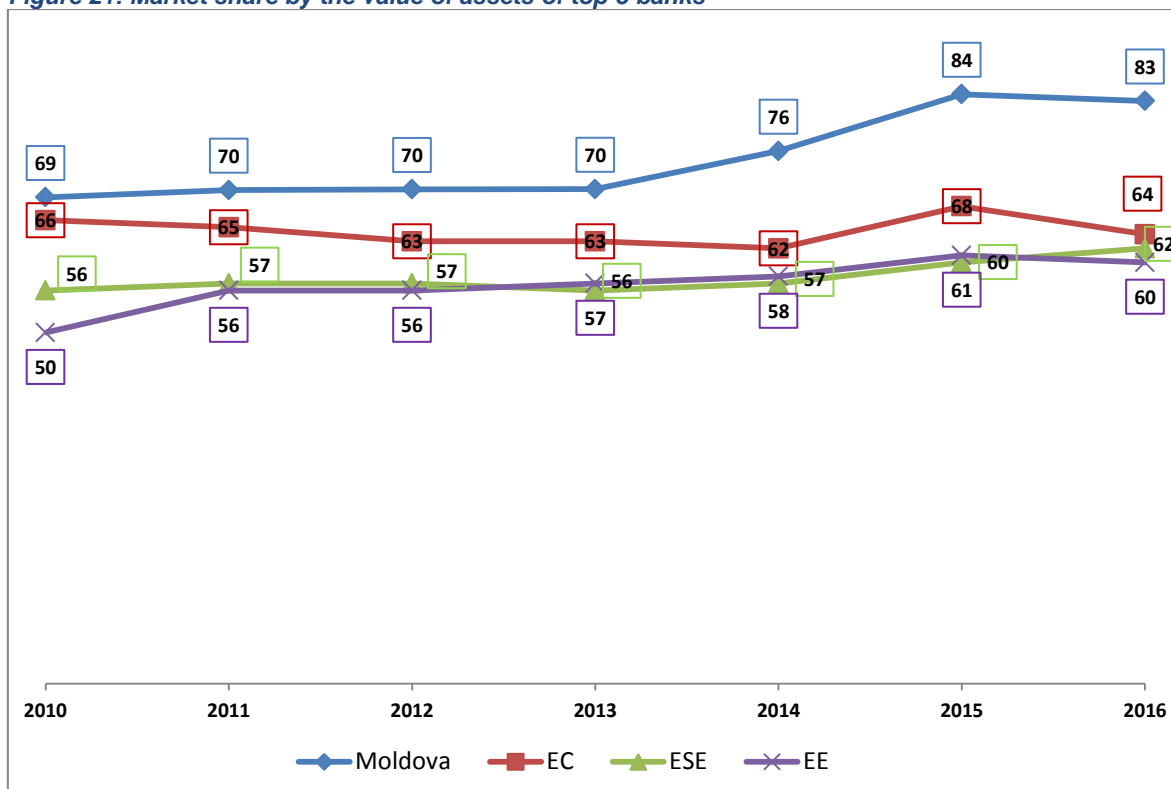
High concentration and limited competition in the banking system

51. Although the Herfindahl-Hirschmann (HH) index for the concentration of Moldovan banking sector shows a moderate level (1682 in 2016)³⁹, the international comparison reveals a higher concentration ratio as compared to countries at similar level of development. The concentration intensified especially after 2009. The top-5 Moldovan banks held 83% of total assets of the banking sector in 2016 (figure 21). Even the top 3 banks had a market share of 64%. This is very high in comparison with peer countries. Thus, the respective average indicator for the market share of the top-5 banks in the CE countries was 64% in 2016, 62% in SEE and 60 in EE. The concentration is even higher for the loan market. About 85% of the overall loan portfolio belongs to the top-5 banks, and even the top-3 banks have a loan market share of 68%. Equally high is the concentration of the bank deposit market (86% for the top-5 and 67% for the top-3 banks in 2016). However, the actual concentration in the Moldovan banking sector might be even higher, given that opaque ownership structure of Moldovan banks may still hide interconnections and affiliations among banks, which was the case with the 3 failed banks. This situation not only undermines competition on the overall bank service and, in particular, loan markets, but also poses substantial risks for the stability of the bank and financial sectors.

³⁸ Data from profit & loss accounts of banks on www.bnm.md.

³⁹ The NBM report for 2016.

Figure 21: Market share by the value of assets of top-5 banks

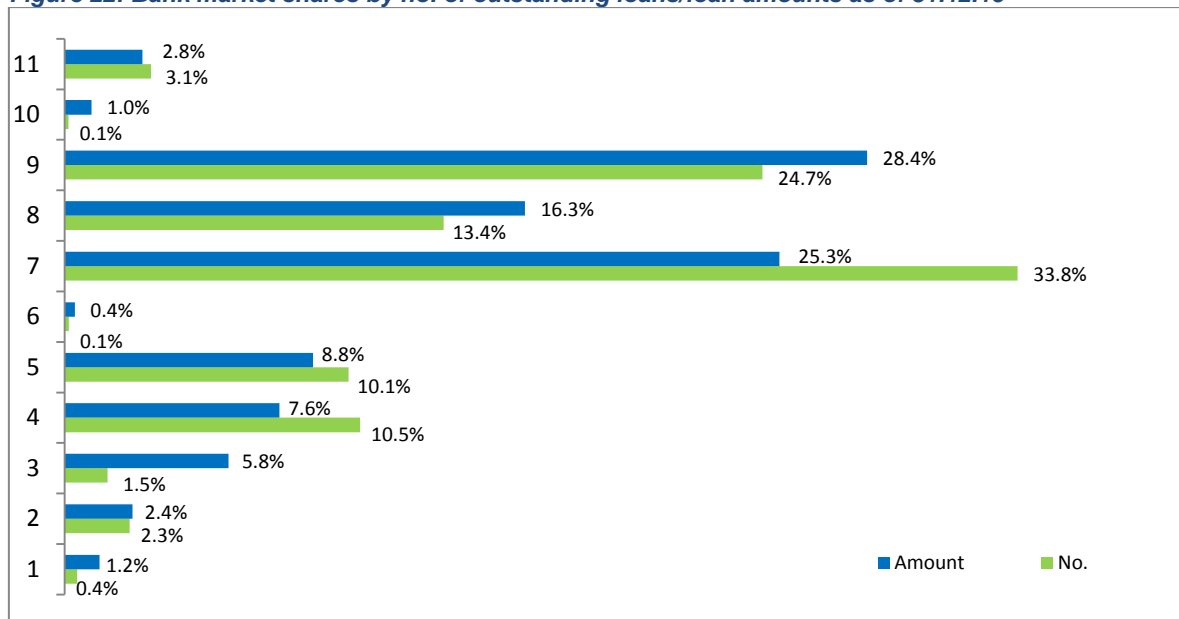


Source: NBM and CEE Banking Sector Report, Raiffeisen Research, June 2016 and 2017.

52. The picture is even more striking when measuring concentration by the number of bank borrowers. The top-5 banks concentrated 92% of all bank loans (by number) in 2015, while the top-3 banks – 80%, with the biggest two banks accounting for 65% of all loans (figure 22). The average business loan size for the entire banking sector was 398 thousand MDL (USD 21 thousand) in 2015, which implies that loan beneficiaries are mainly medium - to big companies. The largest average loan amounts (1.6 million MDL, or USD 87 thousand) had the smallest 3 banks. The average loan amount for the top-5 was almost 376 thousand MDL (USD 20 thousand) and 413 thousand MDL (USD 22 thousand) for the top-3. The remaining 3 banks from the middle size segment of the banking market had an average loan size of almost 770 thousand MDL (USD 41 thousand). Out of the 11 banks operating in Moldova, only the biggest five have more than 8,000 business loans each (on average 15 thousand business loans), with the largest 3 banks retaining in their portfolio on average 19.5 thousand business loans. The smallest 3 banks had on average 194 business loans each and consequently, larger exposures to a few select clients. The remaining 3 medium size banks held on average 1.8 thousand business loans in 2015. High concentration of the banking market and predilection of banks for large loans limit AF for smaller businesses. A WB study found in 2013 that 3% of bank borrowers held 80% of the total loan volume⁴⁰.

⁴⁰ Republic of Moldova Enterprise Access to Finance/Background Notice. The WB, 2013.

Figure 22: Bank market shares by no. of outstanding loans/loan amounts as of 31.12.15



Source: NBM⁴¹

Low level of strategic foreign direct investments in the banking sector

53. A more efficient banking system is believed to facilitate financial intermediation and to contribute to the optimal allocation of financial resources in the real sector. The empirical evidence largely supports the idea that foreign ownership has a positive impact on bank efficiency. Foreign banks have better access to advanced information technologies and more expertise in comparison to their domestic peers. Foreign banks may import better management and internal control practices and, also, increase competition. In addition, they may be less vulnerable to political pressure and less inclined to lend to connected parties. In most cases, joint ownership with foreign strategic investors was the crucial determinant in behavioral change of local banks in transition countries⁴². In evaluating financial sectors after the crises in transition countries, the EBRD concludes that the global financial crisis and the subsequent euro zone debt crisis revealed that increased foreign ownership of banks played a very important role, both as a form of FDI in the financial services sector and as a channel for the financing of investment. Foreign bank subsidiaries' access to parent funding improved the availability of credit in the host economies and helped to reduce the adverse impact of local financial shocks⁴³.

54. On average, foreign ownership in the CE/SEE banking sectors is very high. In the CE countries, the average foreign ownership ratio in the banking sector stood at approximately 63% in 2016⁴⁴. In SEE, the average foreign ownership ratio was even higher and accounted for about 85% of all banking capital at year-end 2016. Notably, the Czech Republic and Slovakia are characterized by very high foreign ownership ratios of 82% and 98% respectively. Romania's banking sector is also marked by an ultrahigh foreign ownership ratio of about 90%. From a pan-European and CEE perspective, the ratio of foreign ownership in the Moldovan banking sector is high - almost 81% at the end of 2016. However, it disguises indirect ownership of many banks "with foreign capital participation" by local individuals or entities through foreign registered companies or citizens. There are only 4 subsidiaries of foreign banks (Mobiasbanca Groupe Societe Generale, ProCredit Bank, Exim Bank-Gruppo Veneto Banca and Banca Comerciala Romana Chisinau) that can be truly considered strategic

⁴¹ These data are not publicly available and have been provided by the NBM on request without bank names.

⁴² John Bonin, Iftekhar Hasan and Paul Wachtel: Banking in transition countries, Bank of Finland, BOFIT, 2014.

⁴³ EBRD transition report 2015-2016.

⁴⁴ CEE Banking Sector Report, Raiffeisen Research, June 2017

foreign investors. With the exception of few minority stakes in several banks by some IFI, the authenticity of other pretended foreign equity shares in Moldovan banks is hard to be asserted.

55. Therefore, by foreign-owned banks in Moldova we will mean in principal the 4 foreign subsidiaries above. These are better capitalized than the rest of the banks (accounting only for 23% of all risk-weighted assets, these banks hold together 30% of the first-tier capital or almost 63% of all banks' statutory capital). All of them pursue different strategies, with at least two prone to micro- and SME lending, one to consumer/mortgage lending and one to large loans. One of them displays almost 100% exposure to business lending, and has the smallest average loan size in the sector, respectively targeting primordially the small business sector. Foreign subsidiaries are not more profitable than other banks, however at least two of them displayed stable growth rates of assets and loan portfolio, having among the smallest NPL ratios in the banking sector. They also seem to adopt more customer-oriented attitude in lending, having among the most diversified range of lending products and better lending practices⁴⁵. Because of better governance and lower NPL rates, the two subsidiary banks are also the banks accepted by all donor funding programs. Evidence from countries in transition suggests that all else being equal, firms prefer to borrow from foreign banks rather than domestic banks where both types of bank are available⁴⁶.

Poor ownership transparency and corporate governance

56. The topic will also be discussed in Section 4.1 "Regulatory Framework" of this Study. However, bank ownership opacity and corporate governance problems have raised challenges not only for the bank regulator. The large-scale fraud in the 3 failed banks (BEM, BS and UB) undermined the confidence of investors, outside lenders, depositors and clients, and created significant public financial liabilities, putting at risk the stability on the entire financial sector. As the last IMF Financial Stability Assessment Program (FSAP) noticed, major changes in the ownership structure of the largest banks in the past years have been accomplished by acquisition of voting shares in parcels below the 5% threshold needed for the regulator's consent, as well as through fraudulent "raider attacks" that undermined the interests of existing bank shareholders. Moreover, the banking sector appears to be controlled by a small number of individuals, who reportedly control much of the non-bank financial sector – insurance companies, securities registries, etc. Ownership shifts have resulted in non-transparent changes in board members and CEOs. Major shareholders - through the new management - have in some cases promoted imprudent lending and dubious activities, which deteriorated the financial situations of those banks. There is also the probability that a substantial portion of the lending of these banks has gone to finance owners' related-party transactions which - as the ultimate beneficiary owners' identity is disguised - cannot be identified as such under the existing regulations.

57. Furthermore, the roles and responsibilities of the owners, boards and the management were often unclear and substantially blurred, undermining corporate governance⁴⁷. Board members lacked independence, and they were not always well qualified to oversee the operations of the financial institution. In many cases board members lacked working experience in financial institutions and they displayed conflicts of interest. In most cases boards did not fulfill their proper role of strategic planning, oversight or risk management. Planning, often, was insufficiently focused on risk and risk control. The risk management mechanisms necessary to identify, measure and report existing and potential risks were not formalized and were not effectively independent. Boards were not explicitly responsible, by law, for the truthfulness and integrity of their banks' financial reporting⁴⁸. Although auditors

⁴⁴ By one of the interviewed stakeholders from the private sector, it took his company 1 week to get a loan from one of the foreign subsidiary banks, in contrast to 3 months from the local bank the company has permanent accounts with.

⁴⁵ EBRD transition report 2015-2016.

⁴⁷ Moldova Financial System Stability Assessment, the IMF, February 2016.

⁴⁸ Ibid.

of banks reported directly to the board, internal audit function lacked independence. In response to these deficiencies, the Executive Board of the NBM has recently adopted several decisions, which, at least on the normative level, "fill the gaps" left by the deficiencies mentioned (Decision no. 146 of 07.06.2017 approving the Regulation on the framework for the management of bank's activity and Decision no. 203 of 27.07.2017 approving the Regulation on the exigencies toward administrators, introducing requirements for banks' administrators according to the "fit & proper" criteria.

58. These deficiencies raised operational problems for the banks and impeded AF for their clients. The board of Vicroriabank, one of the top-3 banks, has been unable to exert its functions for more than two years, given the failure of its majority off-shore shareholder to comply with NBM regulations. The announced intention of the European Bank for Reconstruction and Development to increase its share of capital in this bank to de-block the situation was immediately undermined by suspicious legal changes in the bank security registration procedures, to impede acquisition of shares by the strategic investor. The amendments have been removed shortly after, but this case evidenced high level versed interest in maintaining status quo in the banking sector. The bankruptcy of the 3 banks (BEM, BS and UB) because of shareholder and management governance ill practices (among other reasons) resulted in broader financial implications, including increasing interest rates for loans and deposits, banks asset quality deterioration, poorer territorial coverage and limited physical access to financial services (one of the 3 banks in liquidation had the largest network of bank branches and outlets in the country), loss of confidence in banks (as showed by decreasing deposits at the end of 2015-beginning of 2016) and poorer direct AF for companies because of the exclusion of the largest banks with ownership transparency and corporate governance problems from funding schemes of most donors (see also sections below).

Extra-conservative collateral valuation practices

59. Even though the law recognizes multiple forms of security interests over movable and immovable assets, the practice of banks shows a strong preference for real estate as collateral – 55% of all bank collateral as of December 31, 2015 (table 4). Secured credit dominates the commercial and financial practice, while unsecured credit for business is limited usually to small loans. Even if regulation has been changed to increase unsecured credit limit to 500 thousand MDL from 100 thousand MDL for business loans and from 30 thousand MDL to 100 thousand MDL for loans to individuals, banks are not actively exploring this opportunity⁴⁹. Unsecured credit by banks was only 5% at the end of 2015, and this includes both unsecured credit to business and to natural persons.

Table 4: Structure of collateral in the banking sector as of 31.12.15

Collateral	%
Commercial real estate	40%
Residential real estate	15%
Agricultural produce	8%
Other collateral	7%
Equipment and machinery	6%
Vehicles	5%
Assignment of receivables	5%
Unsecured	5%
Surety	4%
Land	3%
Bank deposits	2%
Personal items	1%
Total	100%

Source: NBM.

⁴⁹ In two of the interviewed banks the amount of unsecured loans to business is limited by internal regulations to 150 thousand MDL, even if NBM regulations allow up to 500 thousand MDL.

60. Collateral must be not less than 100% of the loan amount according to the NBM regulations (except for the unsecured loans described above). Interviewed banks reported between 100%-130% required coverage. However lending practices are based on high or very high collateral to loan ratios; and this translates into the inability of businesses to obtain enough credit based on the collateral that they are able to offer⁵⁰. The evaluation of real estate is done by external evaluation companies; while equipment and other movable assets may be evaluated by internal specialized units or by external evaluators. Collateral values by outside evaluators are assigned using three widely-accepted approaches (market, replacement and liquidation values). However lenders (internal evaluation units) further discount these values. According to banks, liquidation values are further discounted by 10% (liquidation value is usually 30% smaller than the market value). In case of market values, discounts increase to 30-40%. Goods evaluated internally by banks (mostly inventories and equipment) are usually valued by banks at 50% of the balance sheet (acquisition) value. In every case, the final collateral value has to be approved by the bank internal evaluation unit. In case of MFOs, internal evaluation is done by the credit expert. Interviews with bank clients indicate however more strenuous collateral requirements and valuations by banks. In one case, collateral covered bank loan by 215% (at liquidation value, as determined by the evaluation company), or by 280% (at market value, given by the same valuator). In another case, coverage rate was 243% (as evaluated by the bank), or more than 540% at liquidation and balance sheet values. In this case, the bank discounted liquidation value (assessed by the evaluation company) by 30%. In both cases, companies cannot access working capital financing (both loans were for investment purposes) because the bank says there is not enough collateral.

61. The combination of strenuous collateral requirements and valuations, as well as non-transparent and unclear methods (by banks) to set final collateral value based on external or internal valuations, limits access to credit. Clients never know the final collateral value assigned by the bank, which ultimately influences the size of financing they can get from the same bank or from other banks, respectively business planning is affected. Banks justify such a conservative approach to evaluation by difficulties with selling collateral, especially in respect to the equipment, machinery and real estate outside Chisinau, because of the lack of liquid secondary markets for them. Banks also complain about high expenditures and long time needed to go through all legal, enforcement, sale and other procedures to recover the debt. Another practice of banks is to conclude agreements with valuation companies, binding them to sell the collateral if borrowers default on loan. Even if this has no legal or practical effects (the respective arrangements are illegal, while prices are valid only 3-6 months after valuation, which is much less than period needed for the bank to enforce its claims), such arrangements have the potential to influence valuations by specialized companies. Reportedly, market prices assigned by evaluation companies are 20% lower for an asset for collateral purposes than for the same asset for other purposes (selling, etc.), because of the pressure of banks on valuation companies. The NBM published recently a black list of evaluation companies who participated in evaluation of collateral for loans of the 3 banks recently under liquidation, emphasizing once more the problem of the quality of evaluation/evaluators. Some of the interviewed banks use to work only with certain “trusted” outside evaluators, while others, while not having formally such a “shortlist”, also prefer to work with a limited number of reliable evaluators.

Inadequate risk management practices

62. Banks determine their loan approval criteria and the structure of their loan portfolios within rules set by the NBM and their owners. The regulator requires banks to meet prudential requirements and indicators, including minimum regulatory capital, risk-weighted capital adequacy ratio and reserves for losses from assets and conditional commitments. It also

⁵⁰ Moldova Financial Sector Assessment Program, Insolvency and Creditor/Debtor Regimes, ROSC, WB, 2014.

requires risk limits for gaps in matches of asset and liability maturities and foreign exchange as well as for concentrations of loans to related individuals and to any one sector. Banks assign one risk rating to standard loans and four other ratings for loans with different degree of delays/problems. Almost all new loans are rated standard. Banks avoid riskier loans instead of considering raising the price for marginally-acceptable loans⁵¹. Most of the banks look at loan decisions more as to an art (relying heavily on experience and abilities, mostly of senior experts, to differentiate between good and bad projects) and make minimal use of quantified risk measurements. This might work well in case of senior lenders who have extensive experience and expertise. Less senior lenders however may not fully benefit from this experience and expertise. As result, banks may over-estimate risks by using worst case scenarios, compounding independent risks, and failing to calculate off-setting risk factors:

- Risks are defined in words, and often summed;
- Balancing risks is not a usual concept. There is little measurement of risk reduction from diversification and off-setting borrower strengths;
- Because banks rarely use quantifications, they do not calculate probabilities, rankings, and total net risks;
- The result is that banks rarely lower collateral requirements for borrowers with strong cash flows or balance sheets. However, collateral requirements may be lower if collateral liquidity is high;
- The actual risk rating model is based on Basel I international standards for risk measurement to determine capital adequacy. It requires transparency of bank financial reports, assignment of risk weights to asset categories and risk ratings for problem loans based on payment delay, financial situation and sufficiency of collateral. However, a more refined approach toward risk assessment is needed. The NBM started the implementation of the Strategy for converting to Basel II and Basel III principles, providing for new approaches to credit, market and operational risks (see section 5.2 “On-Going Reforms Aimed at Facilitation of Access to Finance” below).

63. Banks do not rank borrowers relative to competitors or position of strength or weakness in value chains (VC). However, banks may be incentivized in using such information/industry data in their risk analysis, should such information be more available. This category of information includes:

- Relative financial strength of borrowers compared to borrower competitors (industry studies or profiles).
- Relative positions of borrowers in their VC (knowing a borrower’s position in their VC, the waterfalls of cash, financing between value chain participants, the timing of payments, and the power structure within the VC).
- Success factors to identify resilient and strong borrowers (optimal product quality, packaging, production, sourcing raw materials and supplies, and choices for distribution and sales channels).

Shortage of long term resources

64. Banks are limited in their ability to issue medium and long term loans by National Bank rules which require that the amount of the bank's assets with a maturity of more than 2

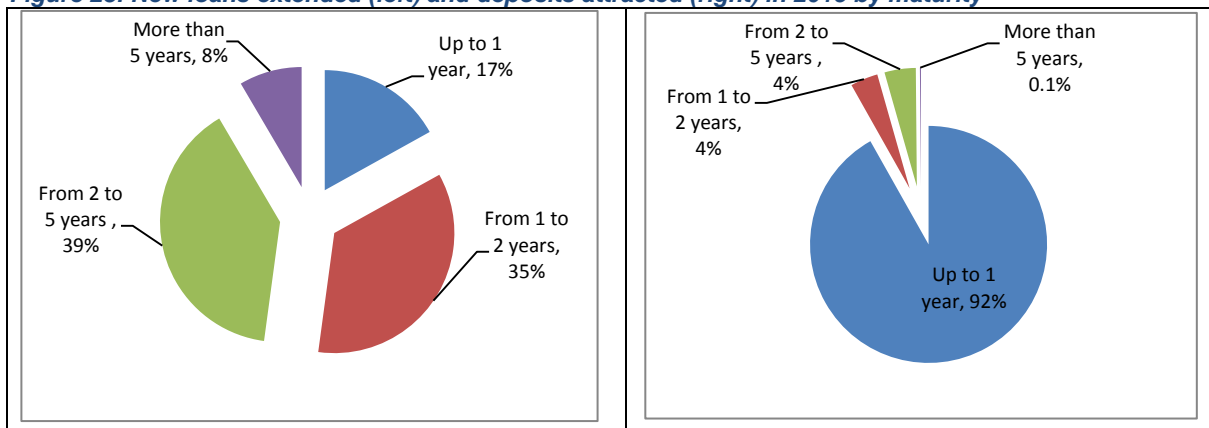
⁵¹ In most developed countries standard business loans are often assigned to 9-14 risk rating categories. Banks decide on total loan portfolio risks and increase loan prices when risk is higher. They manage risks to obtain maximum profits instead of managing to avoid risk.

years does not exceed its resources (Principle I of liquidity or long-term liquidity ratio)⁵². The bank's long-term liquidity (LTL) ratio should not exceed 1. However, it seems that not all banks are actively managing this ratio to increase their ability to lend long term. At the end of 2016 the LTLR for the entire banking sector was 0.64. Only 3 banks had LTLR higher than 0.7. For the rest of banks LTLR ranged from 0.36 to 0.66. Interviewed banks said they would extend loans from own resources without any limitation to eligible clients up to 2 years, while issuance of longer term loans is problematic. Practically this means that banking sector is dependent on own capital and special donor provided funding as the base for their medium and long term lending portfolio. There are also individual credit lines by some IFI with banks, providing mostly long term financing (see development partners' reform efforts section of this study below). However, for reasons of non-transparent ownership and corporate governance problems, most of donors have limited banks' participation in their funding programs, particularly for the 3 largest banks. This reduced substantially the availability of long term financing for business, as the 3 largest banks, as discussed above, account for 80% of all loans by number in the banking sector.

65. Overall, deposits accounted for 75% of all bank liabilities in 2016, being the main source of lending for banks. About 83% of all extended loans granted in 2016 (as value) were with maturities of more than 1 year (39% - from 2-5 years; 35% - from 1-2 years; 8% - more than 5 years). At the same time, depositors choose to place money prevalingly in short time bank deposits – 92% of all new term deposits in 2016 (as value) were up to 1 year. Deposits longer than 5 years made up only 0.1% of all deposits, from 2-5 years – 4%, and from 1-2 years – 4% (figure 23). About 69% of all deposits in 2016 belonged to individuals. The narrow institutional investor base limits the availability of long-term bank deposits. The insurance sector is very small as a share in GDP, while private pension funds are missing. The capital market remains unattractive for investors, so banks do not place bonds on the capital market to raise long-term funds. As for deposits from population, more long term placements with banks are limited by high volatility rates, lack of trust in banks in particular, long-term trust, after a series of recent bank failures and low coverage limit by the deposit guarantee fund – 6,000 MDL (20,000 MDL after 01.01.2018) that cannot guarantee the integrity of bank savings do not increase confidence in banks. Also outreach by banks in rural areas is very low, while rural population accounts for almost 60% of all population.

⁵²The long-term liquidity indicator is the ratio between: the bank's assets with a maturity of more than 2 years and its financial resources. The Bank's assets include: (1) loans and deposits with banks with a maturity of 2 years or more; (2) loans and advances payments to customers with a remaining maturity of up to 2 years or more; (3) financial leasing with a remaining maturity of 2 years or more; (4) ownership interests in the capital of economic agents (including banks); (5) financial assets held to maturity, with a remaining maturity of up to 2 years or more; (6) Fixed assets; (7) minus the write-off for losses on these assets, depreciation of tangible assets and the difference in revaluation of assets. The bank's resources include: (1) the total regulatory capital determined in accordance with the Provision on Weighted Capital; (2) liabilities received from banks and liabilities received from customers (with the exception of savings deposits of individuals) with a remaining period of up to 2 years; (3) 50% of liabilities received from banks and liabilities from customers (with the exception of savings deposits of individuals) with the remaining maturity up to 1 - 2 years; (4) 10% of demand liabilities from customers (with the exception of savings deposits of individuals); (5) Savings deposits of individuals with a remaining maturity of up to 2 years or more; (6) 60% of savings deposits of individuals with the remaining maturity up to 1 - 2 years; (7) 30% of the savings deposits repayable on demand of individuals in sight and the remaining time until maturity of up to one year; (8) bonds in circulation and other securities issued by the bank with a maturity of up to 2 years; (9) 50% of issued securities and other securities issued by the bank with a maturity of up to two years; (10) 60% of the bank's pension reserves.

Figure 23: New loans extended (left) and deposits attracted (right) in 2015 by maturity



Source: NBM.

Complex and lengthy loan application procedures

66. Ability of companies to finance business activities from bank loans is seriously hampered by difficulties in planning and meeting the planned schedules for such financing. According to interviewed representatives of private sector, loan application examination by most banks is unpredictable and extremely lengthy. The process lasts on average 3 months, and in some cases even longer. Even if banks have set time limits (1-2 weeks) for the whole approval process, this doesn't include the time for collecting all the necessary documentation, and relate in fact to the time from the moment the decision has been taken to the actual disbursement of money. Thus, in order not to exceed the time limit set internally for the approval of loan application, some banks ask clients to fill out the loan application only after all the documents have been collected and credit analysis has been made. Most of banks have a two-tier loan approval process. Branches can extend loans within the limits approved by the central office (usually 300-500 thousand MDL). Amounts in excess of these limits have to be approved by the central office. In cases of loans from special donor funds administered by project implementation units (PIU), these often have to be approved also by PIU, which makes the entire application process extremely cumbersome and lengthy. This may discourage many companies from applying for credit. International analysis shows that when SMEs have a choice of various banks in their town or city, they tend to borrow from financially sound banks that have less hierarchical lending procedures.⁵³

67. The documentation package to accompany the loan application include quite a long list of documentation to be collected from different bodies (extract from the Cadaster, confirmations from the state fiscal inspectorate, extract from the state registry of companies, authorization for construction, confirmation of the right to use the land, certificate from department of vehicles registration, consent from the tutorial body, etc.), in addition to the evaluation of collateral, financial documentation, founders' approval of the request for loan, confirmation of managers' powers, transaction proof documentation, etc. Collecting all of the above and other documents greatly delays the approval of loans by banks. Many of the state bodies issuing respective documents don't have electronic registries, or do not recognize electronic signature, therefore paper based documentation is prevalent. In contrast, MFOs have developed a faster approach, often requesting only the confirmation of property right over collateral (for lending to individuals mostly). To avoid enormous delays, many business owners use to take loans from MFOs as individuals, even if these are 30-50% more expensive than bank loans. Client service culture also seems not to be a priority for many banks. Some of the borrowers describe bank branches as LLCs of their managers. Personal relationship with the bank branch director is important to speed up the loan approval process. "Success

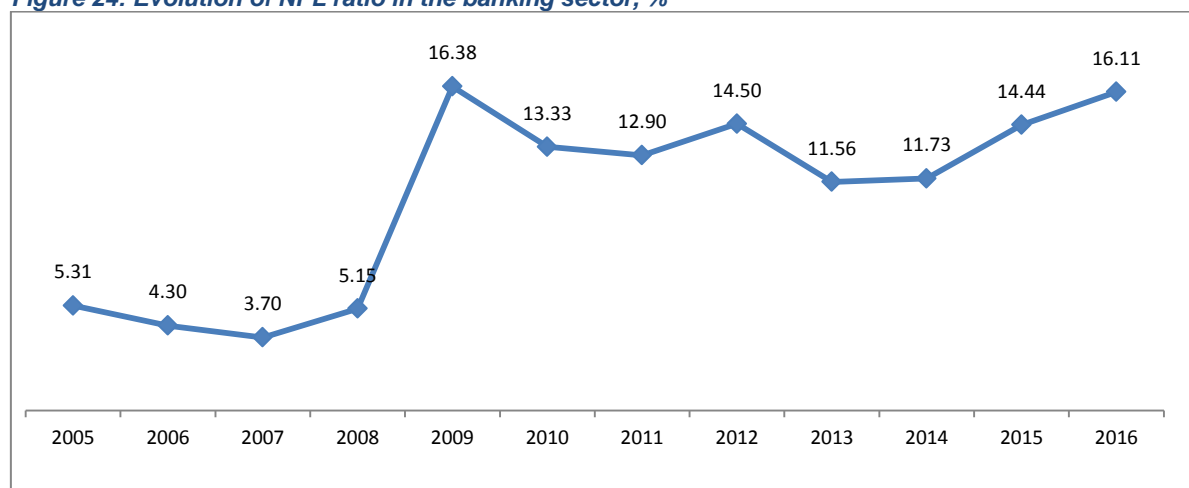
⁵³ EBRD transition report 2015 – 2016.

bonuses” (thank-offerings) for the senior managers also seem to be a widespread practice to smooth the getting of loans. Reportedly, in such cases the examination of the loan dossier may be speeded up to only one-two weeks.

High rate of non-performing loans (NPL)

68. The high rate of NPLs⁵⁴ is another factor that helps to explain low investment levels and restrictive credit practices in an economy. Higher levels of NPLs are associated with weaker growth in domestic credit to the private sector and low investments. Studies show that high NPL levels significantly impact on banks’ lending, economic recovery and ultimately on economic growth, as there is a strong correlation between the level of NPLs and credit/GDP growth. There are two main channels through which NPLs could hold back economic recovery. Firstly, banks burdened with NPLs may be ill-placed to extend new credit. Within banks, the prevalence of NPLs raises funding costs and reduces operational efficiency. Secondly, overextended borrowers face reduced incentives to invest and assets remain under their control rather than being reallocated to more productive users⁵⁵. This pattern is often observed when a financial sector contracts and economic growth stagnates. The problem is exacerbated by uncertainty in the legal frameworks governing restructuring and insolvency, and by constraints in the judiciary. Removing NPLs from the balance sheets of banks and companies could help to reinvigorate credit growth, making more funds available to finance investment.

Figure 24: Evolution of NPL ratio in the banking sector, %



Source: NBM and WB.

69. As figure 24 above shows, NPL ratio in Moldovan banking sector has remained high for the last 7 years. It rose above 16% on the verge of the global financial crises in 2009, however failed to return to the pre-crisis levels in subsequent years, even though years 2010-2011 and 2013 displayed some of the highest economic growth rates in the history of Moldova. As of end June 2016, NPL ratio soared again above 16% (data for 2015 and 2016 don't include the data for the 3 banks under liquidation - BEM, BS and UB). This is quite high in comparison with peer countries and countries in the region (NPL ratio for ECA countries stood at 8.1% in 2015). The prevalence of NPL for such a long time may witness to systemic impediments in enforcing creditors’ rights and insolvency regimes, alongside with the already discussed deteriorated business and macroeconomic conditions. If left unresolved, NPLs can deepen the severity and duration of financial crises, by tying up resources and impeding the funds allocation process, thereby prolonging the economic stagnation⁵⁶. Because of high NPL rates

⁵⁴ Under the NBM Regulation on Classification of Contingent Assets and Contingent Liabilities, NPLs are classified as substandard, dubious and compromised.

⁵⁵ Frank Cmoc, Non-performing loans: addressing legal and regulatory impediments, EBRD.

⁵⁶ David Woo, Two approaches to resolving non-performing assets during financial crises, IMF, 2000.

also (corroborated with the problems of the lack of transparency of ownership and deficient bank corporate governance), many of the banks have been excluded from the funding programs of international donors (IFAD, WB and other), as this is among the eligibility criteria for participating financial institutions.

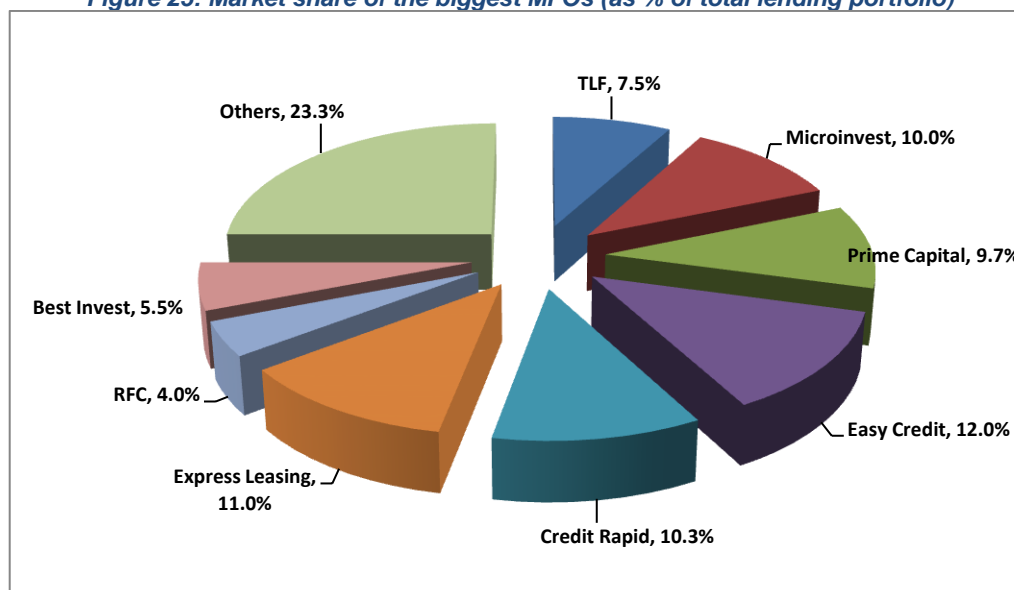
3.2 Microfinance Sector

70. The microfinance sector (MFS) remains the main alternative to the banking sector for many SMEs and individuals in Moldova. Main operators in the sector are microfinance organizations (MFO) and Savings and Credit Associations (SCA). If in 2003 there were only 11 MFOs, by the end of 2016 their number increased to 132. In the same period, the number of SCAs diminished from 405 to 288, indicating that the process of SCA expansion has largely come to an end. The MFS owes its apparition in the late '90s to the financial gap, left by banks in the financing of SME, as well as of individuals, especially in rural areas. MFOs and particularly SCAs went deep into rural regions, bringing basic financial services closer to population. Banks considered these products too small and unprofitable and basically refused to go deep into the market. MFOs emerged from a combination of business and foreign aid initiatives. For example Microinvest and Rural Finance Corporation (RFC), long time the largest two MFOs, have been the result of direct or indirect implication of external donors (Microinvest has been established by Soros Moldova Foundation, while RFC got initial support from the World Bank in 1997). In their turn, SCA also emerged in 1997 from a World Bank rural financing project that initiated the first SCAs in Moldova. In time, many other donors have contributed to the expansion and development of the SCA network.

71. Liberal regulations and high yields have attracted new operators in the MFO sector, many of which with foreign capital. Besides Microinvest and RFC, the other 3 from the top-5 MFOs in lending to microenterprises and SMEs – Prime Capital, Total Leasing & Finance (TLF) and Express Leasing & Microfinance (ELM) are owned by international investors (Prime Capital and ELM by the American group of private equity funds managed by New Century Holdings, TLF – by the Emerging Europe Leasing and Finance B.V. and FMO Bank from Holland). These 5 MFOs account for the largest share of corporate lending in the microfinance sector. Different MFOs pursue various strategies; however the vast majority of them target the consumer credit and mortgage lending segments, and only few of the biggest operators are active in lending to the micro- and SME sectors.

72. The MFO sector is dominated by 8 big MFOs. They account for 72% of total sector's assets and for 70% of the total loan portfolio. These MFOs also account for 76% of the total sector capital and total net profit. Of these - the 5 largest MFOs active in micro- and SME lending, described above, and 3 consumer credit and mortgage MFOs – Easy Credit, Credit Rapid and Best Invest. Moreover, of the corporate lending-oriented MFOs, RFC (and to a smaller extent Microinvest) have initially been conceived to finance SCAs. After the 2009 economic crises, the 2 MFO reduced their loan portfolio exposure to SCAs; however RFC still lends almost 2/3 of its loans to SCAs. Microinvest reduced this exposure to only 4-5% of its portfolio. The market shares by lending amounts of the largest MFOs in 2016 are shown in the figure 25 below. Notwithstanding rapid growth of the sector, its importance for the crediting of micro- and SME sectors is still very limited, though. In 2016, the total loan portfolio of the MFO sector as compared to the banking sector loan portfolio was only 10.9%. If to consider that at least 3/4 of it is consumer and mortgage loans, its role as a potential alternative to bank loans in the AF for micro-companies and SMEs decreases even further.

Figure 25: Market share of the biggest MFOs (as % of total lending portfolio)



Source: NCFM.

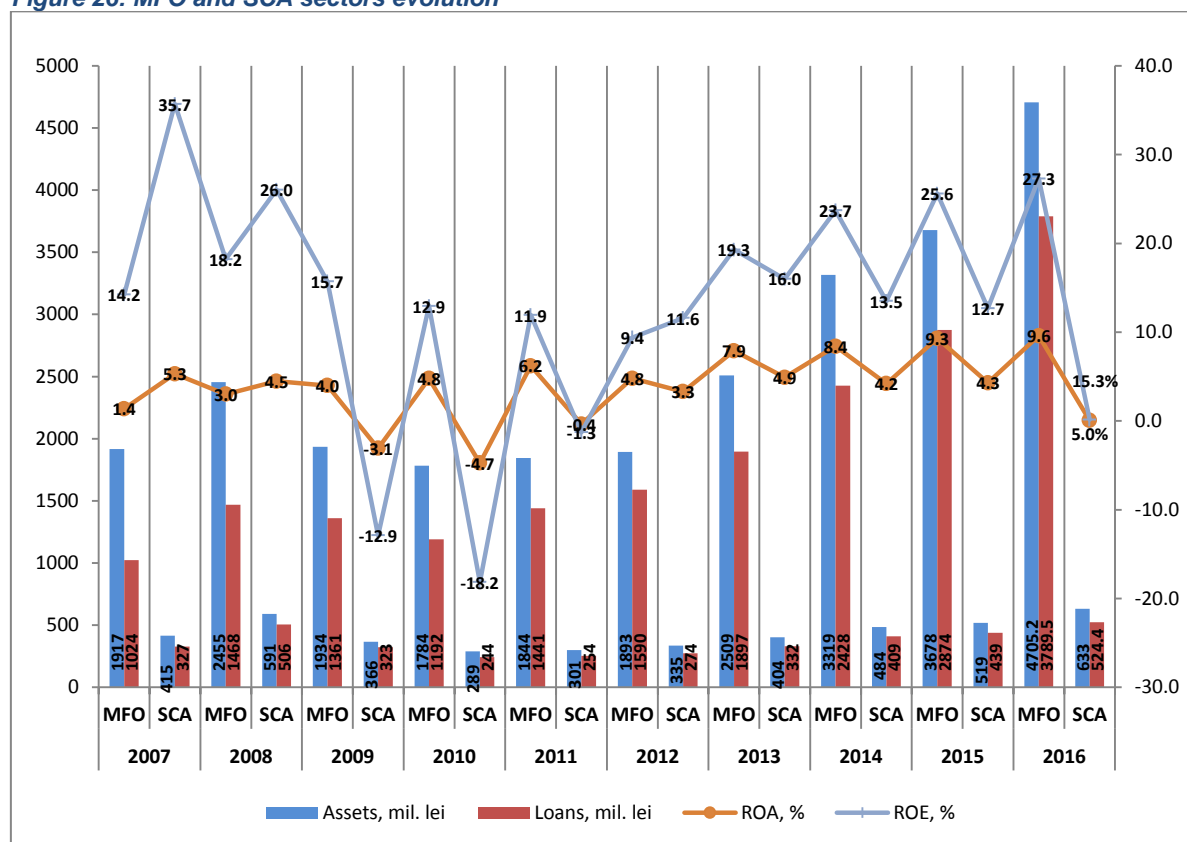
73. The MFO sector displayed an impressive growth not only in terms of the number of registered MFOs. The sector assets increased 2.5 times in 2015 as compared to 2007, while the lending portfolio - almost 3.7 times. Overall, MFOs seem to be highly profitable, and in time their profitability only increased. Average ROA in the MFO sector was 9.6% in 2016, more than seven times higher than in 2007, and ROE was 27.3%, 92% higher than in 2007 (figure 26). Even in years of economic falloffs (2009, 2012), the MFO sector remained overall comfortably profitable. MFOs demonstrated better adaptability to adverse market conditions compared to banks. This is partly due to a more liberal regulation and portfolio diversification. However, data on MFO profitability should be treated with caution. The sector has no regulation, and even though the NCFM introduced common norms in 2012 for loan losses provision determination for fiscal purposes, there are no mandatory requirements as for the auditing of financial reports (for more detailed description of regulation of the MFO sector (see further the regulatory framework chapter).

74. In contrast, SCAs have been severely affected by the economic crises of 2009. Their assets, loan portfolio and ROA surpassed the pre-crises levels only in 2016. It took the SCA sector 2 years to resume growth after the 2009 downfall, but still it displays lower growth rates as compared to the MFO sector (on average 14% a year for both assets and loans in the period from 2011 to 2016, as compared to 18% assets and 21% loans growths for the MFOs). As compared to 2009, the number of SCA borrowers in 2016 decreased by 24% (in the same period the number of MFO borrowers increased 9 fold). The average borrowing for the MFOs decreased from 58 thousand MDL in 2009, to 17.8 thousand MDL in 2016, while for the SCAs increased from 6.5 thousand MDL in 2009 to 13.8 thousand MDL in 2016, reflecting a decrease in the number of borrowers, generally linked to the contraction in the number of active SCAs.

75. Depreciation of MDL however affected the growth rate of the sector. Almost all of the biggest MFOs secure their financing from IFIs or from their international shareholders. They report for management purposes in USD or EUR. Even if in MDL terms the growth of the MFO sector looks impressive, when translated into USD and EUR terms the figures are less remarkable. In 2016, the MFO MDL-denominated loan portfolio grew by 56%, while net profits – by 62%. Given the almost 28% depreciation of MDL as compared to the USD from 2014, the MFO sector loan portfolio increased in the same period almost 22% in USD terms, while net profits – by 27%. In EUR terms the loan portfolio increased less than 42%, while profits increased almost 48%, given the less pronounced MDL depreciation as compared to

the EUR (by 10%). For SCAs, both USD and EUR denominated performance indicators look worse: in USD terms the loan portfolio increased only by 0.1% and net profits by almost 20% in 2016 as compared to 2014, while in EUR terms the growth was 17% and 39% correspondingly.

Figure 26: MFO and SCA sectors evolution

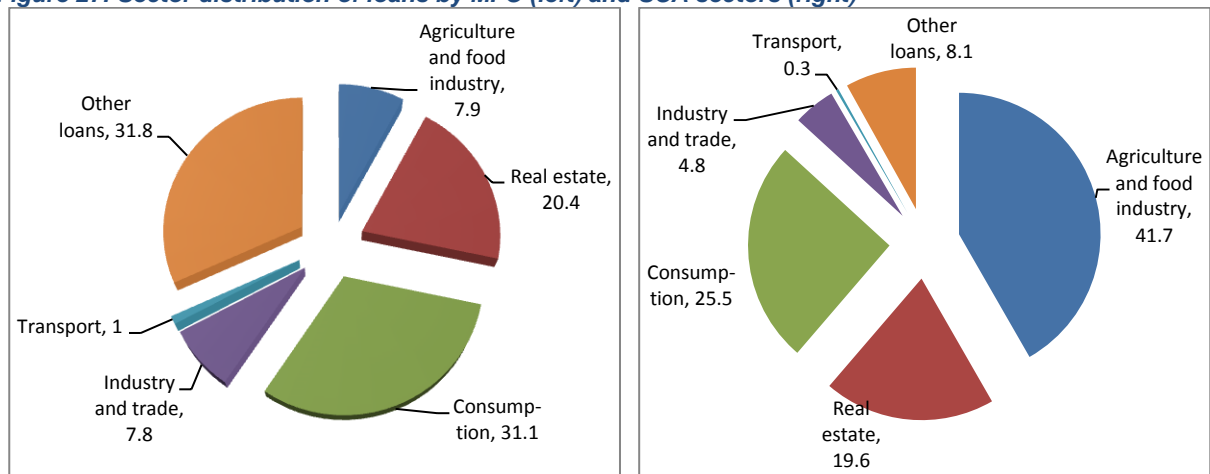


Source: NCFM.

Bias toward consumer and mortgage loans

76. There is no available statistical data as for how much of the MFO and SCA borrowing portfolio goes to “legal persons”, i.e. to entities performing business activities (the NCFM reports don’t provide such information). Indirect assumptions can be made however from sector distributions of loans. Also, data from interviews revealed that business loans hold between 30% and 80% of the total loan portfolios of MFOs active in corporate lending. For the SCA sector it is more difficult to estimate this figure, as many of the SCA individual borrowers are not registered as legal entities, even though they take loans for individual entrepreneurship purposes. Only 7.9% of the 3.8 billion MDL MFO loan portfolio went to the agriculture and food industry in 2016. This figure for the SCA sector is higher (41.7% of the 524 million MDL portfolio), but given the bigger portfolio, the level of agribusiness lending by MFOs is 1.4 times higher than that by SCAs. At the same time, about 83% of the overall MFO and 53% of the SCA sector loans seem to go to individuals (as consumption, real estate and other loans) – figure 27.

Figure 27: Sector distribution of loans by MFO (left) and SCA sectors (right)



Source: Compiled by the author based on the NCFM data.

77. The bias toward consumer and mortgage loans seems to be determined by higher risks perceived by MFOs in lending to micro and small companies (which are primarily determined by constraints described in the private sector constraints chapter of this Study). As the crises of 2009 showed, big MFOs, which credited consumer goods, reported better quality loan portfolios and higher profits. This also discouraged many MFOs from entering the micro- and small enterprise segments in the subsequent years⁵⁷. At the same time, given the high unofficial rate of employment, many natural persons are not eligible for bank loans. This leaves a large market segment uncovered by the bank lending. Also, interviewed MFOs reported that for them it is easier to enforce creditor rights over individual assets, as compared to limited liabilities companies, which can be legally kept liable for their debts (when collateral proves not sufficient to recover debts in full) within the limit of their equity that is often a few thousand MDL.

Limited managerial abilities of SCAs and operational possibilities of both SCA and MFO

78. About 94% of loans by SCAs are unsecured; however this fact doesn't seem to have a negative impact on the quality of the loan portfolio, the rate of non-performing loans being only 4.4% of the total loan portfolio at the end of 2016. However, this may not disguise the fact that at the end of 2009 the portfolio at risk (PR) level was more than 21%, and large portions of them had to be written-off in 2010. In 2007-2008 SCAs exhibited high expansion rates (with loan portfolio growing almost 50% a year). Weak risk management capacities of SCAs, limited abilities and experience in crediting, as well as instruments for mitigating risks as compared to the banking and MFO sectors, determined worse quality of the SCA lending portfolio. There were also numerous cases of frauds from managers and chief accountants, poor risk management practices and non-observance of prudential norms. The 2009 crises revealed all these weaknesses. In their turn, creditors raised standards for SCA crediting, while others (notably Microinvest and banks) reduced or excluded altogether exposures to SCAs, limiting their possibilities to secure financing.

79. SCAs operate in limited geographical (usually rural) areas and are exposed to concentration risks, with limited possibilities for geographical or sector diversification. High exposure to agriculture sector also makes them vulnerable to increased volatility of incomes and earnings in agriculture and dependency often on one value chain. Almost all SCAs lack effective internal control mechanisms, including audit systems, while credit information (delivered by the CHB), is available so far only to 13 them, which limits the ability of many SCA to avoid over-indebtedness of borrowers.

⁵⁷ Studiul de evaluare a pieței de micro-finantare în Republica Moldova, BFC, 2010.

80. Even if MFOs and SCAs are faster and more flexible in lending to microenterprises than banks, they are limited in their ability to offer a more complete range of services to their clients. From an international perspective, SCAs in Moldova are very small. A study in 2010 of the microfinance sector concluded that even though Moldova contributed in 2009 with 16.3% to the total number of Credit Unions in Europe, its share in the total assets was only 0.1%⁵⁸. Loans are main financial products supplied by SCAs and MFOs. In the case of SCAs, these are very simple products. The initial purpose of SCAs was to bring basic financial services (savings and loans) closer to rural population and small farmers, and these were not designed to provide other services. MFOs and SCAs are not part of payment systems, therefore payment services are provided through banks, which make them more expensive. Also, once clients grow up, they require more sophisticated financial products, which MFOs and SCAs cannot provide (letters of credit, credit cards, online banking, etc.).

Short maturities of lending by the non-bank crediting sector

81. Only 17.8% of the loan portfolio by MFOs in 2016 had a maturity of over 5 years, 44.4% were with maturities between 1 and 5 years, while 37.8% - up to 1 year. Loan maturities by SCAs are even shorter. In 2016, only 31.7% of the loans extended by SCAs were with maturities longer than 1 year, with the rest with maturities up to 1 year (a more detailed statistics on loan maturities for SCAs, as well as for MFOs, is not available in the NCFM reports). But given that deposits with SCAs with maturity longer than 5 years account for only 0.1% of total deposits, one can conclude that long term financing by SCAs is even scarcer. At the same time, given their higher interest rates, SCA loans are predominantly sought for short term, and in their actual form SCA don't represent an alternative for long term financing. As in the case of banks, long term loans in the microfinance sector are available mainly from funds of IFIs, CLD, or international shareholders of MFOs.

82. The maturity of loans by MFOs and SCAs derive from maturities of their funds. However, the possibilities of MFOs to provide long term financing to the clients is limited not only by their ability to negotiate long term maturities for the funds from IFIs, but also by exogenous factors. According to interviewed MFO representatives, securing longer than 3-5 years funds from international IFIs and investors is problematic, given the worsened risk profile associated with the country and with the MFOs themselves, as these are neither regulated nor supervised. At the same time, internal resources, provided mostly by banks, are predominantly short term. The same is valid for the SCAs. In their turn, deposits collected by SCAs (with B license) are also prevalingly up to 1 year. For example in 2016 more than 75% of deposits by SCAs were up to 1 year, 21,7% - from 1 to 3 years, 2,7% - from 3 to 5 years, and only 0.1% - more than 5 years.

Dependence on external borrowings, high cost of resources and loans

83. At an international comparison, MFOs and SCAs in Moldova are more dependent on external financing. The main sources of funds for MFOs are borrowings from IFIs and bank loans. MFOs are not allowed by law to collect deposits, and from this perspective they are in a more disadvantageous position than banks, considering that deposits are the most constant, and often the cheapest source of funds for lending. Most important, deposits in MDL allow avoiding exchange rate risks. Theoretically, another source of funding would be the capital market, however in practice this doesn't work, as the capital market is underdeveloped. SCAs derive their funds mainly from member deposits and borrowing from MFOs, banks and IFIs (IFAD, CLD, etc.). However, only SCAs holding B and C licenses have the right to attract deposits (but practically, only B licensed SCAs, as no C license for SCA have been issued so far). Deposits financed only 59% of SCA assets in 2016, which is below the recommended by the World Council of Credit Unions (WOCCU) level (70-80%). Correspondingly, received

⁵⁸ Studiul de evaluare a pieței de micro-finantare în Republica Moldova, BFC, 2010.

loans and borrowings were 2 times higher than the WOCCU recommended level (5%), amounting to 11,3% of total assets of SCAs (B licensed) in 2016. At the same time, capitalization of both SCA and MFO is at good level in international comparison, which is not however sufficient to attract more borrowings to finance increased loan demand from members. The debt to capital ratio for the MFO sector was 1.7 in 2016, much is below the maximal 5.5 level recommended by international practices.

84. High cost of resources and operational costs make loans both of MFOs and SCAs more expensive as compared to loans offered by banks. Risks associated with the MFO and SCA sectors are perceived higher than for the bank sector by IFIs, therefore these lend to MFOs and SCAs at higher interest rates than for banks. The worsening of the situation in the banking sector increased costs of international funding not only for banks, but also for the microfinance sector. According to some MFOs, the cost of international resources for them after the banking crises increased with 1.5-2.5 percentage points. Given the smaller scale of crediting, administrative and operational cost are also higher. SCA's overheads as compared to assets in 2016 were 11%, much higher than the recommended by WOCCU level (5%). Also, SCAs offer higher interest rates for deposits than banks, because of difficulties in getting external financing and more expensive interest rates for borrowings they are able to secure. Interest rates for loans are directly influenced by the cost of funds. Usually, SCAs and MFOs add a 4%-7% margin to the cost of resources to cover operational costs and risks. In case of MFOs, clients also bear exchange rate risks, as most of the resources are in foreign currencies.

3.3 Leasing Sector

85. The leasing market in Moldova is still at an incipient stage. The first leasing companies appeared only in 2002, and there were about 26 leasing companies at the end of 2016, reporting to the NBS. The total number of leasing companies is not known, as these are not regulated, nor supervised. Leasing could be an attractive option for many businesses in Moldova that need medium and long term financing to purchase productive assets, including agriculture. Reasons for businesses to apply for financing to leasing companies include: a) excessive bureaucracy in collecting the necessary documentation and long credit evaluation procedures in banks; b) high collateral requirements by banks; c) requirement to transfer all banking transaction to the institution that holds the loan; and d) limitations for bank lending to a particular sector in accordance with the NBM regulations. Under appropriate conditions leasing can effectively address these constraints to traditional bank loans for purchasing medium and long term assets

86. Total leasing portfolio in 2016 amounted to 1.23 billion MDL, however it is focused primarily on vehicles financing (88,1%), because of the existence of an apparent liquid secondary market in comparison with other types of assets. Equipment purchase through leasing schemes is limited to only 7,2% of the total leasing portfolio, with the remaining 4.5% in buildings and other assets leasing. Agriculture leasing, in turn, is limited to tractors and combines and a very few long-term agricultural medium size investments⁵⁹. Almost 46% of the total leasing portfolio is for a period of up to 3 years. Sales in leasing for more than 5 years is limited to only 7% of the total, with the remaining almost 47% between 3 and 5 years. Almost 55% of the clients of leasing companies are legal entities, and 45% - natural persons. As showed by figure 10, leasing is the third financing option in Moldova, after bank and MFO loans. Regional outreach of leasing financing is also limited, as more than 75% of the leasing portfolio is concentrated in Chisinau. However, statistical data about the leasing market is not very accurate. Some of the banks, as well as microfinance companies, have leasing in their

⁵⁹ Constraints to Agriculture Finance in Moldova, draft report, MCC, 2009.

loan portfolios. No separate statistics for the leasing portfolios of such banks and MFOs is available, however.

87. The Moldovan leasing market has not reached its full potential and is still growing. As in the case of MFOs, liberal regulations and high profit margins attracted foreign investments in the sector. Many leasing companies, among which the biggest companies on the market - Total Leasing&Finance, BT-Leasing, Raiffeisen Leasing, IMC Leasing, Top Leasing - have foreign owners (most notably IFIs and investment companies). Affiliation with foreign financial and investment groups gives them obvious advantages. These companies have easier access to cheap resources of their founders and to credit lines of other financial institutions, thanks to the reputation of the affiliated foreign groups. Secondly, these leasing companies benefit from leasing experience, standardized products, marketing techniques, etc. from their parent companies.

88. However, according to the interviewed leasing companies' managers, high risk profile of the country deprive these companies of their main competitive advantage – access to cheaper and longer term funds. IFIs charge high interest margins, which are ultimately passed on to the clients. Also, the maturity of funds provided by IFIs is usually limited to 3 years, mainly because of the same country high risk concerns. Compared to neighbor countries, leasing in Moldova is much shorter (according to interviewed companies, in Romania the average for the equipment leasing is 8-10 years). Leasing companies are thus restrained in their ability to conclude longer term leasing agreements, given the need to be within the time limits of their resources. Dependence on expensive resources makes leasing also an expensive financing option for businesses. Leasing companies charge 10.5%-12.5% nominal interest rates in foreign currencies (EUR or USD), with effective rates higher by 3.5-4.5% (front end fees, insurance, early payment fees, etc.). Effective payments are made in MDL, so clients bear supplementary the exchange rate risk, extremely volatile in the last years.

89. Another group is formed by leasing companies affiliated with banks - MAIB-Leasing, Euroleasing, BS-Leasing Grup. These were among the first on the market, and the rationale behind them was diversification, decentralization of portfolios and minimization of risks by banks. They explore competitive advantages by using banks' resources, but generally do not price their leasing products lower than the non-bank leasing companies. A third group is formed by leasing companies affiliated to other local financial groups or companies (motor vehicles or equipment dealers). These companies rely mainly on banks to provide capital at general market interest rates. Leasing companies pass this cost on to their customers by charging even higher interest rates. The market in 2016 was dominated by 5 leasing companies, which held together 78% of the market: BT Leasing MD, Total Leasing, Capital Leasing, Finance Leasing Company and Raiffeisen Leasing.

90. The lack of sufficient resources at low cost for Moldovan leasing companies remains one of the major constraints to further expansion of leasing products to the agribusiness and related sectors. Most leasing companies (not affiliated to IFIs) secure their resources from bank loans at market prices, which, as already stated, increase substantially the cost for lessees. As the leasing sector is not regulated, there are no requirements as for the minimal capital for leasing companies. The provision of sufficient capital and resources for the leasing company depends solely on the financial potential of founders, as well as on the management's ability to borrow from bank or secure funds from IFIs in Moldova or abroad. The amendments to the leasing Law, proposed by the NCFM provide for the obligatory minimal capital of leasing companies (240 thousand MDL), however this will not have an impact on the level of capitalization of leasing companies, as most of the existing companies have already much higher equities.

91. Besides high costs and relative short maturities, another constraint to the expansion of the leasing market in Moldova is the need for down payments. Although the advantage of leasing for agriculture equipment purchase financing is evident (no need for full straight

payment and collateral, lower processing expenses, faster delivery times), the requirement for substantial down payments of up to the 35% (required by leasing companies to secure the lease and cover the non-payment risk by clients) still excludes farmers and agribusiness companies which need to take loans from banks or MFOs to finance the down payment (with all the related disadvantages and costs).

92. The growth of leasing financing in developed economies has been largely in the form of operational leasing, where the leasing company retains ownership of the assets throughout the period of the lease and usually takes responsibility for the equipment maintenance and repair. Operational leasing, due to the lack of collateralization and need of cash advances, would represent a suitable alternative source of long term financing for agriculture equipment. However, to date operational leasing is not available in Moldova. Establishing agriculturally oriented operational leasing would require the creation of a liquid secondary market for specialized agricultural equipment through buy-back agreement with dealers and the creation of technical centers for support and service. The market potential for such operations is perceived as limited and therefore no concrete steps have been taken to develop operational leasing⁶⁰. At least 2 leasing companies (Optima leasing and Industrial Access) tried to start operational leasing operations in Moldova, but had to abandon the intention, because of limited demand and high operational costs⁶¹.

93. Currently all leases are financial leases. The leased item appears on the lessee's balance sheet and the lessees deduct depreciation from their taxes. The ultimate owner of the equipment is the lessee but the nominal owner is the lessor until the lease is paid in full. The lack of a sufficiently developed secondary market for the leased equipment is a constraint not only for the operational leasing, but also to the development of financial leasing – lessors consider leasing equipment that don't have a liquid secondary market too risky (if lessees don't pay and leasing companies take back the equipment, they have to look for clients on the secondary market). Similarly, this is a constraint for the faster expansion of lending and the reduction of NPC in the banking and microfinance sectors, notably in the area of lending to agriculture (see Section 2.3 "Access to Finance in Agriculture").

94. The bias towards car-leasing can be explained not only by the existence of a liquid secondary market, but also by the unfavorable VAT regime for the leasing of equipment and machinery. Due to the fact that the transfer of an asset in (financial) leasing from the lessor is not equivalent with transfer of ownership rights for the same asset, before the full debt is repaid, according to the current fiscal rules, the above transaction is documented by a simple invoice (without VAT) and respectively the lessee does not benefit from the transfer of VAT on his account. The transfer of VAT takes place only based on the invoice received from the lessor when the ownership on the assets takes place (when the debt is repaid in full, according to the leasing agreement). On the other hand, if clients finance the same purchase of machinery through bank loans, then VAT paid is subtracted in full. Although this is not the case for some agricultural equipment (tractors, harvesters, irrigation equipment are exempted from VAT), non-agricultural, as well as some agricultural equipment is subject to full VAT payment. Also, the actual fiscal regime allows for VAT exemption for fixed assets included in the company's statutory capital (equity). Companies purchasing equipment in leasing cannot benefit from the respective fiscal incentive.

95. Moreover, purchase of equipment financed from means on international credit lines (provided mostly to banks by IFAD, the WB and other IFIs) are exempted from VAT and sometimes from custom fees. Therefore, there is little incentive for companies to buy equipment from leasing companies, and often from bank loans outside the schemes of international credit lines. However, leasing companies do not benefit from funding from IFIs

⁶⁰ Constraints to Agriculture Finance in Moldova, draft report, MCC, 2009.

⁶¹ De ce în Moldova nu se dezvoltă leasingul operațional?/ Capital Market, no.32 (552), August 20, 2014.

on concessional terms (there are however few exception – BT Leasing benefiting now from the EBRD credit lines, and few other such examples in the past). Also, because leasing companies usually don't benefit from financing from institutional IFIs, they have also fewer long term resources, in comparison to banks that have easier access to such funds.

96. Furthermore, the subvention law doesn't create a level playing field for all the crediting institutions. While clients financing their investments from banks (or other credit institutions) can benefit from state subsidies, companies purchasing the equipment from leasing companies can apply for subsidies only after he leased equipment is paid in full (after 3-5 years)⁶². As state subvention priorities and conditions may differ each year, as well as taking into consideration MDL depreciation, agricultural companies relying on state subsidies to finance investments, never consider purchasing equipment in leasing, and instead apply for bank loans or other forms of lending. Another example of different level playing fields for leasing companies and other lending institutions (banks and MFOs) is the regime of provisions deduction for tax purposes. Leasing companies may deduct provisions for losses from income for tax purposes only up to 5% of the average annual outstanding leasing portfolio. Presumptively, such a provision has been set to prevent tax evasion from leasing and other general finance companies.

97. Leasing companies are carefully evaluating the ability of their clients to pay leasing installments. The reason is that in the case of non-payment it takes sometimes between 1 and 2 years to collect the leased item from clients. In the meantime, the equipment depreciates morally or can be deteriorated (if the insurance expires, the company cannot claim recovery from the insurance company), and often even if the leasing company gains repossession of the equipment, its value decreases significantly. There are 2 ways the leasing company can exert its right of possession over the leased equipment, in cases when clients fail to pay. The first is through *the simplified procedure (ordinance)*. After 1 month of delay of payment, the lessor may proceed by writ in simplified procedure. The court, based on evidence provided by the lessor, may issue an ordinance.. However, it can be cancelled by the court, if the lessee submits objections against the ordinance. In practice, courts often cancel ordinances, even in cases of formal complaints. The second modality is through *court proceedings (judicial dispute)*. But lessees may use formal appeals to delay the process. If the motivation for the appeal is the reorganization (modification of the legal status of the lessee), the proceedings can last for 2-3 years. According to leasing companies, legislation is favorable to lessees, so that lessors cannot abuse of their position in relation with the lessees. If the leasing company cannot rely that it would get repossession in 2-3 months, it would be more selective and restrictive in respect to the potential clients. To minimize potential losses, leasing companies require higher down payments or charge higher interest rate, which in both cases limit access to leasing financing for potential clients.

98. The fact that there are no public⁶³ reporting requirements and supervision over the leasing market limits not only the possibilities of outside observers to analyze tendencies and evolutions on the market, but also is a constraint for the players of the market themselves. These cannot compare their performance to that of the competitors, cannot appreciate the level of provisioning of other leasing companies, and cannot estimate risks accordingly. The regulation and supervision of the market, envisaged by the amendments to the leasing law by NCFM is generally welcome by leasing companies. These don't perceive any threats coming from new law regulations.

⁶² Until the adoption of the new subsidy Law (no. 276 of 16.12.2016), of the same right could also benefit those funded through the Unit for the Implementation and Administration of the agricultural Production Growth Project (2KR).

⁶³ Except for aggregated sectoral situations published by the NBS once a year.

3.4. Findings / Summary of constraints

99. The banking, microfinance and leasing sectors represent the main source of financing for business in Moldova. However the conditions of the banking sector worsened considerably in the last years, limiting substantially the AF for the bank clients. Microfinance organization, saving and credit association and leasing sectors, in spite of their growth, have still a limited role in providing funding to businesses and don't represent yet a viable alternative to bank loans. Main constraints identified in the provision of lending by credit institutions are summarized below:

- Bank intermediation is limited by the lack of trust in banks, shallow economic activity in the country and rudimentary stage of development of the banking system. Volatile macroeconomic environment (including high interest rates for governmental bonds and erratic exchange rates) allow banks to earn hefty profits on the governmental bond and currency exchange markets and create little incentive for them to go down the market to meet the needs of smaller business, develop financial products or improve lending practices. This also limits competition and reinforces tendency to adopt conservative policies.
- The banking sector is extremely concentrated, with the largest 5 banks accounting for 92% of all loans by number while the largest 3 – for 80%. This limits competition with all of the negative consequences of this phenomenon (high interest rates, preservation of conservative practice, including in collateral evaluation, lack of incentives to expand lending, etc.). Also, it poses substantial risks for the stability of the banking and entire financial sectors, given the opaque ownership structure of Moldovan banks and possible hidden interconnections and affiliations. High concentration also excludes most of micro and small companies from the area of interest of banks.
- In comparison with countries in the region, the Moldovan banking sector has a low level of strategic foreign investments. This limits not only competition, but also the implementation of new technologies, more advanced expertise, products and healthy lending and banking practices. While small size of the market is an objective reason for the low penetration of strategic foreign investors, opaque bank ownership structures and vested interests at high level also seem to impede more inflow of strategic foreign investments into the banking sector.
- Low ownership transparency in banks and poor corporate governance practices create substantial risks for the entire financial sector and undermines confidence of potential outside investors, lenders and depositors. The recent failure of 3 banks (BEM, BS and UB) on reason of poor governance and opaque ownership (along with other reasons, described in the chapters below) substantially deteriorated financing conditions of the country and undermined macroeconomic stability. Ownership and corporate governance problems determined donors to exclude the largest banks from their funding programs, which substantially limited the access to long term and cheaper financing for about 80% of bank borrowers.
- Collateral evaluation and lending practices based on high or very high collateral loan ratios by banks translate into inability of businesses to obtain enough credit. This is also a consequence of lack of sufficiently liquid secondary markets for a large part of machinery, equipment and other items offered as collateral. Because of high reliance of banks on collateral and obscure valuation methods and practices, clients are constrained in their ability to plan and obtain financing and incur high costs connected to the valuation and registration of collateral.
- Banks usually manage to avoid risks, instead of managing risks to obtain profits. This is both a result of rigid regulations and inadequate risk evaluation practices.

Many banks perceive loan decisions more as an art and make minimal use of quantified risk measurements. As result, banks often over-estimate risks by using worst case scenarios, compounding independent risks, and failing to calculate off-setting risk factors. There is also limited analysis of borrowers relative to competitors or position of strength or weaknesses in the value chain. This also results in over-estimation of risks, conducting to strenuous collateral requirements and higher interest rates.

- Banks are limited in their ability to extend long term loans both by the regulator's rules and the shortage of long term resources. In 2016 most of deposits with banks (92%), constituting their main resource base was short term (up to 1 year). The narrow institutional investor base and underdevelopment of the capital and insurance markets limits the availability of longer term resources. Volatility of the macroeconomic environment and small coverage limit by the deposit guarantee fund (the actual, of 6,000 MDL as well as the increased one up to 20,000 MDL, starting from 01.01.2018) also limit long term placements with banks from population and businesses.
- Complex and lengthy loan application formalities applied by banks hamper the ability of companies to plan and obtain financing and meet agreed schedules that also incur additional costs to them. Client service culture doesn't seem to be a priority for many banks and state institutions issuing confirmation acts. Getting a loan may last up to 3 months or more, involving physical visits to many institutions and encouraging corruption in order to speed up the issuance of documents. In the case of lending from donor funds, loan applications often have to be approved by the PIU, which complicates the process of reviewing and approving the application. Much of the loan portfolios of consumer credit MFOs may disguise in fact loans to businesses, to avoid delays in getting loans from banks. High NPL rates don't allow for decreasing of funding costs, reduce operational efficiency of banks and hamper reallocation of resources for new investment projects, limiting credit growth.
- High NPL rates do not allow for diminishing financing costs, reducing the operational efficiency of banks and preventing the redistribution of resources for new investment projects, limiting credit expansion. This issue is exacerbated by the uncertainty in the legal framework governing reorganization and insolvency, as well as by the constraints in the judicial system.
- Despite its relatively fast growth, the microfinance sector doesn't represent yet a viable alternative to bank lending for businesses and particularly for agricultural companies. Estimative, 83% of all MFO and 53% of SCA lending is for individual sector. Agriculture makes up 8% and 42% of the overall MFO and SCA loan portfolios, which are respectively only 10.9% and 1.5% of the bank loan portfolio. The role of the SCAs is limited mainly to restrained geographical areas in which these are licensed to operate. At the same time, business loans are concentrated mainly in few big MFOs. The bias toward consumer and mortgage loans of the microfinance sector seems to be determined by the large client base not covered by banks (unofficial employed or not corresponding to rigid bank criteria), higher risk perceived in relation to business lending and easies creditor rights enforcement.
- Even if MFOs and SCAs are faster and more flexible in lending to microenterprises than banks, they are limited in their ability to offer a more complete range of services to their clients (payments, letter of credits, cards, etc.) which prevents their expansion into the corporate sector. At the same time, SCAs are restrained not only by the confined geographical area, but also by the weaker risk management and lending abilities and expertise of their management, as well as limited instruments and possibilities for mitigating risks as compared to the banking and MFO sectors.

- MFOs and SCAs are more limited than banks in their ability to provide long term financing for business. MFOs are not allowed to collect deposits, do not have requirement as for the obligatory minimal capital, relying mainly on private equity, lines of credit from their founders and IFIs, which in their turn are rarely above 3-5 years, given the high risk profile of the country. As for the SCAs, only those who holding category B and C license can practically collect deposits, however these are predominantly short time (68% up to 1 year) and are used to finance 59% of all SCA assets. To finance the rest of the assets, SCAs have to seek financing from MFOs and banks, which are also short time.
- MFO and SCA loans are more expensive (by 30-50%) than bank loans, which also limit their outreach. This comes from higher administrative and operational costs, as well as from the more expansive resource base, given the inaccessibility of deposits for the MFOs and many SCAs, lower capitalization than banks and respectively higher reliance on borrowings from other institutional lenders. In case of MFOs, most of the resources are also in foreign currencies, which given high volatility of exchange rates, places additional significant costs on clients.
- Statistically, leasing is the third financing option in Moldova, after the banking and MFO sectors. However 88% of it is concentrated in vehicle leasing. Expansion of leasing into other market segments (and particularly into the agricultural equipment one) is limited primarily by the absence of liquid secondary markets for such assets. The absence of liquid secondary markets is also a challenge for faster credit expansion in the MFO and SCA sectors, but also in the banking sector, especially in terms of agricultural lending.
- As in the case of banks and microfinance sector, leasing is predominantly short term (up to 3 years) and medium term (3-5 years), given the shortage of longer term resources. Regional outreach is also very concentrated, with 75% of the overall leasing portfolio in Chisinau, given stronger demand and closeness to active secondary markets. The deficit of resources at low cost, and prevalence of funding in foreign currencies also makes lease an expansive financing alternative for businesses.
- The bias towards vehicle leasing is determined also by the unfavorable VAT regime for the leasing of machinery and equipment and for assets included in the statutory capital. Also, concessional credit lines that banks benefit from IFIs allow clients to purchase goods and equipment VAT free, which make acquisition of the same items on lease terms less attractive. Furthermore, the subvention Law doesn't create a level playing field for leasing companies. Clients purchasing equipment in leasing cannot generally claim state subsidies, which prevent agricultural businesses from seeking financing from leasing companies.
- The regime for the deduction of provisions from the tax base and for the enforcement of claims also doesn't create a playing level field for leasing companies. These are limited in their ability to deduct provisions for tax purposes only up to 5% of their average annual outstanding leasing portfolio, while executive titles issued at request of leasing companies are often formally appealed in courts. This makes repossession of leased assets complicated and lengthy, and increases losses incurred by leasing companies. To prevent and limit such losses, leasing companies require high down payments, which reduce the attractiveness of leasing for potential clients.

4. REGULATORY FRAMEWORK AND FINANCIAL INFRASTRUCTURE

4.1 Regulatory Framework

100. The key legal instruments comprising the framework for access to finance includes, but are not limited to: Law of financial institutions no. 550 of 21.07.1995, Law no. 548-XIII on the National Bank of Moldova of 21.07.1995, Law no. 192-XIV of 12.11.1998 on the National Commission for the Financial Market, Law on Pledge no. 449-XV of 30.07.2001, Regulation on the Registry of real movable guarantees no. 210 of 26.02.2016, Law no. 280-XV of 22.07.2004 on microfinance organizations, Law on savings and credit associations no. 139-XVI of 21.06.2007, Leasing Law no. 59-XVI of 28.04.2005, Law on Credit History Bureaus no. 122-XVI of 29.05.2008, Mortgage Law no. 142 of 26.06.2008, Insolvency Law no. 149 of 29.06.2012, Law on capital market no. 171 of 11.07.2012, Law on joint stock companies no. 1134 of 02.04.1997, Law on limited liability companies no. 135 of 14.06.2007, Civil Code no. 1107 of 06.06.2002, Law on state registration of legal entities and individual entrepreneurs no. 220 of 19.10.2007, NBM and NCFM regulations.

101. The regulatory functions in Moldova in respect to the bank and non-bank financial sectors are exerted by two independent, by law, regulatory and supervisory bodies. The National Bank of Moldova is responsible for regulating and prudential supervising the banking sector, and the National Commission for Financial Markets is in charge for regulating, supervising or, as the case may be, monitoring the financial non-bank organizations: microfinance organizations (MFO), savings and credit associations (SCA), the credit history bureaus (CHB), mortgage credit organizations, insurance companies, private pension funds, etc. The NBM regulates and supervises the banking sector, and defines the national monetary and exchange policies. The bank regulatory system norms are in line with or – concerning capital adequacy and loan provisions – even stricter than the Basle I prudential norms. Among the most rigorous requirements are: the obligatory capital adequacy ratio of 16% (in contrast to 8% Basel norms), and loan provisioning rates on a gross loan basis without taking into consideration loan collateral⁶⁴. The latter is stricter than IFRS norms, but necessary because of the difficulties of valuing and realizing collateral in a fuzzy business environment⁶⁵. MFOs' and leasing companies are still not supervised, although there are legal initiatives to bring them under the NCFM supervision (see further below).

102. The IMF Financial System Stability Assessment (FSAA) in 2005 (based on FSAP 2004) mentioned that the NBM Law and the Law of Financial Institution were particularly well-drafted, sound, and in most respects in harmony with modern central banking law practices. These laws established operational independence of the NBM, while banking supervision and internal governance rules were assessed as “mostly appropriate”, and the NBM had adequate powers to deal with banks in distress⁶⁶. The only significant deficiencies noticed then were the lack of immunity for the NBM staff from suit and uneven implementation and enforcement of the applicable laws. This was largely attributed to limited and inadequate resources, excessive bureaucracy, state intervention, and a relatively low level of respect for the rule of law. Opaque ownership of both banks and their clients, the near-absence of fit-and-proper strategic investors, pressure associated with large inflow of

⁶⁴ Except for the governmental or NBM bonds, governmental guarantees, deposits with lender bank and other securities provided by the NBM regulation on large loans, which are recognized as diminishing the net bank loan exposure.

⁶⁵ Gábor Hunya, Jan Mládek and Josef Pöschl: Private Sector and Financial Markets Development in the Republic of Moldova, the Vienna Institute for International Economic Studies (WIIW), 2008.

⁶⁶ Moldova Financial System Stability Assessment, the IMF, February 2005.

workers' remittances, significant exchange rate volatility and high inflation were among main serious structural weaknesses revealed for the financial sector.

103. Since then, several changes have been made to the legal and regulatory environment for the AF, intended mainly to strengthen the framework for creditors' rights: the adoption of the mortgage Law in 2008 and out-of-court enforcement of claims for mortgages in 2012. Also in 2012 creditor rights were strengthened by introducing additional reasons for relief from automatic stay (insolvency Law). The legal framework for collateral was amended in 2014, aiming to facilitate the use of movable collateral and align it with the EU legislation. Despite these improvements, the enforcement of creditors' rights is still subject to lengthy and unpredictable court proceedings (see the "Creditor Rights and Secured Transactions" in Section 4.2. "Financial Infrastructure" below). Risk management infrastructure has been enhanced by the launching in 2011 of the first credit bureau. Banks have now more possibilities to provide credit without collateral requirements. Since 2012, the NBM has increased the limits of uncollateralized loans that banks can extend, by making a provision of 5% of the loan amount, from 30 thousand MDL to 100 thousand MDL for consumer loans, and from 100 thousand to 500 thousand MDL for business loans. However, as already discussed above in this Study, banks don't make use of these opportunities very readily. Little changed though to address structural weaknesses of the financial sector revealed already in 2005 until the outburst of the banking crises in 2014-2015.

104. More shortcomings stemming from institutional and enforcement weaknesses have been revealed since 2005 by a series of takeovers of bank stakes and interferences of the judiciary, limiting the power of regulators to effectively exert their functions. These events brought to the forefront the issues of independence and authority of the NBM and NCFM to effectively regulate and supervise the bank and non-bank financial sectors, the non-transparency of bank shareholders, as well as governance problems in banks - issues that dominate the agenda until now. In December 2012 the Constitutional Court (CC) issued a ruling allowing any court to suspend the NCFM's decisions, and a number of NCFM regulatory decisions have been suspended. A similar CC ruling on October 1, 2013 impeded the NBM's powers to effectively carry out its functions. The decision permitted courts to suspend decisions of the NBM before final settlement of the case, with two exemptions to the ruling: decisions to revoke a license or to liquidate a bank⁶⁷. Subsequent legislative amendments to the laws on the NBM and NCFM restored powers of the regulators. Particularly, the financial-banking law package agreed with the IMF and adopted on April 08, 2016 by the Parliament (Law no. 62) provides among amendments to the law on the NBM that no authority can approve, suspend, cancel, censor, postpone the entering into force of acts of NBM, or influence in any other way the issuance of the final act of the NBM⁶⁸. In relation to the NCFM, law no. 62 also provides that in exerting its supervision powers and responsibilities, the NCFM cannot be restricted by any other authority. According to the interviewed representatives of the NBM however, the courts of circumscription may still issue judgments on the NBM and NCFM decisions, but regulators' acts may not be suspended until their examination in substance in the court.

105. Interferences of the judiciary limiting the authority of the NBM and NCFM, non-transparency of bank shareholders and severe corporate governance problems in banks, as well as the lack of effective counter-measures by regulators and other authorities of the state made it possible that 3 of the banks (BEM, BS and UB) be liquidated due to fraudulent transactions and illicit lending practices. The government interfered in a bail out scheme with an urgent loan equivalent to approximately 12% of the GDP that undermined public finances and macroeconomic stability. Among consequences of these events that are still to be overcome, is the deteriorated AF, due to worsened macroeconomic conditions, increased interest rates, growing NPL, more severe practices for evaluation of loan applications, and

⁶⁷ Moldova Financial System Stability Assessment, the IMF, February 2016.

⁶⁸ Law of the Parliament no. 62 of April 08, 2016 for the amendment and completion of some legislative acts.

exclusion of the largest banks with transparency and governance problems from the funding schemes of IFIs programs.

106. The FSAP 2014 identified a number of other factors hindering the NBM's effective regulatory and supervisory powers. Among these, the possibility by the Ministry of Justice (MOJ) to make amendments to NBM and NCFM regulations through the procedure of legal expertise of the NBM and NCFM acts that undermined the regulators' autonomy and created delays. The same Law no. 62 of 08.04.2016 excluded the possibility for any public authority to issue ex-ante opinions on the acts of the NBM. Also, the NBM and NCFM acts have been excluded from the legal expertise of the Ministry of Justice. The regulators shall only pass over, after adoption, the normative acts to the Ministry of Justice to be registered in the State Registry of legal acts. Both the NBM and NCFM may ask however consultative opinions from the Ministry of Justice.

107. Another IMF objection from FSAP 2004 and 2014, concerning the lack of immunity of the NBM and NCFM staff from civil proceedings in exerting their functions in good faith, has been addressed as well by the Parliament, by including in the Law no. 62 provisions for the legal protection of the NBM and NCFM management and personnel from civil, administrative and penal suits in respect to the fulfillment of their legal responsibilities, with the exception of ill-intended, deficient or negligent performance of attributions. Legal protection of the NBM and NCFM staff implies also legal assistance and reimbursement of costs for the legal assistance provided to the personnel of the two regulators in proceedings connected to the fulfillment of their functions. Given the lack of substantial progress in the reform of the judiciary and persisting suspicions of corruption and political group interference in the judiciary, effective enforcement of the amendments to strengthen the powers of the regulators is still a challenge.

108. Beside efforts to solve the non-transparency and governance problems in the banking sector, the NBM undertook also a series of other actions to ensure stability of the financial sector. These are described in more detail in Section 5.2."On-going Reforms Aimed at Facilitation of Access to Finance" section of this Study, and relate broadly to limiting large exposures of banks, to avoid connected lending and concentration risks given the persisting non-transparency of bank ownership structures; reducing exposures to exchange rate risks, to avoid deterioration of bank loan portfolios from depreciation of MDL; and introducing stricter classification standards for loan beneficiaries, to cut crediting by banks of insubstantial local shell companies (as in the case of the 3 failed banks BEM, BS and UB). However, fighting lending by banks of insubstantial shell companies still represents a challenge for the regulator. After the amendments above have been introduced, banks reportedly started using companies under foreign jurisdiction in such schemes that are beyond the reach of internal regulations.

109. One of the bottlenecks of the bank regulatory framework until recently was the lack of effective bank crises resolution mechanisms. The resolution mechanism in place (until October 2016) lacked effective coordination among different stakeholders and rapidity. There were no specific provisions in the bank legislation for bail-in arrangements. Moreover, the lack of statutory powers to enable the government to provide funding, guarantees, or indemnities quickly (without prior Parliamentary approval) further impeded the ability to implement an effective and timely resolution⁶⁹. As it will be argued in the next chapter, on September 26, 2016 the Government assumed responsibility for the adoption of the Law on recovery and resolution of banks (no.232, approved on October 3, 2016), which transposes partially the Directive 2014/59/EU of the European Parliament and of the Council on the recovery and resolution of credit institutions and investment firms. However effective implementation of all the envisaged by Law 232/2016 resolution tools will take place gradually. According to the Law 232/2016, some of its provisions (to ensure the resolution

⁶⁹ Financial System Stability Assessment, IMF, February 2016.

authority with resources and operational capacity necessary to implement the resolution and actions, coordination, etc.) entered into force starting with July 01, 2017. The provisions relating to the establishment and operation of the resolution fund will enter into force from January 01, 2020, while the utilization of the public tools, provided by the Law, for financial stabilization will be valid from January 01, 2024. At the same time, other provisions of the Law 232/2016, relating to the early intervention mechanism have already been applied in the second largest bank already in 2016 (Moldinconbank), on reasons of concerted actions from shareholders holding almost 64% of the equity without prior approval from the NBM. The other 2 banks from the top-3 (MAIB and Victoriabank) are still undergoing intensive supervision procedure (instituted instead of the special supervision procedure after the changes in legislation in 2016).

110. The MFO sector is regulated by the Law nr.280/2004 on microfinance organizations. However, it doesn't contain any provisions as for the minimum capital levels. The law defines only legal forms of MFOs (joint stock companies or LLC), activities allowed for MFOs (issue loans, guarantees and make investments) and the obligation to form provisions for loan and loan interest losses. Until 2012 no single methodology for the calculation of provisions existed, therefore comparing individual performance of MFOs was difficult. In 2012, the NCFM approved general rules for loan provisions (regulation no. 11/1 of 14.03.2012 on the classification of loans issued and interests calculated by MFO). It is used by all MFOs for fiscal purposes. However MFOs may also constitute provisions for management purposes based on their own policies, and most of them do so, especially those with foreign shareholders. However the doubling of this procedure is not seen as a bottleneck by the interviewed MFOs. Classification of loans and respective provisions are made based on repayment delays and prolongation/renewal history of the loan. No special provisions for uncollateralized loans exist. However, loans in foreign currencies, or those attached to foreign currencies have to be classified lower than the same category of MDL loans, if borrowers don't have sufficient revenues in the respective currencies. Reporting requirements are limited to delivering of reports to the NCFM once in quarter.

111. The NCFM doesn't seem to be supportive of the idea of tightening the regulation of the sector. So are the sector's players. The main argument is that MFO don't take deposits, therefore they do not represent a "public threat". Instead, creditors/shareholders are deemed those to impose prudential norms, risk mitigation rules and internal management control systems. Notwithstanding the generally accepted liberal approach to the regulation of the sector, a draft law on non-bank credit organizations (NBCO), designed by the NCFM, provides for the introduction of mandatory minimum capital levels and for prudential norms. First of all, it provides endorsement from NCFM and registration in the public registry of NBCOs, an alternative to licensing/authorization. Currently, MFOs are not required by law to notify the NCFM, which poses monitoring/supervision problems to the regulator. According to the draft law, the registration regime doesn't provide for any limitation for the entrance to the market, except for meeting the minimum capital sufficiency threshold, and integrity requirements for the shareholders and managers. The minimum capital is stipulated in the draft law at the level of 100 thousand MDL, and the capital adequacy rate (ratio of capital to assets) - not less than 5%. The provision of the minimal threshold for the capital is not seen as a constraint by bigger sector players, as most of them have already capital levels adequate for the envisaged norms or can easily conform to them.

112. The new draft law doesn't allow the NBCOs to attract deposits, or borrowings from individuals, except for the borrowings from shareholders/associates holding at least 5% of the equity. Also, the new draft law provides for mandatory auditing of NBCOs with assets more than 25 million MDL. However, in the appreciation of the NCFM and sector players, the new law provides only for limited regulation and supervision of the sector. In the view of the

interviewed MFOs (from among bigger MFOs), the draft law doesn't raise any concerns as for additional constraints to the sector⁷⁰. However, it is perceived by small and medium MFOs as a threat for the development of the microfinance sector, premature for a sector which doesn't provide yet services at the magnitude and quality of the banking sector. Particularly, small and medium MFOs may be negatively affected by the new law provisions, providing for the prohibition of borrowings from individuals (non-shareholders and shareholders with stakes <5%), as often up to 40-50% of all liabilities of such MFOs represent borrowings from individuals (non-shareholders). Also, the same MFOs consider that the law on NBCO would lead to the overregulation of the sector and their elimination from the market, resulting in a reduction of the competition and higher interest rates on the market.

113. Leasing is regulated by the Law on leasing nr.59-XVI of 28 April 2005, which provides for a good legislative framework for undertaking leasing transactions. Its provisions are considered to be adequate and progressive for supporting further development of leasing in Moldova. Leasing companies are not regulated, in the sense that leasing remains neither licensed nor supervised. However the draft law on NBCO (described above) provides for the expanding of the regulatory and supervision authority of the NCFM over leasing companies. Discussions with leasing companies representatives didn't revealed any threats in connection to the new draft law on NBCO. Even if it provides for a minimum level of capital, minimal capital adequacy ratio and creation of provisions for losses, according to the NCFM, of the total number of 35 leasing companies registered by the end of 2015, 27 had already a sufficient level of capitalization to meet the requirements of the new law. Also, even not required by law, all of the interviewed leasing companies make provisions according to internal risk management rules.

114. Another risk perceived by leasing companies and MFOs is the introduction of the supervision fee by the NCFM. A draft amendment to the Law on the NCFM nr.192/2008 envisages imposing by the NCFM of a supervision fee (to be collected from NBCOs) in the amount up to 0.1% of the average annual loan portfolio or leasing. MFOs and leasing companies consider that the fee would diminish their profitability and pose additional costs to the conformity cost needed to align to the provisions of the new law on NBCO (notably additional personnel for meeting the reporting requirements of the new law). However, according to the NCFM, the 0.1% supervision tax would diminish profits of NBCOs only by 0.9%, or by 0.6%, if a minimal supervision fee of 0.06% is applied⁷¹.

115. SCAs are regulated by the law on SCAs no. 139-XVI of 21.06.2007 and a set of subordinated acts by the NCFM, guiding the creation and functioning of SCAs, establishing prudential norms and mechanisms, including the stabilization and liquidity funds. In 2007-2008 SCAs went through an adaptation period to the SCA Law 139/2007, under which new international standards were imposed, including prudential standards related to capital and compliance with provisions of the Credit Union Model Law developed by WOCCU. Also, in order to ensure smooth transition of the SCA system from the old SCA law to the new SCA Law 139/2007, and allow for more efficient risk management and sustainable development, continuation of deposit taking was allowed only to B and C type SCAs, operations were extended over the limited geographical area depending on the license held, etc. The Law 139/2007 on SCA introduced the classification of SCAs in 3 licensing categories (A, B and C), with the aim to better control and manage risks associated with the activity profile of the respective SCAs. It set corporate governance standards, professional and educational requirements for the administrators, established the rules for the creation and functioning of a new representative structure of the SCA - the Central Association of SCA, to provide support, including financial and technical assistance to its members. Although the regulation

⁷⁰ Another objection raised by sector stakeholders during interviews was the interdiction to externalize lending and leasing services to other NBCOs and to issue mortgage loans outside the residential sector.

⁷¹ Regulation Impact Analysis of the law on non-bank credit organizations.

framework for SCAs is considered to be well articulated and ensures a minimal stability and protection of SCA members and depositors, its enforcement is often difficult, especially for the smallest SCAs (with type A licenses).

116. In 2012 the NCFM amended the legislation on SCAs, to strengthen licensing requirements and prudential norms, diversify SCA services (permitting additional services for SCAs, such as insurance intermediation, or bank assurance), establish competences of the regulator to confirm the SCA administrators and chief accountants, simplify the formalities for the shareholder meetings and the procedures for the radiation of SCA from the State registry of companies, define provisions for the operation of SCA branches and representative offices. After the new amendments, just in one year - 2015 - almost 150 inactive SCAs have been radiated from the State registry. However, the nature and the scale of the amendments alone are not sufficient to increase capacities of the SCAs to manage credit risks and overall operations. Further consolidation and capacity building in the sector, is needed to ensure safe and sustainable growth of the SCA sector.

117. The regulatory framework for bank and non-bank financial institutions does not create a level playing field and the regulatory costs are different. First of all, differences exist with regard to prudential regulations. For example, SCAs appear to have tighter provisions for the capital adequacy ratio (CAR) and net credit exposure to largest 10 debtors, while banks have tighter provisions for the current liquidity ratio and exposures to affiliated parties. At the same time, MFOs and leasing companies don't have any prudential norms, as for the CAR, exposure limits or liquidity (table 5 below). The only prudential norms for MFOs relate to the provisioning for loan losses. Also, the new draft law on NBCO provides for the minimum capital for NBCOs, of 100 thousand MDL (discussed above). However, comparisons between provisioning standards for different lending institutions are only conventional, as methodologies for calculation of indicators differ.

Table 5: Prudential norms of regulatory authorities for lending institutions in Moldova

Indicator	Banks	SCA	MFO, Leasing
Social capital	≥100 million MDL	-	-
Minimal capital	≥200 million MDL	-	-
CAR (Institutional Reserve (RI) for SCAs)	≥16% (of risk-weighted assets)	≥10% of assets	-
Large exposures/Capital	≤5	-	-
Net credit exposure to largest 10 debtors/Credit portfolio	≤30%	≤25%	-
Credit exposure to affiliated parties	≤20% Capital I	10% of loans (A, B), 75% of RI (C)	-
Corporate immobilizations/Capital	≤50%	≤100%	-
Corporate immobilizations & Participation shares/Capital	≤100%	≤100%	-
Long-term liquidity ratio	≤1	-	-
Current liquidity ratio	≥20%	≥10% of savings	-
Non-collateralized loans to one borrower	≤500 thousand MDL for legal entities and 100 thousand MDL for individuals	≤20% of IR (B, C)	-

Source: Own compilation based on legal and regulatory provisions.

118. The differences in provisioning standards are also significant (table 6). While banks and MFOs have the same provision rates, the standards for the determination of payment delays differ. For the SCAs, the NCFM applies a different provisioning scale, than for MFOs. This creates different costs of lending for the respective institutions, and can lead to regulatory

arbitrage through cross-holdings or provision of funding for on-lending⁷². At the same time, the NBM uses different payment delay scales for provisioning of loan losses for uncollateralized loans (up to 100 thousand MDL for individuals and 500 thousand MDL for legal persons): ≤30 days delay – watched; 31-60 days delay – substandard; 61-90 days delay – doubtful; ≥90 days – delay - loss. Provisioning classification also depends on the frequency of payments (on monthly basis or more seldom). Stricter provisioning standards for uncollateralized loans may discourage banks from rendering such loans. Indeed, even if the regulations in force allow banks to issue loans up to 500 thousand MDL without collateral, some of the interviewed banks in fact have set by internal regulations much lower limits for uncollateralized loans.

Table 6: Provisioning standards for different lending institutions

Category	Banks		SCA		MFO		Leasing companies
	% of provision	Payment delay	% of provision	Payment delay	% of provision	Payment delay	
Standard	2%	≤30 days	1%	on time	2%	≤30 days	Provisions not regulated
Watched	5%	31-90 days	10%	≤30 days	5%	31-90 days	
Substandard	30%	91-180 days	30%	31-90 days	30%	91-180 days	
Doubtful	60%	181-360 days	75%	91-180 days	60%	181-360 days	
Loss	100%	≥361 days	100%	≥181 days	100%	≥361 days	

Source: Own compilation based on regulatory provisions.

119. Consumer protection in both bank and non-bank sectors seem to be an unaddressed area. Even though the Parliament transposed Directive 2008/48/CE of the European Parliament and of EU Council of April 23, 2008 on credit agreements for consumers by adopting the Law no. 202 of July 20, 2013 on credit agreements for consumers, it doesn't apply to corporate loans (including microloans). In the banking sector, the NBM obliged banks to disclosure information on their products, corporate governance, financial situation, effective interest rates, etc., by adopting the Regulation on the disclosure by banks of the information pertaining to their activity (Decision of the NBM Administrative Council no. 52 of March 20, 2014). No such provisions exist in the MFO, SCA and leasing sectors, except for the consumer loans. Combined with limited supervision of the respective sectors, this often encourage unfair treatment of clients by lenders.

120. Because of the very loose supervision by the NCFM of the non-bank lending market and the limited competencies and abilities by the Consumer Protection Agency (CPA) to exert its powers in credit consumer protection, there is a vacuum of consumer protection in the sector, especially in respect to corporate clients. The problem stems also from the legal definition of the term „consumer”, which refers only to natural persons (Law no. 105 on consumer protection). The conclusion is valid also for the banking sector, however given the tighter supervision by the NBM of the sector, including in respect to the observance of the transposed Directive 2008/48/CE and Regulation on the disclosure by banks of the information pertaining to their activity, the problems seem less acute than in case of NBCO. However, in both cases, no consumer complaint mechanism is in place. The Action Plan for the period 2017-2020 on the implementation of the Strategy in consumer protection for 2013-2020⁷³ provides for certain actions on financial services consumer protection (inspections by the NCFM at non-bank financial service providers for the identification of breaches in consumer protection; information of the public at large, through the NBM web page, about the important adopted decisions, with impact on consumers; elaboration by the NCFM of a guide on consumer protection for the non-bank financial market), however these measure cannot substitute a veritable and systemic mechanism for the protection of consumers of financial services.

⁷² Enterprise Access to Finance Background Note, the World Bank, 2013.

⁷³ Government Decision no. 449 of 19.06.2017.

4.2 Financial Infrastructure

121. Financial infrastructure (FI) is a core part of the financial system. The quality of financial infrastructure determines the efficiency of intermediation, the ability of lenders to evaluate risks and of borrowers to obtain credit and other financial products at competitive terms. The main elements of the financial infrastructure in Moldova are in place; however all of them they need different degrees of improvement to effectively serve the financial sector.

Credit Bureau

122. The first credit history bureau (CHB) - Biroul de Credit SRL (BC), was established in 2010 and launched its activity in 2011, under the Law no. 122 of 29.05.2008 on credit history bureau. Although it is operational for approx. 6 years, the sectorial coverage of the CHB remains still low – only 21.4% of the active population⁷⁴. At the end of 2016 all 15 commercial banks (including 4 banks in liquidation), 13 microfinance organizations and leasing companies, as well as 13 SCA were connected to the CHB. A proposed law to oblige non-MFOs to report information to the CHB has failed to materialize, reportedly due to resistance from smaller MFOs. Apparently, many MFOs (especially from among the smaller ones) would be afraid of the migration of their clients to competitors from the respective sectors, once the information becomes available to competitors. The same fears existed also in the case of banks (at their joining the CHB), however, the practice showed that these fears were, in most of the cases, ill-founded. According to other opinions, smaller MFO and SCA delay their joining of the CHB, because their clients are predominantly from the informal sector and often the information on such clients is not official and credible. Also, while interconnection and operating costs seem to be affordable to lenders, internal connection costs (for adjustment, acquisition/elaboration of the internal soft) for smaller ones, including MFOs and SCAs, are often quite high compared to the resources available for such investments.

123. The effectiveness of the Bureau is limited by several factors. First, as already stated, only commercial banks are obliged under the law 122 of 29.05.2008 to provide information to the Bureau. Non-bank lenders (MFO, SCA, and leasing companies), as well as insurance companies and those that provide utility and telecommunication services currently are not bound by law to share information with the Bureau, which limits the coverage of the CHB and affects the perception of creditors who participate in BIC, on the credit risks of new applicants. Also, the CHB cannot provide information on debts to the public budget, debts resulting from definitive and irrevocable court decisions. If creditors have insufficient information about potential debtors, they cannot evaluate risks with sufficient accuracy and tend to compensate the information asymmetry with collateral in excess. This, in turn, excludes from lending a large number of financially eligible potential borrowers that don't have sufficient collateral. Also, complete and exhaustive information about all financial obligations of borrowers is the only way to avoid cross-crediting and over-indebtedness.

124. Second, the services provided by the Bureau are limited only to the submission of credit reports/extracts from credit reports. Credit reports contain information about the fulfillment by debtors of their obligations under loan agreements. Other services, such as credit scores, industry data, portfolio monitoring, etc. are not provided. This also reduces the possibilities of creditors to improve borrower risk assessment. Third, until recently there were concerns about the accuracy and actuality of the information provided by the sources of credit histories, as there was no control over the quality of the information shared by these⁷⁵.

⁷⁴ According to credit bureau data provided in June 2017

⁷⁵ On 14 July 2017, the Parliament of Moldova adopted amendments and additions to Law 122/2008 (through Law No 149), which removes this deficiency as well as other constraints that existed until then in the CHB regulation and supervision framework .

125. The International Finance Corporation (IFC) offered support to the first licensed CHB for the elaboration of a market analysis and development of a roadmap; however it was declined by the Bureau, which had to bear the costs. Instead, the IFC has provided support to the NCFM in the elaboration of the new law on CHB. Also, it seems that after the refusal of its support, the IFC renounced from further assistance to CHB and initiated a feasibility study for the establishing of a second credit bureau. According to the NCFM, the IFC is not supportive of the idea to bind non-bank lenders to connect to the CHB, until the market matures. However, most of other interviewed stakeholders consider that provision of data to the CHB by all lenders should be mandatory. In April 2017, the NCFM issued a license for a new credit history bureau to the company „Infodebit Credit Report” Ltd., which represents however an initiative of private entrepreneurs from the RM and doesn't seem to be linked with the activity launched by the IFC.

Risk Register

126. As part of the larger Risk Registry (RR) concept, the NBM established a Credit Risk Registry (CRR) which will enable the NBM to assess risk exposure by banks. The CRR will also be connected to the Credit Bureau. This is an objective stemming from the FSAP recommendations. The RR will allow the NBM to have operative and sufficient information to determine the general risk level confronted by each particular bank, and to better evaluate credit risks. The RR shall lead to improvement of the normative framework relating to the corporate governance, which, also, represents a key area within the banking regulation and supervision process. After consultation with banks of the draft instruction regulating the provision of information for the RR, the NBM concluded that banks were not ready for the launching of the RR in the first quarter of 2016 as initially envisaged, and launched the CRR from July 01, 2016.

127. From the technical perspective, the Risk Registry represents a platform with four distinct information solutions that would help the NBM identify risks in the banking sector. Besides CRR, the platform will provide an information solution (software) for the optimization of bank licensing and notification process, a soft for the monitoring of transparency of bank shareholders and a soft for remote analysis in the area of prevention and fighting of money laundering and financing of terrorism. The Risk Registry will help optimize the provision of information by banks (including in the process of control of banks, the information will be derived from the registry) and the supervision of banks by the NBM. It is especially important in the context of the deficit of personnel for the effective supervision on the banking sector. Given the increased supervision efforts needed after the 2014-2015 banking crises, the deficit of personnel in the supervision department of the NBM was at the middle of 2016 almost 40%. The credit risk registry will contain the same information as the CHB, plus 50% more data from the perspective of banking supervision.

Loan Guarantee Funds

128. There are two Loan Guarantee Funds in Moldova: the Loan Guarantee Fund (LGF) managed by ODIMM, without legal personality, and the Interbank Guarantee Society Garantinvest Ltd., established by 7 commercial banks, 1 MFO and 1 NGO with assistance from the UK Department for International Development (DFID). From 2005 to 2010, Garantinvest issued 96 financial guarantees⁷⁶ for loans extended by its member financial institutions amounting to only about 18 million MDL. Garantinvest issues guarantees up to 1.1 million MDL, covering maximum 50% of the incurred final loan loss (with fees from 2% to 3% of the guarantee). The total guaranteed loan portfolio was 45 million MDL in 2010. More recent data is not available, and attempts to get in contact with Garantinvest representatives for the scope of Study gave no result. It seems that the functionality of the

⁷⁶ <http://www.garantinvest.md/about.html>, last visit on 15.10.2017

Society is limited, if any at all. Interviewed banks also have not been in contact with Garantinvest for a long time.

129. In its turn, the ODIMM issues financial guarantees up to 5 million MDL from the Loan Guarantee Fund (LGF), covering also up to 50% of the loan amount (70% for start-ups and for companies managed by women). The total size of the Fund is 64 million MDL, but this will be increased until the end of 2017 up to 100 million MDL. However, it was not used very actively by banks, while the Fund's attractiveness for creditors seems to be quite limited. Thus, if in 2013 the LGF issued guarantees in the amount of 12 million MDL, in 2014 and 2015 the annual amount of guarantees didn't exceed 5 million MDL. Since its inception, the LGF issued guarantees to 275 micro and small companies in the amount of 73 million MDL. Even if intended to facilitate the access to finance for entrepreneurs lacking sufficient collateral, the scale of the LGF activity and its capitalization are too small to make a systemic impact on the AF in Moldova. Interviewed banks didn't show much interest in using the guaranteeing opportunities provided by the LGF. Besides small size of the Fund, a conceptual bottleneck, until recently, was its "final loss" approach to the issued guarantees. It implied that banks could rely on the reimbursement of part of the loan losses only after they used up all other legal possibilities to recover the loan (including selling of collateral). Often this might take years. In such circumstances, banks never knew, from the beginning, how much of the loan was guaranteed by ODIMM LGF. Even if it formally was covering 50% of the loan amount, after the bank had recovered part of the loan from selling the collateral, the Fund reimbursed 50% of the remaining amount of the loss and not of the initial loan amount.

130. Third, there is low incentive for banks to use the ODIMM LGF guarantees, as these are not considered by the NBM as diminishing the net bank exposure to borrowers (for provisioning purposes)⁷⁷. In such circumstances, banks would consider taking the LGF guarantees only as an "additional" security to the at least 100% collateral or other real security interest on the loan, or in programs financed by ODIMM (PNAET, with a grant portion). Forth, there is no certitude among banks that the LGF will pay against the guarantees. Banks are aware of instances when the OFIMM refused to pay against the guarantees issued, invoking non-compliance with its criteria (for example the client didn't pay the fee for the guarantee, the bank didn't meet all due diligence criteria, etc.). Fifth, LGF works only with the banks with which it has agreements, while OMF, SCAs and leasing companies are not included in the LGF's area of action. In an attempt to increase the attractiveness of LGF guarantees, ODIMM launched new products, such as portfolio guarantees. However, interviewed banks didn't show more interest in the portfolio guarantees, on the same reason of high degree of incertitude about the readiness of the LGF to cover potential losses, as portfolio guarantees involve conditionality criteria, which might be invoked by the ODIMM to refuse payment.

131. Instead, some banks rather use available guarantee schemes from the USAID or IFIs (the European Investment Fund, the EBRD) that pay unconditionally after 90 days of default of the client to repay on the loan (see the USAID DCA guarantee scheme in the next chapter, Section 5.3 "Current Development Partners' Reform Efforts"). However, the situation seems to be changing. At the end of 2014 - beginning of 2015 the World Bank evaluated the LGF, made recommendations and elaborated a new operational manual. Through the CEP II Program, the WB will assist the LGF in changing the soft and establishing of interconnectivity with banks (see also Section 5.3 "Current Development Partners' Reform Efforts", in the next chapter). In July 2016, the Parliament approved the Law on SME (no. 179 of 21.07.2016), which appoints the LGF as a unit of ODIMM and empowers the GoM to approve the Regulation for the functioning and usage of the LGF. As result, in the 4th quarter

⁷⁷ In accordance with the NBM regulations on large exposures, net credit exposures of banks are to be diminished by the value of exposures secured with state guarantees, governmental bonds, etc. However, the LGF guarantees are not equated with state guarantees.

of 2016 the LGF introduced several changes to its products: (i) the maximum guaranteeing threshold was increased from 2 million MDL to 5 million MDL; (ii) fees have been reduced from 2% to 0.5% ; (iii) a new stage of partial pre-enforcement of financial guarantees was introduced after 90 days from the registration of arrears by SMEs, etc. These amendments seem to have increased the attractiveness of LGF guarantees, thus in the first 5 months of 2017 (in spite of the general downfall in bank lending), the LGF issued guarantees in the amount of 23.5 million MDL⁷⁸.

Deposit Guarantee Fund in the Banking Sector

132. The Deposit Guarantee Fund in the Banking Sector (DGFBS) was established in 2004, in accordance with the Law no. 575 of 26.12.2003 on the guaranteeing the deposits of individuals in the banking system. The main purpose of the DGFBS is to guarantee deposits of individuals in banks. All licensed banks are required, by Law, to contribute to the DGFBS. The initial guaranteed maximum amount was 4,500 MDL. In 2010 the threshold was increased to 6,000 MDL. The main sources of the DGFBS are mandatory contributions of banks. Banks contribute with initial installments equal to 0.1% of their capital and with quarterly contributions equal to 0.25% of the total amount of their guaranteed deposits. Available resources of the DGFBS, at the end of 2016, were 339.1 million MDL, or 12.2% of total guaranteed deposits and 0.9% of total deposits of natural persons with banks⁷⁹. At the same time, given the high concentration of deposits, the current fund amount would not be sufficient to protect depositors of any of the three largest banks in the banking system against the consequences of a potential insolvency. At the existing threshold, DGFBS's proceeds would only be sufficient to guarantee deposits in any of the remaining 8 banks (or in 4-5 banks simultaneously). The DGFBS invests available resources in state bonds, issued by the Ministry of Finance, or in Certificates of the National Bank of Moldova. According to reports by the DGFBS, the DGFBS quarterly performs analysis of the possibility to increase the guaranteed threshold. For this scope, the DGFBS uses a set of financial indicators, specified in an internal Regulation. Since its inception, the Fund collected 389.4 million MDL and made payments of 50.3 million MDL for the guaranteed deposits of failed banks.

133. An amendment to the Law 275/2003, approved by the Parliament in March 2017, provides for the increasing of the guaranteed threshold to 20 thousand MDL starting from 01.01.2018. However, this level is also too low to stimulate the savings of population in banks, including long-term ones, as well as the general confidence in the banking system. Also until the adoption of the Law no. 232 of 23.12.2016 on the resolution and recovery of banks, the DGFBS had no role in the resolution of banks, as envisaged by Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes. Law 232/2016 provides for the DGFBS the role of administrator of the Banking Resolution Fund (BRF). In this quality, DGFBS will manage the FRB's resources, set the investment strategy for the BRF resources, and review it at least once a year. The DGFBS may also contract loans from banks or other third parties, if the amounts collected will not be sufficient to cover the BFR's losses, costs or other expenses. Similarly, the NBM may designate the DGFBS as temporary administrator of banks, in cases where, according to the legal provisions, the NBM, as the resolution authority, enacts the replacement of the management of banks.. A draft law providing for conceptual changes in the role of the DGFBS, contributions to the Fund, its corporate governance and increase of the coverage level up to 300 thousand MDL has been prepared by the EU High Level Advisors to the Prime Minister of the Republic of Moldova, in 2016. Another action plan for the reforming of the DGFBS has been developed in the frame of the inter-ministerial action plan, as result of recommendations of the evaluation of DGFBS, by the FSAP mission. However, more detailed information on this plan was not available for the scope of this Study.

⁷⁸ According to data provided by ODIMM in June 2017

⁷⁹ Activity Report 2016, the Deposit Guarantee Fund in the Banking System, 2017.

Creditor Rights and Secured Transactions

134. Several important reforms have been made in the last years to the legal framework for creditor rights and insolvency regime. Despite improvements, effective implementation remains weak⁸⁰. These reforms provided for new basic laws for secured credit, enforcement of claims, and insolvency regime. Moldova, like most transition countries, is now in the second phase of the legal development process which involves a focus on granular improvements, filling in the gaps in the legal systems, which haven't been eliminated with the adoption of basic laws. As noticed by the WB ROSC mission in 2014, the rapid succession of legal reforms has not been followed by a general assessment of the effectiveness of the reforms, the identification of gaps in the legal regime, the interaction between the different pieces of legislation, and the need for integration of such regimes into the existing institutional framework. The report identified shortcomings in the secured transactions and enforcement regime, in the insolvency framework and the institutional framework supporting the creditor-debtor and insolvency regime⁸¹.

135. The creditors seem particularly reluctant in making use of security over movable assets not only because of the lack of a sufficiently liquid market for such assets. By the contrary, some of the bank stakeholders interviewed asserted the liquidity of some movable assets even higher than that of immovable property (including inventory, tractors and harvesters). However there is no mechanism in place to ensure integrity of such collateral. Reportedly (as witnessed by interviewed banks), in most of cases, creditors cannot repossess inventories because these are sold or relocated by debtors, with penalties for such deeds minimal. In other cases, litigations appear because of the interdiction of subsequent pledge by some creditors in the Registry of pledges over movable assets. Although interdiction of subsequent pledge over movable assets is prohibited in the law on pledge, notaries often establish such interdictions in the pledge registry, at request of creditors.

136. Banks, MFOs and leasing companies describe collection of non-performing loans as very complicated. Some indicate that actual legislation acts against credit institutions, allowing debtors to substantially delay the recovery of debts by creditors. Others ascertain that legislation is good, but enforcement is deficient. Particularly they indicate on low qualification of judges in processes of claims over collateral and arbitrariness of court decisions even in similar cases. Often, judges and court officers are not efficient and motivated to speed up the process, either because of insufficient qualification, or ill intention/corruption, which reduces creditors' confidence in courts and incline them to require collateral in excess, or increase the risk margin, limiting further the AF for businesses. Although most of the claims of lenders can be enforced using a simplified ordinance procedure (executive title), there are numerous possibilities for debtors to delay the process, thus transforming the ordinance procedure into a full ordinary (court) proceeding.

137. The EBRD Insolvency Sector Assessment from 2009 concluded, among other things, that the Moldovan insolvency legal framework was of "medium compliance", with major weaknesses particularly in the area of reorganization and liquidation procedures⁸². The main issue of the insolvency procedures under the insolvency legislation was their duration. In certain cases, at that time, such procedures could have lasted up to 15 years, inevitably causing higher costs and lower recovery rates⁸³. Since 2012 Moldova has implemented measures to improve the insolvency framework as well as ensure the protection of creditors' rights. The Parliament adopted a new insolvency law in June 2012 (no. 149 of June 29, 2012). In addition to allowing for out-of-court settlements and making it easier to initiate insolvency procedures, the new law limits the duration of bankruptcy procedure to 2 years. The

⁸⁰ See also the IMF Second Post-Program Monitoring Discussions, Dec. 2014.

⁸¹ Moldova Financial Sector Assessment Program, ROSC, the WB, December 2014.

⁸² Commercial laws of Moldova, an Assessment by the EBRD, EBRD, 2014.

⁸³ Andrian Guzun, Moldova: A New Insolvency Act, Schonherr Legal Insights.

maximum reorganization period was set at 3 years, with possible extension of up to 2 years from the date of confirmation of the reorganization plan by the court. Some categories of debtors can benefit from simplified bankruptcy procedure. However, the new law is still restrictive of creditors' rights to initiate insolvency procedures as the applicant needs to provide a prescript of execution regarding its claim against the debtor, which can be obtained following a previous court decision⁸⁴.

138. In 2017, Moldova ranked 60th in the WB Doing Business (DB) Report for resolving insolvency, the same as in 2016, implying that problems in the insolvency regime persist. Both time and cost for insolvency cases in Moldova are higher than the average for the ECA countries: 2.8 years and 15% cost against 2.3 years and 13.2% cost in ECA. Main reforms noticed by the DB Report after the entering into force of the new insolvency Law include the strengthening of the insolvency process by extending the duration of the reorganization proceeding and refining the qualification requirements for insolvency administrators in 2013; easing of insolvency regime by introducing new reorganization mechanisms, reducing opportunities for appeals, adding moratorium provisions and establishing strict statutory periods for several stages of the insolvency proceeding in 2014; improving of the insolvency system by introducing a licensing system for insolvency administrators, increasing qualification requirements to include a professional exam and training, and by establishing supervisory bodies to regulate the profession of insolvency administrators in 2015. Notwithstanding these improvements, the insolvency regime still has implementation drawbacks. Banks still indicate on lengthy and cumbersome procedures, vested interest from administrators and deliberate initiation of the procedure by debtors to avoid enforcement of security rights by banks. The problem is exacerbated by the low qualifications of judges adjudicating insolvency cases, which increases the time and material costs for participants in the insolvency processes. To overcome some of the bottlenecks of the insolvency regime, the World Bank has contracted technical assistance to amend the insolvency Law, and will render support for this activity the next 2 years, along with support for the CHB.

139. While the current insolvency regime provides for a necessary legal framework to settle insolvency of legal entities, an insolvency regime for debtors-natural persons is missing. As a large (and increasing) part of borrowers from banks, MFOs, SCAs and leasing companies are individuals, there is a need for a legal regulation of insolvency of individuals (debtors, consumers). Most of the countries provide for regimes dealing with individuals' insolvency (USA, Germany, France, Sweden, Switzerland, Romania, etc.). However, there is not a uniform approach toward this issue. In some jurisdictions the application of law is limited to consumers – natural persons whose debts are not connected to business activities (France, Germany), while in others the scope of the law is broader and includes debt from commercial/business activities of natural persons. In Romania an insolvency law for individuals entered into force in December 2015. The rationale of the Law is to safeguard the interests of individuals who are indebted to financial institutions, and who can no longer afford to pay their debts. The new provisions apply only to individuals whose obligations are not commercial in nature. An administrative body, the Insolvency Commission, has been established to manage insolvency claims. It is comprised of a central commission and territorial commissions, one for each of the 41 counties. While the Central Insolvency Commission plays a more regulatory role, the Territorial Insolvency Commissions ("TICs") play an active role during the insolvency procedures. The Law aims to give more power to the administrative body while reducing the involvement of the courts. Nonetheless, the latter still have superseding powers over the decisions of the TICs. A key role is played by the judicial receiver, who is appointed by the competent TIC or, in some cases, by the court. The main role of the judicial receiver is to guide and supervise the debtor's actions throughout the insolvency procedure.

⁸⁴ Republic of Moldova: Small Business Act country profile, OECD, 2016.

Collateral Registries

140. The mortgage regime is predictable and reliable, for the most part because of an efficient real estate registry in place. The only deficiency noted was that the State Enterprise (SE) Cadaster offers access to the electronic registry for subscribers (individuals and legal entities) only for information purposes. Information from the registry doesn't have legal power without hard-copy and seal from SE Cadaster, and there is still no possibility to use electronic documents and electronic signature for this purpose, given that there might be divergences of records in the system, between the electronic and paper records. Even if this technical issue is resolved, several respondents indicated that, apparently, there are still problems with the recognizing in courts of the validity of documents with digital signature. In other words, courts are still reticent in recognizing the legality of acts without ink seals, which reduces practical applicability of electronic registries and acts, and increases administrative compliance costs for the participants in disputes. In addition, access to credit is further restricted by the operation of some of the rules of the Law on mortgage, such as the possibility that the mortgage creditor forbids the mortgagor to grant a subsequent mortgage on the same asset⁸⁵ (see the „Creditor Rights and Secured Transactions” compartment above). In contrast to the real estate registry, the Registry of pledges over movable assets suffers from numerous deficiencies. The soft solution for the registry is not user friendly and is not always functioning. Often the requests are processed in 1-2 days, creating delays, while goods are not always radiated from the registry on time, conducting to confusions. To improve the functioning of the registry, the World Bank will provide technical support in the next 2 years (in amending the regulation for the functioning of the registry), while the Center for Legal Information of the Ministry of Justice is already being implementing technical solutions for improving the operation of the mentioned on-line registry.

Payment and Securities Settlement System

141. The development of a comprehensive risk framework for the National Securities Depository was one of the key recommendations of FSAP 2014. In accordance with this recommendation, the NBM shall elaborate an action plan for the establishment of a Single Central Securities Depository (SCSD). Until recently, there were two central depositories (one for clearing and settlement of governmental and NBM bonds, and another for clearing and settlement of securities sold on the stock exchange market), as well as a large number of independent registrars (11) holding share registries of stock companies. These registrars had outdated standards and practices, while their supervision was limited. The NBM benefited of technical assistance from the IMF in the elaboration of the concept of the SCSD. The SCSD is meant to channel in a single place all accounts of security and financial instruments of public interest entities holders, render clearing/settlement, and connected services. The importance of such changes became evident after the current fragmented and poor controlled securities settlement system have been used in raider attacks on banks and other financial institutions, significantly undermining the protection of property rights. A Law for the amendment of Law no. 171 of July 11, 2012 on the capital market and other laws, for the creation of the SCSD has been adopted by the Parliament in April 2016 (Law no. 62 of 08.04.2016, or the so-called “financial-banking laws package”). According to it, the Government developed the Law on the SCSD, which was approved on 03.10.2016 (no. 234), by assuming by the GoM of the responsibility before the Parliament for the adoption of a law package (see also Section 5.2. “On-going Reforms Efforts Aimed at Facilitation of Access to Finance” in the next chapter).

Financial literacy

142. In March 2014, the NBM adopted a new reading of the Regulation of the modality of disclosure by banks of the information pertaining to their activities (Decision of the NBM

⁸⁵ Moldova Financial Sector Assessment Program, ROSC, the WB, December 2014.

Administrative Council no. 52 of March 20, 2014). The Regulation came effectively into force in October 2014. The new Regulation aimed at increasing transparency in the information provided by banks to the public that would improve the ability of banks' depositors and borrowers to estimate costs, risks, compare among conditions offered by different banks and take more informed decisions. It established clear criteria and defined the way banks shall disclose their financial information to clients and to general public (information on opening and modification of accounts, loan, deposit and card related information, information on shareholders and relate parties holding substantial shares, and on effective beneficiary owners. However, there are still no provisions and mechanisms in place for corporate consumer protection that would allow bank clients to complain about lenders' practices, resolve disputes, or provide feedback on actual practices (see also Section 4.1. "Regulatory Framework"). The same is valid for the non-bank financial market, despite the fact that there are two regulations of the NCFM in this respect: the Regulation on the examination of petitions by the professional participants of the non-bank financial market (approved by the NCFM decision no. 38/14 of 28.09.2012) and the Regulation on the disclosure by the professional participants of the non-banking financial market of information on services provided (Decision of the NCFM no. 8/6 of 26.02.2010). In September 2015, the NBM launched activities for the elaboration of the National Strategy for Financial Literacy. For this scope, the NBM benefited from assistance from the Development Facility of the European Fund for South-east Europe (EFSE DF) and the regional center Microfinance Center (MFC) from Poland, which evaluated of the current level of financial literacy of population and drafted the Strategy. The NBM and the NCFM should have conducted information campaigns for the promotion of financial literacy among population during 2014 and 2015. However, the campaigns have been deferred for after the finalization of the Strategy, which is still being developed.

4.3 Findings / Impact on Access to Finance

143. The Moldovan banking regulatory norms are in line with, and in certain aspects, even stricter than the Basel I prudential norms, given the more volatile and unstable business environment. However, serious constraints limiting the powers and possibilities of regulators to effectively regulate and supervise both bank and non-bank financial markets have been revealed by the recent banking crises, resulting in the failure of 3 banks. These relate mainly to interferences into the authority of regulators, opaque ownership structures and corporate governance problems in banks. The legal and regulatory framework of the bank and non-bank sectors is undergoing now significant changes, most of them meant at ensuring stability of the financial sector. Amendments are guided primarily by the IMF and WB FSAP 2014 recommendations. Most of the recommendations relating to restoring and strengthening the powers of regulators have already been adopted, however concerns remain in relation to effective enforcements of improvements, given the lack of progress in reforming the judiciary, persisting corruption and vested high level political and group interests.

144. The thresholds for the uncollateralized loans have been increased, to allow for increased amount of loans extended without collateral. However, banks don't actively use this opportunity, apparently because of worsened business conditions and stricter provisioning regulations. Also, the NBM tightened regulations to reduce large and affiliated bank exposures, exposures to exchange rate risks and risks of "virtual" lending by banks, aimed at ensuring financial stability of the banking sector. These didn't seem to have an adverse impact on lending and, apparently, prevented worsening of bank loan portfolios because of large exposures to foreign currency exchange rates along with significant depreciation of the MDL. However, many of them were tardy reaction by the regulator on the recent crises in the banking sector. Also, fighting lending to insubstantial shell companies, by banks, still represents a challenge for the regulator.

145. One of the bottlenecks of the bank regulatory framework until recently was the lack of bank crises resolution mechanisms. Previous bailout arrangements lacked effective coordination among different stakeholders involved and rapidity. There were no specific provisions in the bank legislation for bail-in arrangements. The lack of statutory powers, to enable the government to quickly provide funding, guarantees, or indemnities, impeded effective and timely resolution implementation. On September 26, 2016 the Government assumed responsibility for the adoption of the law on recovery and resolution of banks, which transposes partially the Directive 2014/59/EU of the European Parliament and of the Council on the recovery and resolution of credit institutions and investment firms (approved on October 3, 2016). However effective implementation of all the resolution mechanisms will take place gradually until 2024.

146. MFOs, in contrast to banks, are neither regulated nor supervised by the NCFM. There are no prudential norms for MFOs and liberal regulations seem to have favored rapid expansion of the sector. The lack of regulation and supervision of the sector seems to have favored however in some instances, disloyal lending practices by MFOs in relation to their customers and negatively affected consumer protection. A draft law on the NBCO has been developed by the NCFM, endowing it with powers in addressing these issues. However, it doesn't provide for any consumer complaint resolution mechanism. The Action Plan for the period 2017-2020 on the implementation of the Strategy in consumer protection for 2013-2020 provides for certain actions on financial services consumer protection, however these measure cannot substitute a veritable and systemic protection mechanism. This is also an issue for the banking sector. Until the new provisions are adopted and concrete functions developed, it is difficult to assess the effectiveness of NCFM in addressing consumer protection issues.

147. The draft law on the NBCO provides also for a greater degree of regulation and supervision of the sector by the NCFM, including introduction of prudential norms (capital adequacy ratio). The envisaged changes, if adopted, will not put serious constraints to the AF in the sector, except for the introduction of the supervision fee that can lead to an increase in price for the MFO products, which are already quite expensive. Also, small and medium MFOs fear that the new law provisions will deprive them of important resources, as these prohibit borrowings from individuals (non-shareholders and shareholders with stakes of <5%), which often make up to 40-50% of all liabilities of such MFOs, as well as would lead to the overregulation of the sector and elimination of many small and medium-sized MFOs from the market.

148. The activity of leasing companies is not regulated nor supervised by any of the financial regulators. As in the case of MFOs, this seems to have facilitated rapid growth of the sector. The current leasing Law provides a good legal framework for undertaking financial leasing activities. The draft amendments to the Law on leasing provides the regulation and supervision of the leasing companies by the NCFM, however, as in case of MFO, these are only limited. New prudential norms and supervision by the NCFM, if approved, are not perceived as a threat by sector players, the majority of companies comply already, or can easily comply with the envisaged regulations.

149. The SCA sector is closer regulated and supervised by the NCFM, in contrast to MFOs, because of the right of B and C licensed SCAs to accept savings from members. Legislative and regulatory framework has been amended, especially after 2007 and 2009, providing now better control, prudential and non-prudential regulation, support and stability mechanisms for SCAs, etc. Although the regulatory framework for SCAs is quite well articulated, its enforcement is often difficult, especially in respect to the smallest SCAs.

150. The regulatory framework for bank and non-bank financial institutions does not create a level playing field. These have different prudential and provisioning norms, while some financial institutions are absolved altogether of such norms, which may create different costs

of lending for the respective institutions and lead to regulatory arbitrage through cross-holdings or provision of funding for on-lending.

151. A first credit history bureau has been in place since 2011. However its effectiveness is constrained by a number of bottlenecks, among which limited sectorial coverage and products delivered to creditors. Also, internal interconnection costs are often perceived as quite high by smaller lenders in comparison to the resources available for such investments. Initiatives to oblige MFOs to connect to the bureau had been developed, but were withdrawn afterwards, reportedly because of the opposition from smaller lenders on grounds of high interconnection costs and fear that the disclosed information may be used by competitors to take over their clients.

152. AF is further constrained by the lack of effective loan guarantee mechanisms. The only currently functional guarantee fund (ODIMM LGF) failed to bring a systemic impact on the AF, because of limited capitalization and conceptual bottlenecks in relation to services provided: non-recognition by the NBM of guarantees for provisioning purposes exclusion from guaranteeing schemes of MFO, SCA and leasing companies, and incertitude as to the readiness of the ODIMM to pay against the issued guarantees.

153. AF seems also to be hampered by the low coverage level of deposit guarantees by the DGFBS. The actual threshold of only 6,000 MDL, but also the increased up to 20,000 MDL one, starting from 01.01.2018, are too small to spur confidence in banks and favor more savings by population, and particularly long term savings. Initiatives to increase attractiveness of guarantees for depositors and effectiveness of the fund in distress situations have been developed with external assistance. However, there doesn't seem to exist consensus on how to carry forward the reform of the DGFBS.

154. Significant reforms have been made in the last years to the legal and regulatory framework for creditor rights and insolvency regime. However, despite improvements, effective implementation remains weak. The use of movable collateral by banks is limited not only by the absence of liquid markets for such goods, but also by the lack of mechanisms to ensure integrity of the movable collateral and difficulties in registering securities over movable assets. Enforcing claims by lenders in court is hampered by numerous existing possibilities, for debtors, to delay and challenge the process, even in cases of simplified procedures (executive titles). Also, lenders complain about arbitrariness of courts, either because of low qualification of judges, or corruption. The length and costs of insolvency procedures are still very high, the problem being exacerbated by the low qualifications of judges involved in the adjudication of insolvency cases. These kinds of difficulties have the potential to significantly constrain the AF, inclining banks to be selective and require collateral in excess, be extremely conservative in evaluating collateral, increase risk premium or reject applications from borrowers with marginally acceptable collateral.

155. The mortgage regime is predictable and reliable, for the most part because of an efficient real estate registry in place. In contrast, the Registry of pledges over movable assets suffers from deficiencies. However these seem to be addressed by the WB, which will assist in the next 2 years with amending the regulation for the functioning of the Registry, and by the Center for Legal Information of the Ministry of Justice, which is being implementing technical solutions for improvement of the operation of the on-line Registry of pledges. In the case of the real estate registry, the impossibility to use electronic signatures delays obtaining and the circuit of documentation, increasing costs and time for registration formalities.

156. A new Single Central Securities Depository (SCSD), under the regulation and supervision of the NBM will be established, after the Parliament adopted respective amendments to the law on capital markets, and the GoM assumed responsibility for the adoption on September 26, 2016 of the Law on the SCSD. Although with no direct effect on the AF, the SCSD will ensure better protection of property rights, control over clearing and settlement of securities, and though this more stability for the financial sector.

5 ACCESS TO FINANCE REFORMS

5.1 Implemented and Failed/Delayed Reform Efforts

Implemented reforms

157. The resolution of risks in the banking and financial sectors of Moldova is among the main conditions put forward by development partners for restoring external financing for the country, after the banking crisis of 2014-2015. AF reform is also part of a larger body of policy reform documents in Moldova, adopted before and after the banking crises. As already stated, improving AF has been identified as one of the 8 priorities of the National Development Strategy Moldova 2020, adopted in 2012. According to the Strategy, this is to be attained by: 1) developing more options for the placement of savings of population outside the banking system; 2) optimal use of remittances; 3) increasing the ceiling for deposit guaranteeing and efficient supervision of financial service providers; 4) improving of financial tools already in use, together with their diversification (business angels); 5) adaptation of the financial market regulation and supervision to the best European practices; 6) removing of existing deficiencies in collateral registration and developing tools for risk coverage (hedging); 7) development of risk management capacities, including by expanding the coverage of CHB. Many of the reforms intended to attain the above objectives have been described in the chapters above, other will follow in the paragraphs and sections below. As a general remark however, even if 4 years passed since the formulation of the above objectives, the progress in their realization is very slow, is difficult to assess or concrete actions designed to attain respective objectives don't allow for making a substantial difference. Except for the 4 indicators in the table below, there are no measurable impact indicators for the AF objectives of the Strategy. From these, only one has been attained by the intermediate period of 2015 "Deposits to GDP", most likely because of natural evolution of the market, rather than proactive facilitation. At the same time, the risk premium (calculated as the difference between the interest rate for loans and the interest rate for governmental bonds) has been negative, which means that banks have little incentives to lend to businesses and are more inclined to invest in governmental bonds, which ultimately generates an adverse, rather than stimulatory effect on the AF (table 7):

Table 7: Specific objectives for the AF in Moldova 2020 Strategy

Indicators	2010	2015		2020
	actual	target	actual	target
Deposits to GDP, %	35,8	40	41.2	45
Loans to GDP, %	37,2	45	31.3	50
Risk premium, %	10.1	9	-6.4	7
Stock exchange transactions to GDP, %	0.4	2	0.2	5

Source: Strategy Moldova 2020 and own calculations.

158. In January 2014 the GoM adopted the Roadmap for Improving Competitiveness of Moldova (RICM), which is one of the main policy document aimed at attaining the Moldova 2020 Strategy vision. Component no. II of the RICM provides for not less than 40 actions aimed at improving the AF, grouped around 4 objectives: 1) ensuring stability and integrity of the financial system; 2) increasing attractiveness of the investment climate for foreign portfolio investments; 3) facilitating AF for the real sector of the economy through the local financial market; 4) attracting more funds and increasing efficiency of the use of external funds from development partners. Of the total of the RICM actions, only 54% were implemented in 2015 and 61% - in 2016⁸⁶, which is very low to represent a systemic impact

⁸⁶ <https://deschide.md/ro/stiri/economic/13334/61-din-Foaia-de-parcurs-pentru-ameliorarea-competitivitatii-Moldova---realizatiile-2016>, vizitat pe 16.10.2017.

on the AF, beside the fact that even in the case of many actions noted as “realized” there is no practical result. This is either because legislative acts to be deemed to ensure better AF have been developed but have been awaiting approval for many years already (see Section 5.2. “On-Going Reforms Aimed at Facilitation of Access to Finance” below), or because the very substance of the envisaged actions doesn’t allow for commensurable effects (see paragraph below).

159. For the most part, activities envisaged under the objective of “attracting more funds and increasing efficiency of the use of external funds from development partners” have been assessed as realized. Particularly, the National Program for Economic Empowerment of Youth (PNAET), implemented by ODIMM with financial support from the European Commission (EC) has been extended and the grant from the Japanese Government for support for the productive SME from rural areas has been used. Also, a series of draft laws meant to “facilitate AF for the real sector of the economy through the local financial market” have been developed and examined by the Government, but haven’t still been approved by the Parliament and put into effect (the project Law on non-bank credit organizations, the project law on facultative pension funds, amendments to the Law on leasing, Law on undertakings for collective investments, etc. – see Section 5.2. “On-Going Reforms Aimed at Facilitation of Access to Finance” further). However, most of the objectives of the AF compartment of the RICM rely on the elaboration/amendment of the regulatory framework, without practical actions to be scheduled or impact of the envisaged ones to be measured. Therefore, even in the case of actions evaluated as implemented, the impact on AF is limited or impossible/difficult to assess.

160. In accordance with RICM provisions and FSAP recommendations, the NBM developed internal action plans for the enhancement of the effectiveness of banking system supervision and monitors the performance of the respective actions. However, no information on the content of the respective action plans developed by the NBM was available during elaboration of this study (the NBM invoked the confidential character of information). At the same time, key FSAP recommendations relate to: (i) *Financial Stability Framework* - amend the Law on NBM and Law on NCFM, and other legislation to provide NBM and NCFM with the ability to enforce supervisory and regulatory actions in a timely manner; (ii) *Bank Governance* - re-evaluate bank shareholders to ensure disclosure of ultimate beneficial owners; (iii) *Banking Supervision* - amend the Law on NBM to provide full legal protection to all NBM employees in case of lawsuits for action in good faith; (iv) *Crisis Resolution* - develop a comprehensive financial crisis resolution contingency plan, and identify necessary amendments to the legislation; (v) *Deposit Insurance System* - enhance funding of the DGFBS by developing a target fund methodology, amending legislation to provide a line-of-credit to the DGFBS from the Ministry of Finance and amending the Law on DGFBS and Law on NBM to include the NBM as an additional source of back-up funding for the DGFBS; (vi) *Financial Market Infrastructure* - develop a comprehensive risk management framework for the National Securities Depository. Almost 1.5 year after their formulation, FSAP recommendations have been included in a roadmap and most of them already implemented (see Section 5.2. “On-Going Reforms Aimed at Facilitation of Access to Finance” below).

161. In April 2016 the NMB published the Strategy for the implementation of Basel III standards, developed in accordance with the EU legislation. Before this, the NBM has undergone organizational changes: the functions of banking authorization and regulation have been delimited from the banking supervision, as provided by the Basel II/III norms. To prepare the ground for aligning with new Basel norms, the BNM performed so far several activities: (i) evaluated the general correspondence of the national legislation with the EU legislation (Basel III provisions); (ii) performed the legal gap analysis; (iii) evaluated the general impact of Basel III norms on banks (ex-ante evaluation); (iv) agreed with the NCFM major joint issues for the Strategy on the implementation of Basel III; (v) developed the Strategy for the implementation of Basel III standards in line with the European legislative

framework; (vi) evaluated the necessity of personnel and its qualification for performing regulation and supervision according to the new standards; (vii) elaborated the Law on the activity of banks (approved by the Parliament on October 6, 2017); (viii) started the elaboration of the secondary normative framework for the activity of banks; (ix) initiated the development of tools/means for the supervision of the banking sector in line with Basel III standards. According to the NBM, the evaluation of the quantitative and qualitative impact on the banking sector of the Basel III regulations showed that banks will not be adversely impacted by the new standards, although capital requirements and pressure on banks' governance (for the development and enforcement of internal regulations) will increase. To diminish the impact of the capital requirements increase on banks, the NBM raised already in 2012 the norms for the risk weighted capital adequacy ratio from 12% to 16%.

162. With technical assistance from the IMF, the NBM pursued a series of amendments aimed at improving corporate governance in banks and increase transparency of bank ownership. In the attempt to combat non-transparency of bank shareholders, in July, 2014 the NBM decreased the threshold for the substantial share in banks, from 5% to 1%. From March, 2013, holders of substantial shares in banks have to disclose ultimate effective beneficiary owners (UBO) of shares. Starting from October 2014, banks are obliged to disclose all the information about shareholders or groups of persons acting in concert and owning substantial shares in a bank as well as UBO. At the same time, no potential purchaser of a substantial share may acquire or increase its stake in bank to more than 5%, 10%, 20%, 33% or 50%, or any other stake, so that the bank becomes its branch, without preliminary approval by the NBM. At the same time, any potential buyer shall request written preliminary permission from the NBM for acquiring or increasing of substantial share in the bank's equity by which the above mentioned levels shall be reached. However, challenges in respect to transparency of bank ownerships persist. According to the IMF, 41% of shares of the five main banks were in groupings between 4% and 4.99% of shareholding, immediately below the 5% threshold, which didn't require (previously) the NBM prior approval, while 25% of UBO were foreign individuals, which poses additional challenges in terms of verification⁸⁷. At the same time, the NBM lacked effective tools to verify the information disclosed by banks on their shareholders, especially on those registered abroad.

163. Numerous cases of loan misclassification that undermined the reported capital adequacy, weak governance, allowing for a significant degree of connected lending by banks, some of which - to insubstantial shell companies, as well as concentration risk from breaches of large exposure limits – all these bottlenecks revealed by the IMF - determined the NBM to adopt new provisions on large exposures and classification of assets and conditional commitments. In August, 2009 the NBM limited the net bank exposure for the biggest 10 debtors to 30% of the total loan portfolio, while the sum of all large exposures shall not exceed 5 times the total normative capital (TNC). To reduce banks' exposure to exchange rate risks (and avoid such situations that affected banks in other countries of the region), in November 2011 the NBM limited the total amount of bank net exposure to individuals (including those engaged in entrepreneurial activities) with loans attached to a foreign currencies to only 30% of the TNC, of which net exposures, other than mortgages, to 10% of the TNC. At the same time, such loans are subject to higher provisions for loans losses, if borrowers don't have sufficient incomes in the respective currency. As already discussed, these provisions limited bank lending linked to foreign currencies and avoided serious distress situations after sharp depreciation of MDL in 2014-2015.

164. Measures taken by the NBM to discourage lending by banks of insubstantial shell companies provided for the introduction of stricter classification standards, while maintaining differentiate clauses for small businesses. Thus, loans to beneficiaries with debts exceeding

⁸⁷ The IMF, second post-program monitoring discussions, December 2014.

more than 8 times their capital are to be classified now not higher than “supervised” . Loans of borrowers with debts exceeding more than 30 times their capital are classified now not higher than ”substandard”, with the exception of loans, secured minimum 50% with real securities in the property of debtors (secured with real estate and fixed assets, movable assets with the exception of receivables and patrimonial rights, etc.). Another exception from the respective norm is loans smaller or equal to 1 million MDL (for excluding “live” SMEs from provisions of the regulation). Also, loans secured with cash, deposits with the bank, state bonds or government guarantees, guarantees of some international organizations and multilateral development banks, are diminished for the value of such security for provisioning purposes, However, after the reforms above have been introduced, banks reportedly started using companies registered abroad in such schemes that are beyond the reach of internal regulations.

165. On December 16, 2016, the Parliament approved the Law no. 276 of 16.12.2016 on the principles for the subsidizing of agricultural producers, establishing general principles for state policies in subsidizing of agriculture and rural development. In particular, the Law provides for the creation of the National Fund for Agricultural and Rural Development (NFARD) to support the subsidizing and financing of the priority measures of the National Strategy for Agricultural and Rural Development 2014-2020. The NFARD will be formed from budget allocations (not less than 2% of the annual revenues of the state budget) and other sources (donors). Concrete support measures are set based on policy documents (regulation approved by government decision) for a period of 5 years, to ensure continuity of state policies in subsidizing, while subventions will be calculated based on reference prices. Also, a new Supervision council will supervise and monitor efficiency of state subventions allocated by the Agency for Interventions and Payments in Agriculture. Subventions will be allocated as direct payments (calculated as fixed amounts on 1 ha/1 animal). Direct payments (subventions) will not surpass 50% of the NFARD). Certain categories of beneficiaries (from strategic sectors) could benefit from increased subventions: by 20% - for organic production; by 15% - for young farmers and women-farmers, as well as for producers from disadvantaged zones; by 10% - for producers acquiring local goods (from subventions). At the same time, up to 5% of the NFARD is to be allocated to start-ups, while in certain circumstances subventions could be allocated in advance. The new Law also provides for the establishment of an integrated agricultural information system, as an informational resource on agricultural producers and production capacities.

Failed/delayed reforms

166. In June 2010, by Government Decision no. 449, the GoM established the National Committee for Financial Stability (NCFS), with the main aim of creating a platform for communication and coordination among institutions responsible for ensuring financial stability (this was also an IMF recommendation). It was chaired by the Prime Minister and comprised representatives of the State Chancellery, of the Parliamentary Commission for the Economy, Budget and Finance (CEB); the NBM; the Ministry of Finance (MOF); the Ministry of the Economy and Infrastructure (MEI); the DGFBS; and the NCFM. However, the NCFS proved to be inefficient both in preventing and in tackling the banking crisis of 2014-2015. First of all, it had a strong political bias, whereas more than half of its members had political affiliations. This contradicted international best practices in setting up similar bodies and recommendations of external consultants that assisted the GoM in establishing the NCFS. Also, the mandate of the NCFS overlapped in many aspects with the responsibilities of member authorities, especially with those of the NBM. During the recent banking crises the NCFS acted more as a law enforcement body, interfering with and undermining the authority of its member bodies, rather than a communication platform, while its focus was on crisis

management, rather than on crisis prevention⁸⁸. Consequently, reforming the NCFS became part of the efforts to strengthen the financial stability of the country.

167. In October 2016, the GoM modified the Decision no.449, approving a new structure of the NCFS and excluding its members with clear political affiliations, including the Prime Minister (Government Decision no. 1140 of 12.10.2016). The NCFS consists presently of representatives of 5 state authorities: NBM, MEI, MF, NCFM, and DGFBS. Its chair and deputy chair are elected by the NCFS members, while the NBM ensure the secretariat of the Committee. However, for the NCFS to become efficient there is still a need for capacity consolidation and setting of effective communication and coordination among member bodies.

168. Provision of financing for agriculture at reasonable costs and terms has always been a main issue for sector representatives and authorities. At the initiative of the MARD (former MAFI), the RICM included a provision for the elaboration and approval of the Law on agricultural credit, with the aim of creating a legal framework for the regulation of issuance of preferential loans in agriculture. According to the MARD, the intention was to create a legal framework for the establishment of an agricultural development bank. In the light of the banking crises and associated public finance constraints, discussions didn't even start. Also, there seem to be no concept or feasibility research associated with the respective initiative. In the frame of the same initiative, MADR proposed to establish a Fund financed from the state budget, for the guaranteeing of loans up to EUR 1 million extended to agricultural companies. However, the Ministry of Finance didn't support this initiative, and the proposal didn't materialize in the 2015, 2016 and 2017 budgets. There is another initiative, however, from IFAD, to establish a guarantee fund for agricultural loans (see Section 5.3. "Current Development Partners' Reform Efforts" below).

169. In order to alleviate collateral constraints in AF for agricultural companies, the Parliament adopted the Law on warehouse storing and regime of warehouse receipts for cereals (no. 33 of 24.02.2006), providing for a mechanism for the use of warehouse receipts (WR) for cereals as pledge. However, their use in the lending practice is very limited. None of the interviewed stakeholders had recent experience in dealing with warehouse receipts. According to banks, warehouse receipts suffer from the same drawback, as all movable assets more generally – they do not guarantee integrity of the pledge, while enforcement is subject to challenges and delays by borrowers. Others pointed to the lack of interest from the borrowers themselves, given high level of opacity of businesses. It seems also that warehouse operators lack incentives as well to use WR, as they have to contribute to the Fund for the guaranteeing of WR, established by Government Decision no.1027 of 14.09.2007. Despite the fact that according to the respective GD, the Fund has an independent status as legal person, with a Board and its own office, no public information on the activity of the Fund, for the scope of this study, was available, apparently the Fund is non-operational. By and large, warehouse receipts failed so far to ease AF for farmers. Their enacting by law has to be complemented by actions aimed at raising awareness and interest from market participants in making use of this tool.

170. Another RICM provision refers to the elaboration of a normative and institutional framework for the implementation of international evaluation standards. The MEI, the NCFM and the Land and Cadaster Agency (LCA) work on the implementation of the international standards for evaluation, including elaboration of national standards for evaluation of immovable assets used as collateral. Despite the fact that the respective activities should have been finished in 2014, their implementation has been deferred until the end of 2018. According to the NCFM, work stopped because of the lack of a single strategy in this respect,

⁸⁸ Adrian Lupușor, Ricardo Giucci: The National Committee on Financial Stability, Why and how to reform it; GET Moldova and Expert-Grup, March 2016.

while the LCA invokes the lack of financing and the absence of a single vision among the responsible authorities (while the NCFM insists on the approval of international evaluation standards as national standards, the LCA supports the elaboration of national evaluation standards based on the international and European ones). A draft law providing for the right to perform evaluation activities only by evaluators operating in accordance with international evaluation standards has been developed, however the evaluation standards themselves have not been approved yet and an implementation program for the new evaluation system hasn't been developed yet. The new draft law provides for the following reforms: (i) licensing of evaluating companies of immovable and movable assets, intangible assets and securities (at present only evaluation of immovable is licensed); (ii) unique requirements for individual evaluators and evaluating companies for each of the respective fields (state attestation, issuance, interruption and revocation of evaluator's certificate); (iii) additional professional requirements for the issuance of qualification certificates for evaluators of real estate/mortgages, (given that the majority of collateral is real estate- not less than 3 years of experience, etc.); stricter ethic requirements (the applicant for qualification certificate doesn't have to be sanctioned by the attestation Commission in the last five years); supervision of the evaluation activities for each of the envisaged fields; establishment of a supervision Council and reporting requirements for evaluators; introduction of third party liability insurance for evaluating companies performing evaluation of collateral/mortgages. The envisaged changes would have had, at least theoretically, the potential to improve quality of collateral evaluation, by committing the entire evaluation work to qualified evaluators and institutionalizing the control and supervision over evaluation activities.

171. One more RICM provision envisaged the elaboration by the MEI, in 2014, of a Program for supporting productive SMEs from rural areas, similar to the mechanism used by the Implementing Unit for the Japanese Grant. According to the MEI however, the implementation of the respective action was deemed impossible because of financial limitations, given that the MEI is implementing already three similar programs – PNAET, PARE 1+1 and “Women in business”. For the same reasons, another RICM provision – the development of attractive financial instruments for the priority sectors of the economy, including in the area of innovation and technology – was not accomplished.

172. The lack of progress in reforming the judiciary sector in Moldova represents a serious constraint to the implementation of many reforms, including those that would facilitate better AF. Even if a Strategy for the reforming of the judiciary sector (for the period 2011-2016) was approved in 2011, it didn't bring any significant results. The level of corruption in the judiciary is perceived as extremely high, while market participants complain about the lack of an impartial and predictable rule of law. And this relate both to the lack of confidence in the judiciary from lenders (which determines them to be extremely selective and conservative in taking and evaluating collateral) and to the effectiveness of bank regulation and supervision actions. The raider attacks on banks on ground of fraudulent court rulings limiting NBM powers to exert regulation and supervision undermined seriously the effectiveness of the regulatory and supervisory actions. Even after the amendments made to restore the powers of the regulators, risks in the financial sector persist, as far as the judiciary remains vulnerable to corruption, versed political and group interest interferences.

5.2 On-going Reforms Aimed at Facilitation of Access to Finance

173. In 2016 the Parliament examined 2 major law packages meant to strengthen NBM powers in dealing with non-transparency of bank shareholders and quality of corporate governance. The first one (Law no. 62 of April 08, 2016), as well as other undertaken reforms, have been described in the sections above. On July 22 and October 03, 2016 (the second major package) the Parliament adopted amendments to the Law on financial institutions no. 550/1995 and other legislative acts. Amendments provide, in particular, that selling of new shares, issued as result of the annulment of old ones on reasons of concerted

actions would be possible only upon prior consent from the NBM. At the same time the regulator will get the right to deny the acquisition of shares to those who provided erroneous information. The NBM could deny the acquisition of shares even before examining the submitted documentation, if it got information that potential shareholders do not correspond to integrity criteria. Persons, previously sanctioned for breaching the requirements for the quality of shareholders, would have no more the right to hold directly or indirectly stakes in banks. Amendments allow the NBM, as well, to withdraw prior permission to hold shares, suspend the voting right, the right to influence banks' governance decisions and to receive dividends, dispose selling of shares and/or undertake early intervention measures and enforcement of resolution tools provided by the Law 232/2016 on recovery and resolution of banks, in cases of holders of more than 50% of the bank equity or in cases of concerted actions of shareholders holding more than 50% of the equity without prior approval of the NBM.

174. To foster the supervision capacity of the regulator, and its ability to react quickly to potential problems, the amendments provide also for the electronic transmission of internal regulation of banks to the NBM. They allow also the right to the NBM to perform controls in banks more often than once a year, according to current provisions. Another modification allows the NBM to request from audit companies performing audit in banks any information pertaining to the banks' activity. By the same law package, the period for bank liquidation would be extended from 3 to 5 years, with the possibility of prolongation for 2 more years, instead of the actual 1. The July 2016 amendments also stem from FSAP 2014 recommendations, and aim at increasing transparency of shareholders, as well as allowing early interventions from the regulator and facilitation of ownership supervision.

175. According to the NBM representatives, after a series of legislative and regulatory changes directed at increasing transparency of bank shareholder structures, the regulator's efforts will be focused toward the enforcement of the respective provisions. Already in 2015 and 2016 the NBM revealed several instances of concerted actions from bank shareholders, holding substantial shares without prior permission from the NBM. As result of non-conformance with the NBM prescription to sell the stakes in breach, Moldova-Agroindbank initiated procedures for writing off respective stakes and issuance of new shares instead, in accordance with the amendments from July 22, 2016 to the Law 550/1995, described in the previous paragraph. In September 2015, on grounds of persisting problems with bank shareholders transparency, the NBM instituted special supervision in the 3 biggest banks: Moldova-Agroindbank (MAIB), Moldindconbank (MICB) and Victoriabank (VB) providing for close monitoring of financial situation of these banks. Since then, the NBM has repeatedly prolonged the special supervision regime (substituted by the intensive supervision regime after the adoption of the legislation on the recovery and resolution of banks). Also, the NBM disposed that these banks undertake international audit (KPMG Advisory SRL in VB, Deloitte Audit SRL in MAIB, and „Mazars Romania” SRL in MICB), for the assessment of financial situation in these banks and identification of ultimate effective beneficiaries (see the RPRA in annex 4). In October 2016, the NBM introduced the early intervention regime in Moldinconbank, in accordance with the Law 232/2016, on reasons of concerted actions from shareholders holding almost 64% of the equity without prior approval of the NBM.

176. In response to the conclusions of the EU Council for External affairs of February 15, 2016 and to recommendations from development partners, the GoM developed the Roadmap for Priority Reforms Agenda (RPRA), containing priority reform actions, including in the financial sector, which have been implemented until July 31, 2016. In respect to the financial sector, the RPRA provided for the audit and elaboration of action plans for the 3 banks under special supervision, appointment of the management of the NBM, adoption of the legal changes agreed with the IMF, including FSAP recommendation, etc. (for the evaluation of progress in the implementation of the RPRA please refer to annex 4). As part of the agreement signed with the IMF in November 2016, the GoM also undertook to protect long

term financial stability by enhancing the soundness of financial institutions, improving the regulatory and supervisory environment. This is to be achieved by addressing 4 main areas: (i) taking enforcement actions to address breaches with bank regulations identified in the special audits and ongoing onsite inspections in order to improve banks' internal governance and risk management; (ii) enhancing the NBM powers and capacity to identify banks' ultimate beneficial owners and related-party lending in order to achieve a transparent shareholder structure in all banks in the system by end-June 2017; (iii) strengthening the regulatory, supervisory, and resolution framework in line with international standards; and (iv) enhancing the governance of the NBM itself, by completing the staffing of the Supervisory Board, Executive Committee and Audit Committee, as well as reinforcing its human resources and operational capacity⁸⁹.

177. In the context of the Association Agreement (AA) signed with the European Union, the NBM started the implementation of the standard approach for credit, market, and operational risk under Basel III Capital Accord. As already stated in Section 5.1. "Implemented and Failed/Delayed Reform Efforts", in the process of transitioning from Basel I to Basel III, the NBM has tightened capital requirements to increase banks' resilience, has divided the regulation/authorization functions from the supervision ones and has committed a special division to deal with banks' ownership transparency. According to the AA, Moldova committed to implement and apply in the banking sector the Basel Committee's Core Principle for Effective Banking Supervision within 3 years from the entering into force of the AA (until July 2019). In particular, these commitments relate to transposing into the national legislation of the Directive 2013/36/EU (CRD IV) on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, and of the Regulation 575/2013 (CRR) on prudential requirements for credit institutions and investment firms.

178. Next stages in the implementation of Basel III Strategy envisage: (i) quantitative impact studies for the implementation of new liquidity and leverage indicators in the context of CRD IV –performed until the end of 2016; (ii) transposing of the CRD IV/CRR package into the national legislative and regulatory framework: a) the NBM has drafted the new Law on the activity of banks, in accordance with CRD IV/CRR that will replace the current law on financial institutions – the new Law has been approved by the Parliament on October 6, 2017; b) in quarter II 2016 the NBM started the elaboration of the secondary framework for the enforcement of the new Law (regulations) , which shall be finished in quarter III 2018; (iii) development of tools for the enforcement of banking supervision in accordance with Basel III and applicable European standards (training of NBM personnel; development of institutional capacities and tools for off-site and on-site supervision of banks in accordance with CRD IV/CRR Regulations; impact studies on capital and liquidity, stress scenarios, for the finalization of the secondary legislative framework, etc.; development of tools for the staffing, selection, motivation and training of the NBM personnel for the regulation and supervision functions) – all of these to be finished until the end of 2018; (iv) enforcement of supervision and regulation in accordance with the provisions of the new Capital Agreement-Basel III in the banking sector – during 2018, monitoring and updating of the legal and regulatory framework – during 2018-2019⁹⁰. All these changes have a potential to positively impact banking sector through better financial, risk management and prudential discipline. However, availability and cost of finance could be affected. As experience of CE and SEE banks shows, after converging to Basel III norms banks require substantial guarantees as they have to

⁸⁹ IMF Country Report No. 16/343, November 2016.

⁹⁰ The NBM Strategy for the implementation of Basel III standards in Moldova of April 07, 2016, complemented by the Decision of the NBM Executive Committee no. 148 of June 7, 2017.

comply with a number of new regulations, such as capital adequacy and liquidity provisions in⁹¹.

179. In contrast to banks, the AA between the EU and Moldova exempted the MFO and SCA sectors from the scope of the EU Directive 2013/36/EU and Regulation 575/2013. However, the NCFM started a process of strengthening the regulation and supervision of the MFO sector, as already described in Section 4.1. "Regulatory Framework" of this study. As already discussed, as early as in 2012 the NCFM developed the draft law on non-bank credit organizations (NBCO). The draft law was approved by the Government Decision (GD) no. 96 of February 15, 2012 and was submitted for approval to the Parliament. However, it was sent back to the Government for improvement. With support from WB experts, the NCFM drafted amendments and completion to the Law on leasing and Law on the NCFM, envisaging supervision and regulation of leasing companies by the NCFM. The draft law has been approved by the GoM (GD no.95 of February 15, 2012) and sent to the Parliament. However, as in the case with the NBCO law, it was sent back for completion. For the SCA sector, major changes envisage amendments to the Law on SCA no. 139 of 2007, as provided by a draft law approved by the GoM on November 09, 2016. The amendments, if approved by the Parliament, will introduce: (i) a Savings Guarantee Fund (SGF) made up of contributions of 1% of total savings by individuals in each SCA (B and C licensed), to protect individuals' savings (up to 15,000 MDL for a depositor) against liquidation or insolvency of SCAs; (ii) new services to be rendered by SCAs (issuing of financial guarantees, leasing, distribution of public financial resources (subsidies); (iii) the possibility for the NCFM to introduce special administration in distressed SCAs; (iv) regulation of internal control and risk management activities in SCAs; (v) the right of delegation of certain supervision powers by the NCFM to the central Associations of SCAs.

180. As part of the conformation to the EU regulations, the NCFM drafted the law on facultative pension funds, which was later approved in the first reading by the Parliament in November 2013, but failed to pass approval in the final reading. According to a joint decision of the Parliament and Government from March 2016, it will be withdraw from the Parliament and revised. The draft law on facultative pension funds provides for the implementation of Pillar III of the pension system, which is also a commitment stemming from the AA between Moldova and the EU (with the deadline as of end 2018). The current legislation on pensions also allows for the establishment of facultative pension funds; however it is not harmonized with the EU legislation. Pension funds would be important in the context of providing cheap and long term resources for the banking sector. However, all previous attempts to set up private facultative pension funds failed, apparently because of various reasons, including mistrust from population in such saving options. According to the NCFM, even if approved, the new law on facultative pension funds would not have an impact on the AF, as the saving capacity and trust from the population is very low.

181. One of the activities envisaged by the Action Plan 2015-2017 for the implementation of the Strategy for SME development for the period 2012-2020 ("Improving access to finance for SMEs" priority) envisages the development of the draft law on venture funds. The elaboration of this draft law stems also from the commitments of the AA and is provided by the National Action Plan 2014-2016 for the implementation of the AA between Moldova and the EU (GD no.808 of 07.10.2014). A draft law in this respect has been developed by the MEI. It transposes the EU Regulation no. 345/2013 of the European Parliament EU Council of April 17, 2013 on European venture capital funds (VCF). The draft law envisages regulation of conditions for the establishment and supervision of VCF, requirements toward investments and eligible investors, eligible portfolio enterprises, structure of investment portfolio, administrators of funds, the regime for the administration and internal organization

⁹¹ EBRD transition report 2015-2016.

of VCF. It also envisages fiscal incentives to stimulate the creation of VCF and venture capital investments. However, the biggest constraint to the emergence of VCF in Moldova seems to represent not the absence of a dedicated law, but apparently the complex and cumbersome conditions for business and banking activities, as well as limited possibilities for the entry and liquidation of investments, which create little incentives for potential venture capital. Hybrid instruments, including mezzanine financing, are missing, and so are internal systems of institutional investors, to stimulate the development of this market⁹². The lack of a truly functional capital market also impedes the apparition of venture capital in Moldova.

182. On July 21, 2016 the Parliament adopted the Law on SMEs no.179 (entered into force on December 16, 2016). Major novelties envisage the creation of a Consultative Council for SME, in charge of making recommendations for the improvement of the business environment for SMEs. The state controls for SMEs in the first 3 years from their start will have a non-penalty (consultative) character, while expenses for continuous education and training of personnel will be deductible from the fiscal base. The law also warrants a minimal share of all public procurement contracts to SMEs, provided by the Law on public procurements no. 131 of 03.07.2015. A separate paragraph relate to the AF for SMEs, providing for the general framework for facilitating SMEs AF, including supporting investments by business angels. However, it doesn't provide for the concrete tools for the realization of the respective support measures, which have still to be developed and applied. The new law on SMEs also introduces entrepreneurial education at all levels of education, starting with primary education, as well as enacts the operation of the LGF as a subdivision of ODIMM. At the same time, the Law allows ODIMM LGF to conclude agreements only with financial institutions (banks), thus excluding MFOs and SCAs from the guarantee schemes of the LGF.

5.3 Current Development Partners' Reform Efforts

183. The Moldova-2020 Strategy acknowledges that until the change in the economy's development paradigm occurs, Moldova will continue to rely on its development partners. Indeed, as the history of reforms in Moldova witnesses, the main economic reforms have been conducted with support from the international partners. Since the beginning of the independence of Moldova, donors committed almost 4.8 billion EUR in external assistance. Total disbursements amounted to almost 2.6 billion EUR, in about 2000 activities⁹³. After a short overview of the evolution and structure of the overall official development assistance to Moldova in the last years, the chapter below provides an overview of development partners' activities in Moldova that are of relevance to the AF and reforming of the financial sector. According to the OECD Official Development Assistance data, funds registered as official development assistance (ODA) to Moldova evolved from less than USD 200 million in 2005 to about USD 552 million in 2014.

184. After 2014 however, ODA dropped sharply. The pro-reform agenda of the country, culminating in June 2014 with the signing of the Association Agreement with the EU, has been diverted later by political turmoil, slowdown of reforms and theft in the banking sector. From the beginning of 2015, the majority of development partners (the EU, WB, multilateral agencies and bilateral donors) decided that support would not be provided until the country reverted to its reform commitments and the risks in the banking sector risks had been addressed. Consequently, ODA in 2015 and afterwards decreased significantly. Most donors conditioned the resuming of ODA funds allocation with the conclusion of an agreement with the IMF. In its turn, the conclusion of a new program with the IMF has been subject mainly to the progress in the implementation of the Roadmap of Priority Reform Agenda (RPRA). Following satisfactory progress in the implementation of reforms, on November 07, 2016 the

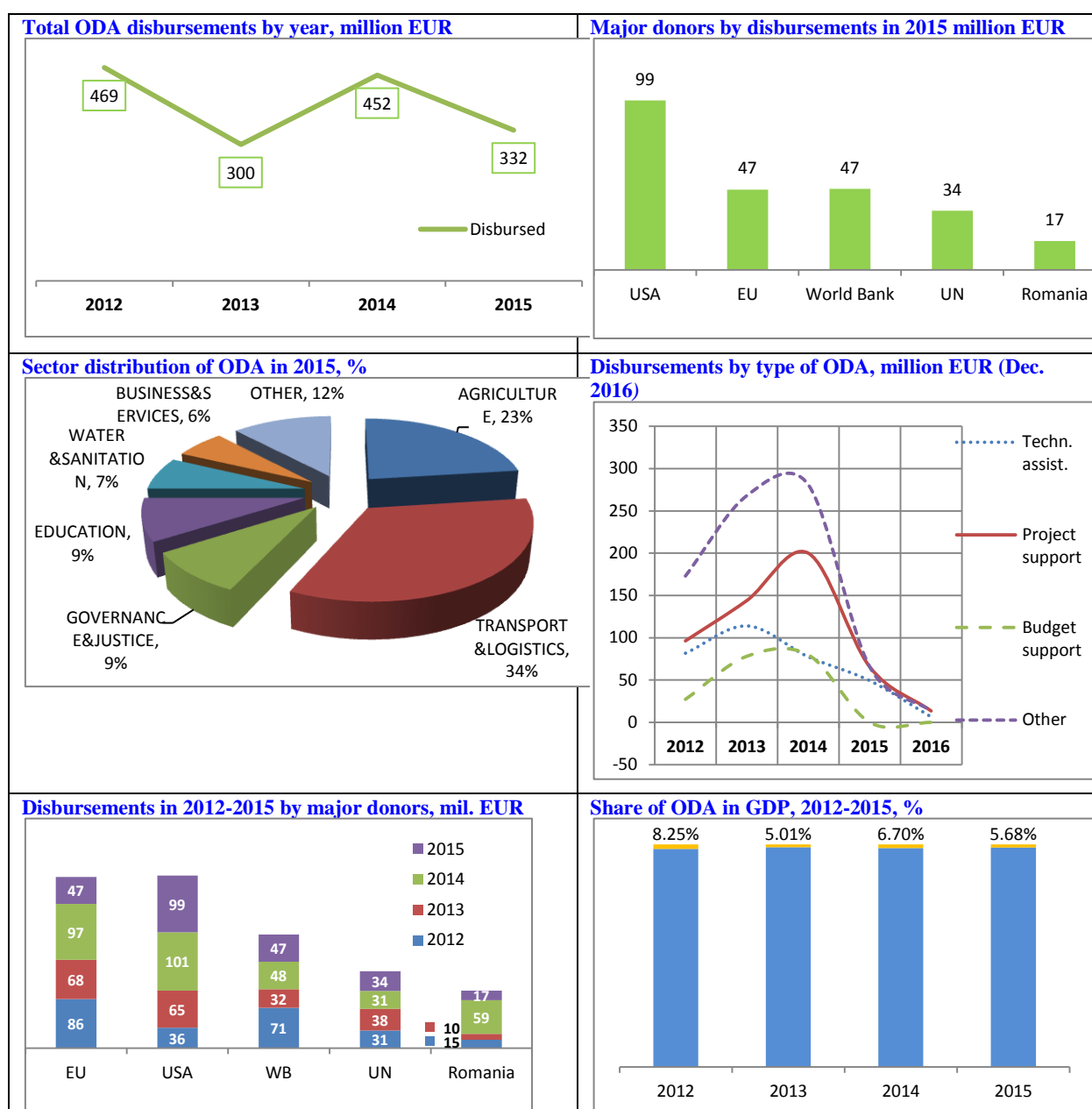
⁹² Index of economic policies for SME in Eastern Partnership Countries 2016, OECD.

⁹³ State Chancellery aid management platform: <http://amp.gov.md/portal/>, visited in June 2016.

IMF approved a three-year USD178.7 million agreement under the Extended Fund Facility (EFF) and the Extended Credit Facility (ECF) with Moldova to support the country economic and financial reform program, which should have also opened the way for other external financing.

185. According to data from the State Chancellery, ODA disbursements decreased from EUR452 million in 2014 to EUR332 million in 2015, or by 27% (of which only 247.4 million EUR for the governmental sector). In the first half of 2016, ODA dropped further to about 4 million EUR. Partially, this might be a consequence of the fact that the GoM gave preference to technical assistance and grants, in external assistance. However, the drop in ODA was mainly due to the stoppage of budget support from the EU and WB. In fact, in 2015-2016 Moldova didn't receive any budget support (figure 28). As result, ODA share in GDP decreased from 8.25% in 2012 to 5.68% in 2015. Major donors from 2012 to 2015 have been the USA, EU, WB, UN agencies and Romania. The largest donor in 2015 was the USA with EUR99 million (MCC Compact), EU and WB (EUR47 million each), UN (EUR34 million) and Romania (EUR17 million). Agriculture was the second largest recipient of external assistance funds by disbursements in 2015 – 23% of total, after transport and logistics (34%). Annex 5 summarizes main ODA programs and projects relevant to the AF, active as of end June 2016 (it does not include the Polish EUR100 million credit, whose active period expired, see paragraph 213 below).

Figure 28: Official development assistance statistics (as of 2015)



Source: Annual report for 2015 on the use of external assistance (State Chancellery) and Aid Management Platform.

186. The list of projects in annex 5 includes mostly technical assistance and apex-based financing. Besides, there is direct financing, mostly granted at commercial terms, the 2KR Program and revolving funds from the apex-based financing programs, managed by the Credit Line Directorate (CLD). The paragraphs below focus on tendencies and approaches by development partners in the implementation of their AF related programs and projects in Moldova.

The EBRD

187. The EBRD, probably, is not the most important development partner in the area of AF. However, its change in approaches toward projects in Moldova in the last years is symptomatic for the evolution of the attitude of most development partners toward their programs in Moldova, maybe because most of the funds provided by the EBRD are on commercial (as opposed to concessional) terms. About 73% of EBRD portfolio in Moldova⁹⁴,

⁹⁴ According to data provided by the EBRD in June 2016

at the end of 2015, were in public infrastructure projects (road rehabilitation, water utilities, heating or urban/national transportation projects), which is not typical for the strategy of this IFI in Moldova. According to the EBRD office representatives in Moldova, EBRD would prefer to increase its exposure to financial institutions, which was its usual approach to financing in Moldova. However, problems in the banking sector forced EBRD to shift its focus on municipal infrastructure, road and direct industry, commerce and agribusiness financing. Once dominant, the EBRD financial institutions portfolio in Moldova decreased to only 9% of the total, direct company financing (in industry, agribusiness, and commerce) is 12% of the EBRD portfolio, with the rest of 6% - in the energy sector.

188. Total EBRD portfolio in Moldova, at the end of 2015, was almost 467 million EUR (including undisbursed commitments). Operating (outstanding) EBRD assets were 154 million EUR. Annual investments decreased from 128 million EUR in 2013 (15 projects) to 98 million EUR in 2015 (11 projects). In the private sector, the EBRD enters niches not covered by banks: financing of large companies, of high risk profile companies, and of foreign investors not trusting the local financial market. EBRD investments take several forms: (i) classic loans (up to 5-7 years for the private sector and 35-50% of the project investments); (ii) equity investments (portfolio investments) – up to 25-30%, usually with the aim of avoiding over-indebtedness of client companies, to prepare them for selling to strategic investors, or in by-back schemes. EBRD is not financing primary agriculture in Moldova, because of its low efficiency and high risks. For the EBRD this is a non-bankable sector, a potential area of interest for venture funds and for investors looking for agricultural raw materials. Also, start-ups are excluded from the EBRD financing schemes; however it finances "greenfield" investments by mature companies (up to 30% of the project value or 50% of the equity).

189. In the financial sector, EBRD works with 2 banks – Mobiasbanca and ProCredit Bank, as well as with a leasing company - – BT Leasing, providing them financing through a multi-product framework facility of up to 80 million EUR (SME credit lines, mortgage and retail financing, leasing products, subordinated debt, small equity investments, etc.). In the past, EBRD used to work with several banks, including Victoriabank, MAIB, Moldindconbank and Eximbank, and provided financing for several MFOs. However, shareholder transparency problems in the banking system determined EBRD to limit its exposure to Moldovan banks only to the two foreign subsidiaries. Recently, the EBRD increased its share in the equity of Victoriabank from 15% to 27.5%, and was approved with two members in the 7-member Board. It also announced intention to grow it further up to 100%. It is not typical for the EBRD equity investment strategy to acquire the control stakes; however the reasons behind this decision lie, apparently, in the willingness of the EBRD to restore efficient corporate governance in Victoriabank.

190. Besides direct financing, the EBRD is working toward policy dialog – improving of local legislation and practices (leasing Law, Law on energy efficiency, mortgage Law, regionalization of municipal services, etc.). Financed projects usually create platforms for the EBRD activities on policy dialog. One of most notable policy dialog EBRD project in Moldova is the establishment of the Economic Council by the Prime Minister, to address the problem of enterprise growth in Moldova. The Council promoted several important reforms, however often government changes and political instability slowed down its activity. The project is financed by different donors, but coordinated by the EBRD. The EBRD decided, in 2016, the extension of the project for a new period. Other future plans for the EBRD activities in Moldova include investments in the corporate sector; policy dialog projects (for the transparency of company and bank shareholders, territorial reforms, regionalization, improving of the investment climate). EBRD runs also a business consultancy project financed from funds of different donors – Advice to Small Businesses, to provide support services in helping small and medium businesses grow.

191. As of April 2016 the World Bank (WB) had nine active projects in Moldova in the amount of USD335.3 million, of which 66.3% was undisbursed⁹⁵. The WB disbursement ratio, in 2015, was only 25.8%, while budgetary support was stopped already in 2014 on the background of the risks in the banking sector. Support for the AF in Moldova falls under Pillar 1 (Increasing competitiveness) of the WB Country Partnership Strategy for 2014-2017. The assistance under this pillar is intended to support improvements in the business climate and promote financial sector stability. However, as noticed by the WB performance review report of April 2016⁹⁶, many actions intended to increase competitiveness were undermined by weakened governance and control of corruption, by the large banking fraud, while political instability has led to frequent changes in government counterparts and delays in policy decisions.

192. In enhancing the business climate the WB is working toward regulatory reform through **the Competitiveness Enhancement Project II (CEPII)**, including in establishing a Single Window for permissive acts. It has also been supporting the Government in developing a system of performance indicators for public authorities with business regulatory functions. In its turn, **the IFC Investment Climate Reform (ICR)** project supports reforms to improve the business climate and enhance competitiveness. In particular, it helped modify and streamline the insolvency framework, aimed at speeding reorganization procedures, simplifying dissolution procedures and clarifying practices relating to rights and obligations of participants to the process. Work in this direction will continue, as further legal reforms are needed and their implementation to speed up insolvency proceedings. In June 2016, technical assistance has been offered by the WB to amend the insolvency Law no. 149/2012. The beneficiary of this assistance is the MEI. The project has also supported trade facilitation through support to the Customs Service to establish a trade facilitation committee, to strengthen efforts for the trade automation, risk management and support for the drafting of a new Customs Code and of related regulations. The ICR project and IDA-financed **Moldova Agriculture Competitiveness project (MACP)** supported the creation of the National Food Safety Agency (FSA) and capacity building of staff responsible for inspections and controls in the newly introduced risk-based inspections approach.

193. Another **IFC project, on the Financial Infrastructure**, has supported since 2013 the NCFM to improve operation of the CHB. The NCFM asked for support to amend the law on Credit History Bureau no. 122/2008 and guidelines for supervision of private credit bureaus. The project assisted the NCFM to draft amendments to the Law no. 122/2008 and undertake regulatory impact analysis. The draft law provided initially for the compulsoriness of the delivery of information to the CHB by MFOs and insurance companies. However, even if it has been approved by the Parliament (Law no. 149 of 14.07.2017), the provisions relating to the compulsoriness of information provided by MFOs and insurance companies have been excluded. Starting from 2017, the WB will have a component for the assistance to CHB in the elaboration/improvement of the legislation, including for the supervision of CHB. Also, the WB will render assistance for the improvement of the functioning of the real movable collateral Registry and amendments to the Regulation on the operation of the Registry, approved by GD 210/2016. It will address deficiencies in the operation of the registry described in Section 4.2. “Financial Infrastructure” of this Study.

194. Under the private sector development component, the CEP II provided support for the elaboration of MIEPO and ODIMM strategies, approved in April 2016. Also, as part of the support for ODIMM in 2014-2015, the WB made an evaluation of the performance of the LGF and formulated a series of recommendations to overcome its low attractiveness for banks, supported the elaboration of the LGF Operational Manual and finances the elaboration

⁹⁵ Performance and Learning Review (Report No. 105224-MD), the World Bank Group, April 2016.

⁹⁶ Ibid

of an electronic platform and the acquisition of software to ensure connectivity of banks. The CEP II project is financing also the Cost of Doing Business study in Moldova.

195. Under the access to finance component, the CEP II provides a Credit Line of USD29.4 million for direct and indirect exporters (participants to the value chain). Funds are disbursed through 4 banks: Mobiasbanca, ProCredit Bank, Fincombank and Comerbank. Other banks are not eligible for reasons of not meeting criteria of transparency and corporate governance, or because of high non-performing loan (NPL) rates. The Credit Line (CL) is financing both investment (up to 8 years) and working capital (up to 4 years). Interest rates in MDL, as of June 2016, were 13-15% and 4,5-5% in USD and EUR, adjusted semiannually on the basis of inflation rate (MDL) and LIBOR (6 month) for foreign currency loans. Besides the longer periods and slightly lower interest rates compared to loans from the own bank resources, beneficiaries of CEP II CL can benefit from VAT and customs duties exemption on imported equipment. After the interest rate modification on March 31 2016, the CL became less attractive (given the higher inflation rate for the previous 6 months), so that only USD2 million have been granted in the first half of the year 2016, compared to USD7 million until the interest rate change. The CEP II manages also a Matching Grants Facility, providing co-financing of consultancy services up to 50% of their cost for the increasing of SMEs competitiveness at export. The total value of the Matching Grants Facility is USD3 million, for a period of 3 years. Other WB support activities in the AF include technical assistance for the NBM in improving the payments system, corporate governance (amendments to the legislation on shareholder transparency, money laundering fighting, etc.). However, information on the concrete activities performed and recommendation under the respective activities was not available.

196. Financial support and technical assistance from WB for agriculture are provided by MACP. The project aims at enhancing the competitiveness of the agro-food sector by supporting the modernization of the food safety management system, facilitating market access for farmers, and mainstreaming agro-environmental and sustainable land management practices. 30 producer groups have been established and supported financially by MACP by the middle of 2017, to establish partnerships (cooperatives) and make investments, particularly in cold storage and post-harvest facilities. These partnerships have also benefited from support in implementing sustainable land management practices. In 2015, the WB allocated USD12 million to finance compensation for fruit-growers affected by the 2014 Russian import restrictions. In 2013-2014, the WB allocated about USD 6,5 million within the Emergency Agriculture Support Project to diminish the negative consequences of the 2012 draught, by providing compensations to the affected corn, grain and animal producers. The second MACP additional financing has been carried forward from 2017 to 2016, given the fast implementation of the Grants Facility through the allocation of USD10 million in grants for investments of groups of agricultural producers from horticulture and animal breeding sectors (especially milk and honey producers).

197. From the autumn of 2016 the WB launched the elaboration of the new Country Strategy (Country Partnership Framework - CPF) for Moldova for 2018-2021, approved in July 2017. For this scope, the WB has developed also a country diagnosis. In 2014-2016 the IFC has provided loans to Moldovan banks to finance SMEs through three credit lines. However, given the economic governance problems and less favorable outlook for the investment climate, other IFC activities have shifted away from investment towards advisory services and analytics (ASA)⁹⁷ In the economic governance sector, the new CPF provides for three priority assistance areas: (a) the policy framework for supporting the development of the private sector and the creation of new jobs; (b) increasing the accountability of state institutions from

⁹⁷ Performance and Learning Review (Report No. 105224-MD), the World Bank Group, April 2016.

the economic block (ministries, governmental agencies, state enterprises); (c) improving the governance of financial institutions. For this, the ICR project will continue support for the regulatory reform, directed at reducing of the administrative burden of inspections, licensing procedures and issuance of permissive acts. It will render also assistance for the improvement of trade logistics, policies for FDI attraction and private sector export capacities to the EU, in cooperation with CEP II and MACP. Moreover, two new projects will be launched: Rule of Law in the Economy (financed by the EU) and Economic Governance. The last one will provide consultancy services and technical assistance in the following areas: business environment, justice reform, management of state enterprises, management of state assets, regulatory transparency.

International Fund for Agricultural Development (IFAD)

198. The International Fund for Agricultural Development (IFAD), a specialized agency of the United Nations, has implemented so far four programs in Moldova: IFAD I (2000-2005)/Rural Finance and Small Enterprise Development Project (USD 8.0 million); IFAD II (2006-2013)/Agriculture Revitalization Project (USD15.5 million); IFAD III (2006-2011)/Rural Business Development Program (USD13.7 million); IFAD IV (2009-2014)/Rural Financial Services and Marketing Program (USD13.2 million); IFAD V (2011-Sept. 2016)/Rural Financial Services and Agribusiness Development Project (USD24.5 million). One more program, IFAD VI (2014-2020)/Inclusive Rural Economic and Climate Resilience Program (USD26.1 million) is being implemented at the moment. It focuses on 3 main areas: (i) financing of agricultural businesses; (ii) financing of rural economic infrastructure (irrigation, agricultural markets, roads, etc.); (iii) diminishing of the impact of climate changes (forest belts, soil treatment technologies, etc.) – from grant component. IFAD programs are complemented by a consultancy and technical assistance (TA) component. It provides technical assistance and support to agricultural companies, benefiting of investment financing from IFAD programs: training for producers and their associations, apex organizations, pre- and post-financing training for young entrepreneurs, training for SCA members, SCA management and central SCA associations, training for the NCFM in supervising and monitoring of SCAs; consultancy for producers and their associations (in technological processes, marketing, accounting systems, etc.); financing of business plan elaboration. The entire TA component is rather small however – only USD 0.5 million.

199. The IFAD Programs in Moldova are implemented by a Consolidated Program Implementation Unit (CPIU IFAD). IFAD funds have traditionally been actively sought by beneficiaries, given more attractive interest rates (as compared to local resources), longer terms and fiscal incentives (0% VAT and exemptions from customs duties and taxes on imports; 0% VAT on domestic supplies of goods and services). However, demand for IFAD funds reduced sharply recently. According to CPIU IFAD, there are several reasons for this: (i) limited demand for loans, induced by the economic slowdown/increased interest rates/MDL depreciation; (ii) the exclusion from IFAD financing schemes of several banks for the breach of eligibility criteria, including high NPL rates and corporate governance problems; (iii) stern collateral requirements from banks and lack of special guaranteeing mechanisms. At middle June 2016, only 2 banks were eligible to work with IFAD funds (out of 10 before the banking crises and 7 before the NBM appointed special supervision over the 3 largest banks). This limited substantially the number of potential IFAD borrowers.

200. CPIU IFAD launched discussions for the softening of eligibility criteria, to allow more banks to participate in the programs, however this has to be approved by IFAD office. All the IFAD funds are for investment purposes (5-8 years, with a grace period of up to 4 years). Working capital is financed by participating banks (from internal resources or from the 15-20% mandatory contribution to the IFAD programs). IFAD also encourages co-financing by beneficiaries to ensure sustainability of the financed projects. Because of the decrease in the

demand for loans, only USD 2-3 million from the IFAD VI have been assimilated by June 2016 (the Program started in 2014)⁹⁸.

201. IFAD is trying to establish a common platform together with AIPA (the Agency for Interventions and Payments in Agriculture) and ODIMM for grant histories of beneficiaries (work has been undertaken for the concept of the platform, structure and soft). The grant history database is deemed necessary for the coordination of donors' efforts. It is envisaged that the database will be managed by AIPA or by the Agriculture Information Center of the Ministry of Agriculture, Regional Development and Environment (MARDE). Also, the IFAD is working toward the establishment of a Guarantee Fund for Loans in Agriculture (GFLA), at the initiative of MARDE, undertaking a feasibility study in this respect. It is envisaged that the GFLA would be financed from IFAD VII Program, however by the date of discussions with the IFAD representatives (June 2016) no such decision was taken yet. IFAD VII was set to be launched until the end of 2017, the financing Agreement being ratified by the Parliament by Law no. 138 of 17.07.2017. IFAD VII will have 3 main components: (i) agriculture, (ii) infrastructure financing and (iii) climate resilience. Starting from 2019, IFAD intends to launch its eighth program (IFAD VIII). According to CPIU, IFAD has already allocated funds for IFAD VII and VIII, but conditions are tougher: the periods of the programs will be reduced from 40 years to 25 and less, the programs size will be smaller. This is because Moldova has been upgraded in the IFAD classification (by the level of development of countries), according to earlier evaluations, notwithstanding the fact that in the meanwhile country conditions worsened.

United States Agency for International Development (USAID)

202. In the area of economic reforms, the USAID is providing assistance to the Republic of Moldova in accordance with the Economic Growth Assistance Agreement. Within this agreement, 2 projects finalized in 2016: the Agriculture Competitiveness and Enterprise Development Project (ACED) and Moldova's Business Regulatory, Trade, and Investment Environment (BRITE) program. A third one, the Competitiveness Enhancement through Workforce Development and Innovation (CE-WIN) Project, implemented by Chemonics International Inc. started in 2015 and will run through 2020. It aims at improving competitiveness and efficiency in some of the key Moldovan industries: information and communications technology (ICT); wine production and export clustered with the tourism sector; light industry (clustered textiles and apparel with footwear sectors). Activities for direct facilitation of the AF are provided mainly through the Development Credit Authority (DCA) Loan Portfolio Guarantee Agreement with Prime Capital (2 DCAs), Rural Finance Corporation and Comerbank. Under the guarantee schemes, USAID guarantees 50% of net losses of participant financial institutions. USAID used to have such DCAs with 6-7 banks, in the past, but given the governance problems in the banking sector, it limited the scheme to only 1 bank and 2 MFOs.

203. The aim of the DCA is to grow clientele for the partner institutions. The guarantee mechanism is appreciated by banks that used to work with USAID in the past. In contrast to the ODIMM guarantees, payments on guarantees are made upon default of the borrower to fulfill obligations under the loan agreement (usually, after 90 days of delay). Final settlements are made after the bank/MFO exerts its claims over the collateral. The NBM admitted the US Treasury guarantees as sufficient (state guarantees), so that DCA guarantees diminish the capital adequacy requirements for risk assets. However, according to USAID, even the DCA improved guaranteeing practice showed that guarantees do not diminish banks' requirements for collateral. Also, the USAID used to practice the loan portfolio guaranteeing mechanism (which is trying to promote now ODIMM), but it didn't have significant effect on banks'

⁹⁸ According to the IFAD office in Moldova.

collateral practices. Now, USAID is testing the mechanism of “portable guarantees”, which are letters of guarantee commitment allowing borrowers to seek the most advantageous financing terms from any of the financial institutions. However, this activity will be limited in scale (in fact, only one portable guarantee, for an IT park will be issued).

204. Upcoming USAID projects include a structural reform project (the successor of BRITE project) that would have a technical assistance component for the diminishing of risks in the banking sector (technical assistance for the NBM, NCFM, and DGFBS). No more details on the projects were available at the moment of interview with the USAID representative, as the project was still in the tendering phase. The new agricultural USAD project - Moldova High Value Agriculture Activity (in continuation of the ACED), implemented by Chemonics started in February 2017 and focuses on expanding trade and strengthen the market linkages; improving productivity; building post-harvest infrastructure and developing private sector capacity to meet international quality standards in four value chains: apples, table grapes, stone fruits and vegetables produced in greenhouses. In 2014 USAID undertook a study on the DGFBS and plans to continue the work with the analysis of constraints and elaboration of an action plan for the DGFBS. Also, the US Treasury financed two consultants to provide technical assistance for the NBM (a distinct from USAID activity).

Credit Line Directorate (CLD)

205. The Credit Line Directorate is an autonomous public institution, subordinated to the Ministry of Finance, established for the re-crediting and administration of resources of credit lines provided by external projects and programs for the financing of the private sector, through eligible participant financial institutions (PFI). In this sense, all of the external financing, in form of loans, administrated by the CLD is guaranteed by the Government. Credit and exchange rate risks are assumed by PFI; exchange rate risks are transferred by PFI on refinanced businesses. The CLD worked at the end of 2016 with 17 credit lines, of which only 3 were direct financing (CEP II, Filiere du Vin and Fruit Garden). All the rest were revolving (re-financing) funds. The outstanding amount of funds provided by the CLD to PFI as of December 31, 2016 was 2.8 billion MDL (cca. 7.4% of the total portfolio of the banking sector). Since the beginning of operation in 2001, the CLD has provided funds for 14 PFI for the re-financing of more than 10.4 thousand projects, in the cumulative amount of about 8.6 billion MDL. More than 1/3 of the administered resources have come from the 6 IFAD programs, 18.7% - from Filiere du Vin, 14% - RISP 2, 12.4% - RISP 1, 10.3 - CEP I, 10.6% - other projects (KfW, PNAET, CEP II, MCC Compact, Fruit Garden)⁹⁹.

206. Almost 70% of funds go to the agribusiness sector. Traditionally, resources from the CLD have been of big demand, because of longer terms, smaller than the market average interest rates and tax advantages offered. The cost of resources is revised periodically, according to the conditions of the credit line agreements. For the revolving funds, conditions may slightly differ from the initial ones. At the moment of the interview (June 2016), the CLD provided revolving funds for PFI at an average interest rate of 7% for MDL loans, 1.7% for loans in USD and 1.55% in EUR. Although not formally prescribed, the PFI margin should not be more than 4% (recommended by the Ministry of Finance) for the revolving funds, as well as for resources from Filiere du Vin and IFAD. The CLD evaluates monthly the compliance of PFI with eligibility criteria, and provides funds no more that 80% of the total normative capital of the PFI. Most part of the funds is for investments up to 7 years, but may differ depending on the program (e.g. IFAD – 5-8 years, CEP – 8 years, Filiere du Vin – 10 years).

207. Because of non-compliance with the eligibility criteria, the CLD provided at the moment of visit funds to only 4 banks – Mobiasbanca, ProCredit Bank, Energbank and

⁹⁹ Data from interview with CLD.

Comertbank. The largest 3 banks – MAIB, Moldindconbank and Victoriabank - have been excluded from re-crediting schemes of the CLD, given the appointment by the NBM of the special supervision in the respective banks. This has dramatically reduces the utilization of re-financing funds. The 3 largest banks accounted for about 80% of the projects re-financed though the CLD. The demand of funds from MFOs doesn't exceed 2-3% percent, given the fact that only 2 MFOs benefit from CLD resources. Also, the demand for investment funds has dropped significantly, while the demand for working capital increased, reflecting a reaction to the economic slowdown.

2KR

208. Initially, the 2KR quasi leasing program was funded from the Government of Japan's (GoJ) grants provided periodically since 2000. By agreement with GoJ, money collected from the first year of operation has been used for additional equipment procurement, creating a permanent revolving fund, used at the same conditions as the initial grants. The budget of the 2 KR program financed from Japanese grants was approx. 158 million MDL, by the middle of 2016. The program is administered by the Implementation and Administration Unit of the Agricultural Production Growth Project (2KR), with a status of non-profit organization, established by the MARDE (ex-MAFI) and managed by a Board (the majority - MARDE representatives) and an executive director, both appointed by order from the Minister of MARDE (ex-MAFI). Grants are were given for the purchase of agricultural equipment, such as irrigation equipment, tractors, combines, etc. Since the year of 2000, about 5000 clients benefited from financing through the 2KR to purchase approx. 7500 new pieces of equipment for primary agriculture, which represents about 40% of all new agricultural equipment operating today in the country¹⁰⁰.

209. Equipment procured through the 2KR was less expensive than in case of direct procurement, given that the large lots of purchased equipment from the Japanese grants allowed the 2KR a good negotiating position with suppliers/dealers of the equipment. Once the equipment is delivered, clients are asked to pay a front-end participation amount which differs on the type of equipment. For tractors or other agricultural equipment, financed from Japanese grants, the up-front payment is 50% of the selling price to Moldovan farmers, with 25% due each year in a 2 year scheme. The price paid by clients, includes transportation costs to Moldova, FOB and custom charges (if there is no exemption), training, administration costs, post-selling monitoring, etc. (which account, in total, approx. 6-7% of the selling price) The approached proved successful in time, so that other donors start using the 2KR to provide financing for agriculture in Moldova. For example, in 2006, the European Commission (EC) financed small scale irrigation equipment, with a budget of 24.9 million MDL (40% up-front payment and successive 30% equal installments in 2 years). The same scheme is used by the UNDP and EU in a USD 0.4 million project for the financing of biomass equipment. So are the resources of the Compact Program of the Millennium Challenge Account (now the Sustainable Development Account Moldova) - USD4.6 million for the implementation of the Irrigated High Value Agriculture 2KR Hire-Purchase Program. Within this, besides irrigation equipment, agricultural producers may also hire-purchase other farming equipment and machines to increase the high value agricultural production on irrigated land. Beneficiaries make a 25% up-front payment and then 3 equal 25% annual installments, with total amount not to exceed the MDL equivalent of USD 100 thousand per beneficiary or group of affiliated beneficiaries, at no interest rate)¹⁰¹. In contrast to other donors who offered grants to 2KR, the MCC Compact offered its resources as a 10-year loan to be fully repaid to the Ministry of Finance by August 2025.

¹⁰⁰ <http://www.2kr.md/>, visited in September 2016.

¹⁰¹ <http://www.sda.gov.md/en/2KR-Program.html>, visited in September 2016.

210. The 2KR leases the equipment, charging no interest rate. The ownership passes to the client when the full price of the equipment has been paid. In addition to equipment procurement, the 2KR provides other useful services. These include advice on the equipment selection, training in a specialized Center on how to use the equipment, repair and maintenance of equipment by authorized dealers. Also, an important part of the equipment is exempted from VAT (and customs duties, as the case may be) and is subject to state subventions, in contrast to leasing. However, given large delays in the provision of state subventions (when these are used to finance equipment from the 2KR), clients usually have to get loans from banks or MFOs to pay the up-front payment to the 2KR, which to some extent minimizes the advantages of the Program, including the lack of need for collateral for the leasing scheme.

The European Investment Bank

211. The European Investment Bank (EIB) has signed 13 projects with Moldova since the start of its operations in the country in 2007, for a total amount of EUR586 million in support of transport and water infrastructure, agriculture and food processing sectors, and small and medium-sized enterprises¹⁰². Large portion of EIB loans has been accompanied by EU grants. Moldova is the biggest recipient of EIB loans among the Eastern Partnership countries in per capita terms. Current commitments of EIB in Moldova amount to EUR372.6 million, and include mostly public infrastructure and utility projects (road rehabilitation, water and sanitation, upgrading of power transmission networks, etc.). Activities for the AF in Moldova relate predominantly to the provision of credit lines for financing of the agriculture/private sector through local banks. The largest project is “Fruit Garden”, with a budget of EUR120 million, to support SMEs and micro enterprises active in the horticultural sector. It is intended to support activities in the entire food value chain, from the training of farmers through to harvesting and food production. The agreement was signed on July 31, 2014 however it started only in the second part of the year 2016, being delayed by the political instability and crises in the banking sector. Through two other projects in Moldova EIB provides lines of credit of EUR 20 million each to ProCredit Bank and Mobiasbanca, for the financing of small and medium-scale projects carried out by SMEs. In 2010 the EIB granted to Mobiasbanca another loan of EUR 20 million that has also been disbursed to support SME projects in Moldova.

212. “Filiere du Vin” (Wine Sector Restructuring Program), financed by the EIB was designed to address the structural weaknesses of the Moldovan wine industry. According to the financing agreement signed in November 2010, EIB granted Moldova a loan of EUR75 million. It became effective in January 2012 and is scheduled to be disbursed through December 2017. The program aims to contribute to the redressing of the country's wine sector and related industries (package, labels, cork, etc.), to the promotion of wine Protected Designation of Origin (P.D.O) and Protected Geographical Indication (P.G.I), to the diversification of markets by ensuring the authenticity of produced wines. It has 4 main components¹⁰³: (i) *Winemaking enterprises development* (upgrade the equipment and facilities, establish new winemaking enterprises, or expand the activities of the existing ones); (ii) *Viticulture sector development* (restructure and revitalize the old and unproductive vineyards, introduce new growing technologies-drip irrigation, other protection systems, and upgrade the viticulture equipment at the farm level); (iii) *Support industries enterprises development* (upgrade the equipment and facilities); (iv) *Laboratories, training, education and development of food security*. The program is implemented and monitored by the Consolidated Unit for Implementing and Monitoring the Wine Sector Restructuring Program (UCIMPRSVV), created by the Government by GD no. 1005 of 26.10.2010. Loans are

¹⁰² <http://www.eib.org/infocentre/press/releases/all/2014/2014-234-eu-bank-opens-office-and-strengthens-presence-in-moldova.htm>, visited in September 2016.

¹⁰³ <http://winemoldova.md/files/raport/Activity%20Report%202015.pdf>, visited in December 2016.

provided through Participant Financial Institutions (PFIs); while leasing of wine related equipment and machinery is implemented by UCIMPRSVV (at the end of 2016, leasing operations were implemented through 2 Specialized Partner Institutions: Raiffeisen Leasing and Mobiasbanca). Also at the end of 2016, there were only 4 PFI in the Program: Mobiasbanca, Energbank, ProCredit Bank and Comertbank. Other 2 banks (Moldindconbank and Moldova-Agroindbank) have been temporarily excluded from the Program (since the NBM instituted special supervision in these banks). Clients can benefit from loans up to EUR5 million to finance investment projects in a 50/50 financing scheme (50% funding from EIB and 50% beneficiary's contribution). The maximum financing period is 10 years, with a grace period of up to 4 years¹⁰⁴.

The European Union

213. The EU was providing, at the end of 2016, support for Moldova primarily through the European Neighborhood Instrument for the period 2014-2020. Indicative allocations for this period range from EUR 610 million to EUR 746 million. The EU support is conditioned primarily with the adoption of horizontal legislation for each of the sectors envisaged by the AA, as well as with the progress in each of the 3 priority areas of interventions of the Single Support Framework (SSF) for Moldova for 2014-2017: (1) Public administration reform; (2) Agriculture and rural development; (3) Police reform and border management. Indicative financial allocations set out in the Single Support Framework for 2014-2017 range from EUR335 million to EUR 410 million (with the allocations divided as follows: public administration reform-30%; agriculture and rural development-30%; police reform and border management-20%; Complementary support-20%, including capacity development and institution building-15%, civil society-5%)¹⁰⁵. Allocations are indicative, as their final value depends on the necessities of the country and on progress in the implementation of reforms. Moldova also benefited from additional financing through the multi-country special measure “umbrella program”. For example, the “Support to the implementation of DCFTA process in Moldova” was financed through the special measure umbrella program 2014 in favor of Georgia and Moldova. It aimed at increasing the competitiveness of Moldovan small and medium enterprises; development of national legislation in line with EU quality standards; promotion of export and investment opportunities.

214. The European Neighborhood Program for Agriculture and Rural Development (ENPARD) Moldova is an EU Budget Support Program of EUR64 million approved in 2014 in the frame of the SSF 2014-2017. It consists of two components: 1) EUR53 million for budget support, meant to support governmental efforts in implementing agricultural and rural development policies, mainly through subventions in agriculture (will be disbursed in 3 installments until 2018) and 2) EUR11 million for complementary support (grants for civil society organizations and local authorities involved in agricultural and rural development activities; capacity building for AIPA; capacity-building and institutional-strengthening in the area of improving competitiveness of the agri-food sector). For the year 2016, ENPARD allocations were set at 380 million MDL (EUR17 million). These, but also next instalments from the budgetary support (EUR17 million in 2017 and EUR19 million in 2018), are subject to conditionality: satisfactory progress in the implementation of the Agricultural and Rural Development Strategy 2014-2020; sound macroeconomic policy; satisfactory progress in the implementation of the Strategy for the Management of Public Finances; satisfactory progress in the public availability of accessible, timely, comprehensive and sound budgetary information, etc.

¹⁰⁴ http://winemoldova.md/conditii_creditare.php?lng=en, visited in December 2016.

¹⁰⁵ Programming of the European Neighbourhood Instrument (ENI) - 2014-2020, Single Support Framework for EU support to the Republic of Moldova (2014-2017).

The Polish loan

215. In May 2014 the GoM signed in Warsaw a loan agreement with the Government of Poland for the amount of 100 million EUR for increasing competitiveness of the Moldovan agricultural sector, on concessional terms (for a period of 25 years, with 0.15% annual interest rate and 5 years grace period). It was intended to be a technical credit delivered to beneficiaries in form of equipment, goods and services, of which minimum 60% - of Polish origin. According to the agreement, EUR 90 million had to be disbursed for the restructuring of the primary agricultural sector and EUR 10 million for the modernization of related industries and infrastructure. However, even if the active period expired in August 2016, only 6 loans for an aggregate amount of less than EUR 10 million have been approved¹⁰⁶. The difficulties resided mainly in the implementation mechanism. Initially, the implementation of the project was given to AIPA, for the EUR 90 million to agriculture (though its subordinate, Public Institution „Unit for the implementation of assistance loan offered by the Government of Poland” (UICAAGRP), created by GD no. 953 of 17.11.2014) and the Implementation Unit of the Japanese Grant/IUJG, for the EUR 10 million to related industries, while the monitoring - to the MARDE (ex-MAFI) and MEI, correspondingly. However actual disbursement of the loan was delayed by long approval of operational manuals, disputes among MARDE, MEI and MF about the size of the interest rate and implementation issues. . According to the MF, the UICAAGRP raised serious public risks, as it lacked adequate capacities to manage the loan (experience, institutional, risk management and monitoring capacities)¹⁰⁷. Correspondingly, the MF refused, for a long period, to give final approval of financing projects from the Polish loan, which had state guarantee. Besides, there have been also delays caused by the frequent changes of governments. After almost 2 years of subsequent changes of the implementation mechanism, financing conditions, and other delays, the GoM decided, by Decision no .841 of July 07, 2016 that the Polish loan would be implemented by the CLD (MF) through the participant financial institutions (banks). Two months later, the GoM liquidated the UICAAGRP (Decision no.1026/2016). An Operational Manual for the implementation of the Polish loan has been developed by the Ministry of Finance and approved by the GoM (Decision no. 1133 of 12.10.2016). It sets the conditions for financing from the respective program, among which: financing activities, conditions and eligibility criteria for beneficiaries, eligibility criteria for participating financial institutions (banks). The GoM is expected to sign a new agreement with the government of Poland, replacing the expired one, however, given the weak assimilation of the loan, the total amount might be reduced to only half of the initial amount.¹⁰⁸

5.4 Key Findings

216. Facilitating AF is among objectives of the main policy documents of the country. However, impact of the envisaged actions is often difficult to assess, either because there are no quantifiable impact indicators set, or the respective actions are very loosely defined and refer mainly to the amendment of the regulatory framework, without practical actions and commensurable impact. Existing strategies and plans focus on activities and process, rather than on results.

217. Also, progress in the implementation of many actions is very slow and the degree of realization of the envisaged actions is very low. For example, as of the end of 2016, out of the only 4 intermediary specific objectives set for the AF in the Moldova 2020 strategy, barely one has been attained, but in the near absence of proactive measures in the subsequent plans

¹⁰⁶ <http://www.timpul.md/articol/statul-nu-are-capacitai-de-a-gestiona-creditul-polonez-96101.html>, vizitat în iulie 2017.

¹⁰⁷ <https://www.mold-street.com/?go=news&n=4932>, visited in December 2016.

¹⁰⁸ <https://agrobiznes.md/guvernul-va-negocia-micsorarea-creditului-polonez-de-la-100-la-50-de-milioane-de-euro.html>, vizitat în iulie 2017.

and their slow progress, the merit of governmental policy actions is hard to be ascertained. Also, slightly more than half of the actions provided by the RICM for improving AF have been implemented by the end of 2016, which makes most of the tiny progress achieved so far in the AF a merit of market development, rather than that of the policy actions implemented. The more so, as the majority of the RICM actions are of immaterial character, while some of the “realized” ones are only draft laws still awaiting approval. There is no proper system for monitoring and measuring of the impact in place, and there appears to be limited effective monitoring of the outcome of activities undertaken under the existing strategies and plans.

218. A large body of reforms in the AF, particularly those for the ensuring of stability in the financial sector, origins in the recommendations of development partners, most notably, as result of the IMF/WB FSAP mission in 2014. Only after approximately 1.5 years from their formulation, these recommendations have been included in a governmental roadmap and their implementation started, given the political instability. Also, reforms in the financial sector have been speeded up by the conditionality set by most development partners, which provided for the resuming of external financing only after the registration of clear progress in attaining stability of the financial sector. The FSAP induced reforms in the financial sector have been in most part realized, but the new agreement with the IMF shapes up further reform agenda in the financial sector, aiming at protecting long term financial stability by enhancing the soundness of financial institutions, improving the regulatory and supervisory environment. However, their efficiency will depend on the quality of the enforcement of newly made legislative amendments. Besides, effect of reforms in the financial sector is directly linked to progress in the reform of the judiciary.

219. The efforts of the NBM have been directed primarily to improve corporate governance in banks and ensure transparency of their ownership structures. Despite significant legal and regulatory changes, there are still big challenges in attaining veritable ownership transparency and better corporate governance in most banks. Banks use parceling of shares below the set limits to avoid prior approval by the NBM, while ultimate effective beneficiaries of many banks are still unknown, as these are foreign individuals and the regulator lacks effective tools to verify their identity. After a series of legislative improvements, the NBM will focus on their enforcement. The process started with two of the largest banks, big stakes of which had been written-off as result of breach of ownership regulations. Instead, new shares have been issued in accordance with newly made legal amendments. However, progress will depend on the determination of the NBM in implementing reforms, as well as in the political will to adopt and enforce the entire agreed reform agenda.

220. Implemented reforms envisage, also, tightening of provisions for currency exchange rate exposures, as well as stricter classification loan standards, to combat concentration risks from large exposures and affiliations, , as well as virtual lending to insubstantial shell companies. Apparently, these didn’t have an adverse impact on AF, as special provisions have been set for SME and ‘live’ businesses, while limiting exposure to exchange rate fluctuations helped avoid distress situations after sharp depreciation of MDL. At the same time, there are still challenges for the NBM in fighting virtual lending to shell companies registered abroad. To prepare banks for switching to Basel III norms, the NBM tightened capital adequacy requirements for banks as early as in 2012. It seems to have a positive impact on banks’ readiness to meet new prudential standards.

221. State subsidies for the agricultural sector are also undergoing reforms aimed at their efficiency. A new law on the principles for subsidizing of agricultural producers provides for the creation of the National Fund for Agricultural and Rural Development (NFARD) to support the subsidizing and financing of the priority measures of the National Strategy for Agricultural and Rural Development 2014-2020. The NFARD is to be formed from budget allocations (not less than 2% of the annual revenues of the state budget) and funds from donors. Predictability and continuity of state policies in subsidizing are ensured by the setting of concrete support measures by the state for a period of 5 years (Regulation on the

conditions, regime and procedure of allocation of resources from the National Fund for Agricultural and Rural Development, approved by GD no. 455 of 21.06.2017). A Supervision Council will supervise and monitor efficiency of state subventions allocated by the Agency for Interventions and Payments in Agriculture, while certain categories of beneficiaries (from strategic sectors) could benefit from increased subventions.

222. Stability of the financial sector was undermined by the lack of viable crises prevention and coordinating body. The NCFS established in 2010 for this scope proved inefficient both in preventing and resolving the banking crises of 2014 and required cardinal reforming. In the autumn of 2016, the Government approved the new NCFS structure, excluding its political exposure. However in order for the NCFS to become efficient, there is still a need for capacity consolidation and establishment of effective communication and coordination among relevant member bodies.

223. Several tentative to improve AF for agriculture by MARDE, by promoting a law on agricultural credit and establishing a guarantee fund for agricultural loans, as well as initiatives from MEI to support productive SME from rural areas didn't materialized because of public finance constraints and lack of sufficient argumentation and elaboration of the solutions. Also there is an initiative for the implementation of international evaluation standards and supervision of evaluation activities, including evaluation of collateral that also failed to materialize so far because of financial constraints and dissonance among involved stakeholders. This would have theoretically the potential to improve quality of collateral evaluation, by committing the entire evaluation to qualified evaluators and introducing control and supervision over evaluation. The introduction of warehouse receipts for grains in 2006 failed to bring positive impact on AF, given deficient legal enforcement framework for movables, opaque behavior of businesses and low awareness and limited incentives for using this tool.

224. Another initiative that could have had a significant impact of easing access to affordable and cheap financing by agricultural companies - the Polish EUR 100 million loan - didn't materialize as initially agreed because of the ill-conceived implementation mechanism. After 2 years of several subsequent changes in the implementation concept and mechanism, the implementation of the project was passed to the CLD to be implemented through selected banks. However, costs for borrowers will inevitable increase in this case, diminishing the attractiveness of the loan for borrowers. Total amount of the loan might also be reduced to only EUR 50 million.

225. The lack of progress in reforming the judiciary represents a serious constraint to the implementation of many reforms, including those that would facilitate better AF. The level of corruption in the judiciary is perceived as extremely high, while market participants complaint about the absence of an impartial and predictable rule of law. This determines lenders to be more selective and more conservative in taking and evaluating collateral, affects effectiveness of bank regulation, and supervision. Despite the fact that regulators' powers have been mostly restored and strengthened, risks persist as far as the judiciary remains vulnerable to corruption, versed political and group interests.

226. In 2016, the Parliament adopted 2 law packages intended to strengthen NBM powers in dealing with non-transparency of bank shareholders and quality of corporate governance in banks. These allow early intervention by the regulator and better supervision of shareholder structures, more possibilities to intervene in case of disguised concerted actions and reasons to deny acquisition of shares by untruthful buyers of bank shares. Notwithstanding that most of the envisaged reforms to conclude an agreement with the IMF have been implemented until July 31, 2016, further reforms to protect long term financial stability of the country are needed. These are guided by the recently concluded 3-year arrangements with the IMF. Success in ensuring financial stability will also depend on the effective implementation of the newly adopted reforms.

227. The NBM started implementing the standard approach for credit, market and operational risk under Basel III, in accordance with the AA commitments. The implementation is planned to last through 2019. Based on general impact evaluation performed, the NBM concluded that in general the Moldovan banking sector is prepared for the Basel III standards, although compliance with new norms may require additional capital and put more pressure on internal governance for banks. In line with Basel III standards, the NBM elaborated a new Law on the activity of banks and is being developing/approving the secondary framework for the enforcement of the new Law. Basel III norms have the potential to positively impact financial stability of the sector, although AF could be constrained by more strenuous requirements of banks stemming from the new capital and liquidity regulations.

228. The microfinance and leasing sectors are also expected to undergo legislative changes. The NCFM developed a new draft law on the non-bank credit organizations (NBCO) that will substitute the Law on MFO, providing for closer prudential regulation and supervision of the MFO sector. Even though these will not put significant constraints on MFOs, some of the provisions (especially those referring to the minimal capital adequacy rate, supervision fee and the interdiction to collect borrowings from individuals (non-shareholders and shareholders with stakes <5%), have the potential to eliminate small and medium MFOs from the market, as well as to lead to the rise in price of lending products. There are also amendments to the leasing Law providing for the regulation and supervision of the sector by the NCFM. Both the draft law on NBCO and amendments to the leasing Law are awaiting approval since 2012. For the SCA sector, major changes envisage amendments to enact the establishment of a Savings Guarantee Fund, new services by SCAs, the right for the NCFM to introduce special administration in SCAs, regulation of internal control and risk management activities in SCAs and delegation of certain supervision powers by the NCFM to the central Associations of SCAs.

229. As part of the AA commitments, the NCFM drafted a law on facultative pension funds. This failed also to be approved by the Parliament so far. Theoretically, pension funds may have high potential impact on the provision of more long term and cheaper funds for banks; however, given the low saving capacity and limited awareness from population in their usage facultative pension funds represent, rather, a long term solution. The law on venture capital funds (VCF) drafted by the Ministry of Economy, represents another reform action, stemming from the AA commitments. The biggest constraint to the emergence of VCF in Moldova however seems to be not the absence of a dedicated law, but complex and cumbersome conditions for business activities, limited possibilities for the entry and liquidation of investments, which create little incentives for potential venture capital, and the lack of internal systems of institutional investors, to stimulate the development of this market. The absence of a truly functional capital market also impedes the emergence of venture capital in Moldova.

230. The newly adopted Law on SMEs envisages the creation of a Consultative Council for SME, a consultative character for the state controls in SMEs in the first 3 years, the right for the SMEs to deduct from the fiscal base expenses for the continuous education and training of personnel. The Law also warrants a minimal share of all public procurement contracts to SMEs, provides for a general framework for facilitating SMEs AF, including investments by business angels. The new Law on SMEs also introduces entrepreneurial education at all levels of education, starting with primary education and enacts the operation of the LGF as a subdivision of ODIMM. At the same time, the Law allows ODIMM LGF to conclude agreements only with banks, thus excluding MFOs and SCAs from the guarantee schemes of the LGF.

231. Because of the vulnerability of economic growth model, Moldova is relying heavily on assistance from external donors. After 2014 however, development assistance dropped sharply (by 27% in 2015 and probably even more in 2016). As share in GDP official development assistance diminished from 8.25% in 2012 to 5.68% in 2015. Budgetary support

was stopped completely in 2015 and 2016. The pro-reform agenda, culminating in June 2014 with the signing of the AA with the EU has been diverted shortly after by political turmoil, slowdown of reforms and theft in the banking sector. From 2015, the majority of development partners stopped/limited financing and conditioned its resuming by the reversal to the reform agenda and addressing of risks in the financial sector.

232. Many assistance actions by external donors have been undermined by weakened governance and control of corruption, by the large banking fraud, while political instability led to delays in policy decisions. Correspondingly, most of the donors rethought their strategies for Moldova. Budget support has been stopped completely. Provision of funds to financial institutions was limited, mainly, to only 2 subsidiaries of foreign banks and few MFO/leasing companies with foreign ownership. Instead, money has been diverted mostly to public infrastructure projects, direct financing of the private sector or reforms in the business environment, to support growth of enterprises. Substantial support is provided in form of technical assistance to improve the payments system and financial infrastructure, corporate governance, strengthening of the NBM and NCFM powers and abilities to regulate and supervise respective markets.

233. Development partners' efforts address some of the constraints in the AF identified in this Study. These envisage support for structural reforms, addressing weaknesses in the business regulatory framework, competitiveness enhancement in agriculture and rural development, through project and direct budgetary support, further strengthening of the financial sector by addressing regulatory and enforcement weaknesses, as well as by tackling most of the financial infrastructure constraints: the functioning of the CHB and LGF of ODIMM, the payment and securities settlement system (SCDS), creditors' rights and insolvency regime, DGFBS and bank crises resolution system. At the same time, there doesn't seem to exist a sufficient coordination among different donors in the provision of the assistance for the implementation of the vast reform agenda, including in facilitating the AF. Some of the donor activities may however overlap, others, from sectoral perspective, are too atomized and don't allow for the efficient use of the synergy potential, in order to amplify the final effect. The political will, leadership and initiative at country level proved often insufficient to be able to advance the reform agenda. A significant proportion of assistance continues to be supply-driven. In such circumstances the role of coordination, among various donors, increases.

234. The majority of donors seem to prefer establishing their own Project Implementation Units (PIU). In addition to less efficient coordination of different development assistance programs, this may fail to foster more sustainable internal capacity development of the country (systems, processes and institutions), and may conduct to less efficient use of available assistance funds. As the State Chancellery report for 2015 on the external official development assistance (ODA) points out, donors mostly use their own PIU to deliver assistance relating to the implementation of investment projects, avoiding national financial management and procurement systems. This caused a discrepancy of 39% between the figure of ODA reported by donors for 2015 (EUR331.6 million) and by the Ministry of Finance (EUR 202 million), explained by transactional costs of donors for the delivery of ODA. Also, the report noted a weakening of national institutions as result of the usage of donors' PIUs, difficult to coordinate, monitor and to evaluate their efficiency¹⁰⁹. At the same time, the approved mechanisms for the implementation of the "Polish loan" at the governmental level proved inefficient, which precluded the rapid absorption of EUR 90 million from the Polish loan for the agricultural sector, with potentially high impact on improving the AF in agriculture.

¹⁰⁹ Raport anual 2015 cu privire la asistența externă acordată Republicii Moldova, Cancelaria de Stat a RM.

6 CONCLUSIONS / SUMMARY OF CONSTRAINTS

235. Access to finance is the result of a complex interplay of different factors, both endogenous and exogenous to the financial sector, the right kinds of financial infrastructure, and a sound legal and regulatory framework. Expanding access to finance by influencing endogenous factors entails a dual strategy: (i) create and improve the different financial infrastructure elements, such as credit bureaus, payment and securities settlement systems, deposit and loan guaranteeing mechanisms, collateral registries, crises resolution settlements, as well as creating an enabling legal and regulatory framework to allow the proper functioning of the financial markets and of the various financial infrastructure elements; and (ii) address the various financial institutions themselves (banks, microfinance organizations, leasing, etc.), and develop institutional capacity and practices within. In their turn, exogenous factors influence access to finance through the macroeconomic environment, in which businesses and financial institutions operate; business and investment climate that determine economic intensity and development of enterprises; the level of economic integrity, affecting balanced regional development, availability of infrastructure and efficiency of institutions; quality of judiciary to ensure adequate law enforcement. Not lastly, the access to finance is influenced by the speed and quality of reforms to get all the mentioned elements on track, as well as the interaction among them. Table below summarizes the main constraints to AF discussed in the present Study:

Elements of AF	Constraints
Demand side	
Private sector	<ul style="list-style-type: none"> • Volatile and lethargic economic growth, given the unstable macroeconomic environment, frequent exposure to external shocks (through heavy reliance on imports and remittances, low diversification of exports, trade barriers by main export country-Russia), conducting to decreased revenues/earnings. • Low competitiveness of local produce, restrained and stagnant production capacities. • High reliance on private consumption fueled by (decreasing) remittances. • Deficiencies in the business environment (corruption, inefficient courts, political and policy instability, bureaucratic/inefficient institutions, burdensome regulatory framework, increasing the costs of businesses, etc.). • High rate of unofficial economy, which distorts competition, diminishes revenues/earnings by legal operating businesses and limits expansion of financial/lending products. • Small businesses do not grow because of adverse business environment (takeovers, poor investment protection and law enforcement). • Limited FDI inflows because of unattractive investment climate and lack of proactive actions. • Weak economic intensity in the regions that reduces incentives for lenders to expand geographical outreach. Limited economic integration of country's localities. • Difficult long- and medium-term planning because of volatile macroeconomic environment and frequent shocks. • Shortage of bankable firms because of the tendency to operate 'in the shadow', limited financial management and planning abilities, poor quality of financial reports. • Limited integration into value chains and awareness of the benefits of collaboration within value chains, insufficient linkages with FDI companies. • Insufficient availability of business support services for medium sized businesses, little support for integration into value chains from institutional structures for FDI promotion and SME development. • High real interest rates in comparison with profits earned, restraining firms from increasing the demand for financing, making investments and expanding business operations. • High volatility of revenue and earnings in agriculture. Profits by agricultural companies have been more volatile and unpredictable, although higher, as compared to the rest of the economy. • The lack of an effective market for land, including low prices, limiting the attractiveness of

	<p>land as pledge for lenders.</p> <ul style="list-style-type: none"> • Illiquid secondary markets for a large part of equipment, machinery and other pledges that businesses can offer to secure financing.
Supply side	
Banking sector	<ul style="list-style-type: none"> • Limited bank intermediation because of the lack of trust in banks, shallow economic activity and rudimentary stage of development of the banking system. • High interest rates for governmental bonds and erratic exchange rates allow banks to earn hefty profits and create them little incentive to increase lending, develop financial products or improve lending practices. • High concentration of the banking sector determines an ultra-conservative behavior of the largest banks, limits competition, excludes micro and small companies from the area of interest of banks and poses substantial risks for the stability of the financial sector. • Little strategic foreign direct investments in the banking sector limit competition, implementation of new technologies, advanced expertise, products and sound lending and banking practices. • Low ownership transparency in banks and poor corporate governance practices, which create substantial risks for the financial sector and undermine confidence of potential investors, outside lenders and depositors. • Exclusion, by donors of the largest banks from their funding programmes, which limited the access to financing for about 80% of bank borrowers. • Collateral evaluation and lending practices based on high or very high loan to value ratios. Because of high reliance of banks on collateral, obscure valuation practices, clients cannot plan for financing and incur high costs for the valuation and registration of collateral. • Banks manage to avoid risks, instead of managing risks to obtain profits. This is both a result of rigid regulations and inadequate risk evaluation practices. • Minimal use of quantified risk measurements and limited analysis of borrowers relative to competitors in the value chains. As result, banks often over-estimate risks by using worst case scenarios, compounding independent risks, and failing to calculate off-setting risk factors. • Banks are limited in their ability to extend long term loans, by regulations and shortage of long term resources. Most of deposits (86%) are short term (up to 1 year). The narrow institutional investor base and underdevelopment of the capital and insurance markets limits the availability of longer term resources. • Volatility of the macroeconomic conditions, lack of trust in banks and small coverage by the DGFBS (6,000/20,000 MDL) also discourage long term placements with banks from population and companies. • Complex and lengthy loan application procedures and poor client service culture by banks. Limited use of electronic registries and digital signatures in the loan and collateral registration. • The prevalence of NPL increases funding costs and reduces operational efficiency of banks, preventing the credit expansion. • Overestimation of agricultural risks by banks, and the use of inappropriate risk evaluation and mitigation techniques are accompanied by the lack of, or insufficiently developed facilitating tools (loan guaranties schemes, deposit certificates, warehouse receipts, etc.).
Microfinance sector	<ul style="list-style-type: none"> • The bias toward consumer and mortgage loans of the MFO sector, determined by the, higher risk perceived in relation to business lending and easies creditor rights enforcement in relation to individuals. • High concentration of business loans in a few big MFOs. • MFOs and SCAs are limited in their ability to offer a more complete range of services to their clients. At the same time, SCAs have weaker risk management and lending abilities and expertise of their management, limited instruments and possibilities for mitigating risks. • MFO and SCA are more limited than banks in their ability to provide long term financing for business. MFO are not allowed to collect deposits and do not have capital requirements. Most of deposits collected by SCA are short term (68% up to 1 year). Given the high risk associated with the country, funds borrowed from IFI are usually up to 3-5 years. • MFO and SCA loans are more expensive (by 30-50%) than bank loans. This comes from higher administrative and operational costs, as well as from the more expensive resource base. • In case of MFOs, most of the resources are in foreign currencies, which place additional significant costs on clients given high volatility of exchange rates.

Leasing sector	<ul style="list-style-type: none"> • 88% of leasing is concentrated in vehicles. Expansion into other market is limited primarily by the absence of liquid secondary markets. • As in the case of banks and microfinance sector, leasing is predominantly short term (up to 3 years) and medium term (3-5 years), given the shortage of longer term resources. • Regional outreach is very low, 75% of the leasing portfolio is concentrated in Chisinau, given stronger demand and closeness to active secondary markets. • The lack of resources at low cost, and prevalence of funding in foreign currencies makes lease an expansive financing alternative for businesses, as compared to bank loans. • The unfavorable VAT regime for the leasing of machinery and equipment, as compared to other forms of lending. • The VAT regime for the leased assets is less favorable than that of assets purchased from concessional credit lines of banks, which make acquisition of the same items on lease terms economically irrational. • The subvention law doesn't create a level playing field for leasing companies. Clients purchasing equipment on leasing terms can claim state subsidies only at the end of the leasing period. • The regime for the deduction of provisions from the tax base also doesn't create a competitive playing level field for leasing companies. These are allowed to deduct provisions for tax purposes only up to 5% of the average annual leasing portfolio. • Enforcement of rights is lengthy and complex. Executive titles can be formally appealed in courts, which make repossession of leased assets lengthy and increases losses incurred by lessor. To prevent such losses, lessors require higher down payments, reducing attractiveness of leasing.
Regulatory framework and financial infrastructure	
Regulatory framework	<ul style="list-style-type: none"> • The legal and regulatory framework of the bank and non-bank sectors is undergoing significant changes, most of them for ensuring their stability. Concerns remain in relation to effective enforcements of improved regulations, given the lack of progress in reforming the judiciary, fighting corruption and, apparently, vested high level political and group interests. • Banks don't actively use eased regulations by the NBM for uncollateralized loans because of worsened business conditions and tougher provisioning conditions. • Some of the regulatory changes have been tardy reactions to the banking crises (tightening of regulations for large and affiliated bank exposures and lending to insubstantial shell companies). Fighting "virtual" lending still represents a challenge for the regulator. • Limited regulation and supervision of MFO sector result in disloyal lending practices in relation to customers and negatively affects consumer protection. There is no corporate consumer complaint resolution mechanism in place for the financial services. Certain provisions of the draft law on NBCO (minimal capital adequacy ratio, supervision fee, and interdiction to contract borrowings from individuals) create potential prerequisites for unfair competition and increase in price for lending products. • Although the regulatory framework for SCAs is quite well articulated, its enforcement is often difficult, especially, in respect to the smallest SCAs. The large number of SCAs makes challenging their effective supervision by the regulator. • The regulatory framework for bank and non-bank financial institutions does not create a level playing field, while regulatory costs are different. These have different prudential, including provisioning norms, while some financial institutions are absolved altogether of such norms, which may create different costs of lending and lead to regulatory arbitrage through cross-holdings or provision of funding for on-lending.
Financial infrastructure	<ul style="list-style-type: none"> • In spite of the recent improvements, the effectiveness of the CHB is still constrained by certain bottlenecks: limited sectorial coverage and products provided, high internal interconnection costs for smaller lenders. • Low effectiveness loan guaranteeing mechanisms. The ODIMM LGF failed to bring a systemic impact on AF, given limited capitalization and conceptual bottlenecks: non-recognition by the NBM of guarantees for provisioning purposes, exclusion of MFO, SCA and leasing companies from guaranteeing schemes and precedents from the LGF of refusal to pay against issued guarantees. • Low coverage level of deposit guarantees by the DGFBS. The actual threshold of 6,000 MDL (as well as the increased one, up to 20,000 MDL, from 01.01.2018) is too small to spur confidence in banks and more savings, especially long term. • Despite numerous improvements, effective implementation of the legal and regulatory

	<p>framework for creditor rights and insolvency regime remains weak. The use of movable collateral is limited by the lack of liquid secondary markets, mechanisms to ensure integrity of the movable collateral and difficulties in registering and enforcing securities over movable assets.</p> <ul style="list-style-type: none"> • Enforcing claims by lenders in court is hampered by numerous possibilities for delay by debtors, even in cases of simplified procedures (executive titles). Arbitrariness of court decisions, either because of low qualification of judges in adjudicating security claims cases, or, apparently, corruption. • The Registry of pledges over movable assets suffers from technical deficiencies in the online operation. In the case of the real estate Registry the impossibility to use electronic signatures delays the circuit of electronic documentation, which doesn't allow for the decreasing of costs and time for registration formalities. • Lack of an insolvency regime for natural persons (legal, regulatory and institutional framework), lengthy and costly insolvency procedures for legal persons.
Access to finance reforms	
AF Reforms	<ul style="list-style-type: none"> • Facilitating AF is among objectives of the main policy documents of the country, but impact is often difficult to assess, either because there are no quantifiable impact/final result indicators or actions are very loosely defined, without commensurable impact, proactive actions are almost missing. Focus is on activities and process, rather than on results/final impact. • Progress of many reforms is very slow. Slightly more than half of actions of the RISM for the improving of the AF have been implemented so far. The majority of RISM actions are of immaterial character, while some of the "realized" ones are only draft laws awaiting approval. This makes most of the tiny progress achieved a merit of market, rather than that of the policy actions implemented. • Political instability greatly delayed reforms. Only after 1.5 years from the formulation of 2014 FSAP recommendations, these were implemented. There is still low internal resolution to implement reforms; these are often driven by the conditionality set by donors. The agenda of reforms for the next 3 years will be dominated by the commitments in the agreement with the IMF. Also, their efficiency will depend on the quality of the enforcement of already adopted amendments and progress in the judiciary reform. • Despite significant legal and regulatory reforms, there are still challenges in attaining veritable ownership transparency and better corporate governance in most banks. The regulator lacks effective tools to verify identity of numerous foreign individual UEB. Progress also will depend on the resolution of the regulator in implementing reforms, as well as, apparently, in the political will. • Stability of the financial sector was undermined by the lack of viable crises prevention and coordination among member-bodies, system. The NCFS proved to be inefficient in preventing and resolving the banking crises of 2014. The GoM reformed recently the NCFM, excluding its clear political bias; however there is still a need for capacity consolidation and establishment of effective communication and coordination among its member bodies. • The lack of efficient argumentation and elaboration of solutions in circumstances of budgetary constraints prevent implementation of some initiatives from GoM to facilitate AF, including for rural SME, agricultural companies, and improving evaluation standards and practices. Use of warehouse receipts is constrained by the lack of reliability in their enforcement, limited awareness and incentives from market participants. • Ill-conceived implementation mechanisms, lack of adequate capacities, disputes among different implementing bodies, delays provoked by frequent changes of the Government and the need to create institutional capacities prevented the efficient and timely implementation of the assistance project from the Government of Poland (the EUR100 million loan). • Lack of progress in reforming the judiciary represents a serious constraint to the implementation of many reforms, including those that would facilitate better AF. The level of corruption in the judiciary is perceived as extremely high, impartial and predictable rule of law is still missing. The judiciary remains vulnerable to corruption and, apparently, to vested political and group interests. • Strengthening regulation and supervision, including consumer protection in the MFO and leasing sectors, was delayed. The Law on NBCO and the amendments to the leasing Law are awaiting approval since 2012. • Laws on facultative pension funds and venture capital financing are also being delayed. These might have, however, only marginal effect on improving AF, given low saving capacity and trust from population, the lack of a truly functional capital market, cumbersome conditions for

	<p>business, limited possibilities for the entry and liquidation of investments, lack of internal systems of institutional investors.</p> <ul style="list-style-type: none"> • After 2014 official development assistance (ODA) dropped sharply, because of the slowdown of reforms, political instability and banking fraud. This negatively affected AF through limited funds available for direct and indirect financing from development partners, including through less available funds for the reform actions in the AF. • Because of the same problems, most of the donors rethought their strategies. Budget support has been stopped, provision of funds to financial institutions was limited mainly to 2 subsidiaries of foreign banks and few MFO/leasing companies with foreign ownership, money being diverted to projects with indirect effect on AF. • Some of donor activities might overlap, there doesn't seem to be sufficient coordination among different donors in providing assistance for the implementation of the vast reform agenda, including in facilitating the AF. Lack of an effective implementation mechanism at the national level precludes the implementation of some assistance projects with potential high impact on AF and determines less efficient use of ODA.
--	--

BIBLIOGRAPHY

1. Association Agreement between the European Union and the European Atomic Energy Community and their Member States and the Republic of Moldova;
2. Adrian Lupușor, Ricardo Giucci: The National Committee on Financial Stability, Why and how to reform it; GET Moldova and Expert-Grup, March 2016;
3. Analiza generala a sectorului leasingului, BIS, 2008;
4. Andrian Guzun, Moldova: A New Insolvency Act, Schonherr Legal Insights;
5. Aviz la Legea nr. 39 din 24.03.2017 privind modificarea art. 6 din Legea privind garantarea depozitelor persoanelor fizice în sistemul bancar;
6. Best practices of public support for early-stage equity finance, final report of the expert group, DG Enterprise and Industry, September 2005;
7. Briefing book from development partners of Moldova, January 2015;
8. CEE Banking Sector Report, Raiffeisen Research, June 2015;
9. CEE Banking Sector Report, Raiffeisen Research, June 2016;
10. CEE Banking Sector Report, Raiffeisen Research, June 2017;
11. Commercial laws of Moldova, an Assessment by the EBRD, EBRD, 2014;
12. Conceptul Bancii Nationale a Moldovei privind implementarea centralei riscurilor, 2013;
13. Constraints to Agriculture Finance in Moldova, draft report, MCC, 2009;
14. David Woo, Two approaches to resolving NPL during financial crises, IMF, 2000;
15. De ce în Moldova nu se dezvoltă leasingul operațional?/Capital Market, no. 32 of 20.08.2014;
16. Doing business 2016 and 2017, the WB Group;
17. Financing agreement sector reform contract ENPARD, the EC and Moldova;
18. EBRD transition report 2015-2016;
19. Evolutia pietei funciare agricole in Republica Moldova, Viorel Chivriga, IDIS Viitorul, 2009;
20. Financing Technology Entrepreneurs & SMEs in Developing Countries: Challenges and Opportunities, the World Bank InfoDev Program, 2008;
21. Foaia de parcurs privind agenda de reforme prioritare (până la 31.07.2016), Guvernul RM;
22. Frank Cmoc, Non-performing loans: addressing legal and regulatory impediments, EBRD;
23. Gábor Hunya, Jan Mládek and Josef Pöschl: Private Sector and Financial Markets Development in the Republic of Moldova, WIIW, 2008;
24. Global Competitiveness Report 2015-2016, World Economic Forum;
25. Global Competitiveness Report 2016-2017, World Economic Forum;
26. Helmut Kraemer-Eis, Frank Lang: Guidelines for SME Access for Finance Market Assessment, the European Investment Fund, 2014;
27. HG nr. 849 din 27.06.2002 cu privire la Registrul gajului bunurilor mobile;
28. Hotărârea CNPF cu privire la aprobarea Regulamentului cu privire la clasificarea împrumuturilor acordate și dobânzilor calculate de organizațiile de microfinanțare nr. 11/1 din 14.03.2012;
29. Hotărârea BNM nr. 240 din 09.12.2013 cu privire la aprobarea, modificarea și abrogarea unor acte normative ale BNM (Regulamentul cu privire la expunerile „mari”);
30. Human Development Report 2014, UNDP;
31. IMF Country Report No. 16/343, November 2016;
32. Index of economic policies for SME in Eastern Partnership Countries 2016, OECD;
33. Ion Tornea, Finantarea IMM-urilor in Republica Moldova, IDIS Viitorul, 2011;
34. Janet Buresh and Ion Tornea, Expanding Issuance of Loans to Agriculture and Agribusiness in Moldova, CNFA, 2007;

35. John Bonin, Iftekhar Hasanand Paul Wachtel: Banking in transition countries, BOFIT, 2014;
36. Legea nr. 62 din 08.04.2016 privind modificare și completarea unor acte legislative;
37. Legea nr. 179 din 21.07.2016 cu privire la întreprinderile mici și mijlocii;
38. Legea nr. 232 din 03.10.2016 privind redresarea și rezoluția băncilor;
39. Legea nr. 575 privind garantarea depozitelor persoanelor fizice în sistemul bancar;
40. Legea cu privire la organizațiile de microfinanțare nr. 280-XV din 22.07.2004;
41. Legea nr. 149 din 14.07.2017 pentru modificarea și completarea unor acte legislative;
42. Legea nr. 33 din 24.02.2006 privind depozitarea cerealelor și regimul certificatelor de depozit pentru cereale;
43. Moldova Financial System Stability Assessment, the IMF, February 2005;
44. Moldova Financial Sector Assessment, the World Bank Group, December 2014;
45. Moldova Financial System Stability Assessment, the IMF, February 2016;
46. Moldova Financial Sector Assessment Program, Insolvency and Creditor/Debtor Regimes, Report on the Observance of Standards and Codes, the World Bank, 2014;
47. Moldova Trade Study, the World Bank, December 2015;
48. Moldova Trade Study Overview, the World Bank, December 2015;
49. Monitorul financiar: Analiza principalelor reforme din sectorul financiar, Expert-Grup, 2016;
50. National Strategy for Investment Attraction and Export Promotion (2016-2020);
51. Normele de prudent financiară a AEI, Anexa la Hotărârea CNPF nr. 17/8 din 30 aprilie 2008;
52. Notă informativă la proiectul de lege pentru modificarea și completarea unor acte legislative (Legea nr. 122-XVI din 29 mai 2008 privind birourile istoriilor de credit), CNPF;
53. Notă informativă la proiectul Legii pentru completarea Legii leasingului, CNPF;
54. Nota informativă la proiectul legii cu privire la organizațiile de creditare bancară, CNPF;
55. Nota informativă la proiectul de lege pentru modificarea și completarea Legii asociațiilor de economii și împrumut nr. 139-XVI din 21 iunie 2007;
56. Nota informativă la proiectul Legii privind fondurile cu capital de risc și proiectului legii pentru completarea articolului 20 din Codul fiscal nr. 1163-XIII din 24 aprilie 1997, Ministerul Economiei și Infrastructurii;
57. Nota informativă la proiectul de HG cu privire la aprobarea Avizului asupra proiectului de lege pentru modificarea și completarea unor acte legislative (privind includerea în lista entităților supravegheate a companiilor de evaluare a bunurilor depuse în gaj la instituții financiare);
58. Planul de acțiuni al Guvernului pentru anii 2016-2018;
59. Planul de acțiuni privind implementarea Strategiei sectorului IMM pentru anii 2015-2017;
60. Performance and Learning Review (Report No. 105224-MD), the WB Group, April 2015;
61. Planul național de acțiuni pentru implementarea Acordului de Asociere RM - UE în perioada 2017-2019 (HG nr. 1472 din 30.12.2016);
62. Planul național de acțiuni pentru implementarea Acordului de Asociere RM - UE pentru anii 2014-2016 (HG nr. 808 din 7 octombrie 2014);
63. Planul Strategic al Băncii Naționale a Moldovei pentru anii 2013-2017;
64. Proiectul legii cu privire la organizațiile de creditare nebancară, CNPF;
65. Proiectul Strategiei de dezvoltare a pieței financiare nebancare pe anii 2016–2020 și a Planului de acțiuni pentru implementarea Strategiei, CNPF;
66. Proiectul Hotărârii Guvernului cu privire la aprobarea Cadastrului funciar conform situației la 01 ianuarie 2017;
67. Proiectul Legii privind activitatea băncilor;

68. Raport anual 2015 cu privire la asistența externă acordată RM, Cancelaria de Stat a RM;
69. Raport de activitate 2016, Fondul de Garantare a Depozitelor în Sistemul Bancar;
70. Raportul de evaluare a competitivității și a impactului realizării matricei de politici a Foi de parcurs privind ameliorarea competitivității Republicii Moldova, INCE 2015;
71. Raportul privind implementarea Matricei de politici a Foi de parcurs pentru ameliorarea competitivității Republicii Moldova pentru anul 2015, MEI, 2016;
72. Raportul privind implementarea Matricei de politici a Foi de parcurs pentru ameliorarea competitivității Republicii Moldova pentru în prima jumătate a anului 2016, MEI, 2017;
73. Raport privind rezultatele atinse în trimestrul II, 2017, Proiectul Agricultură Competitivă în Moldova (MAC-P), August 2017;
74. Regulament privind condițiile, ordinea și procedura de acordare a mijloacelor Fondului Național de Dezvoltare a Agriculturii și Mediului Rural (HG nr. 455 din 21 iunie 2017);
75. Regulamentul privind cadrul de administrare a activității băncii (aprobat prin Hotărârea Comitetului Executiv al BNM nr.146 din 7 iunie 2017);
76. Regulamentul cu privire la exigențele față de administratori (aprobat prin Hotărârea Comitetul executiv al Băncii Naționale a Moldovei nr. 203 din 27 iulie 2017);
77. Regulamentul cu privire la lichiditatea băncii, aprobat prin Hotărârea Consiliului de Administrație al BNM, proces – verbal nr.28 din 8 august 1997;
78. Regulamentul cu privire la clasificarea activelor și angajamentelor condiționale, HCA al BNM nr.231 din 27.10.2011;
79. Analiza impactului de reglementare la proiectul de Lege cu privire la organizațiile de creditare nebancară;
80. Regulamentul privind dezvoltarea de către bănci a informației aferente activității lor (Decizia BNM nr. 52 din 20.03.2014);
81. Regulation No. 1303/2013 of the European Parliament and of the Council of 17 December 2013;
82. Republic of Moldova Second Post-Program Monitoring Discussions, IMF, December 2014;
83. Republic of Moldova Enterprise Access to Finance/Background Notice, the WB, 2013;
84. Republic of Moldova investment policy review, UNCTAD, 2013;
85. Republic of Moldova: Small Business Act country profile, OECD, 2016;
86. Foaia de parcurs pentru ameliorarea competitivității Republicii Moldova, HG nr. 4 din 14.01.2014;
87. Second Post-Program Monitoring Discussions, the IMF, December 2014;
88. Strategia de dezvoltare a sectorului întreprinderilor mici și mijlocii pentru anii 2012-2020;
89. Strategia de implementare a standardelor Basel III în RM prin prisma cadrului legislative European (CRD IV), Hotararea Comitetului Executiv al BNM nr. 91 din 07.04.2016 și Planul de acțiuni cu privire la calendarul de transpunere în legislația RM a cerințelor pachetului UE – CRD IV/CRR;
90. Studiul de evaluare a piete de micro-finanțare în Republica Moldova, BFC, 2010;
91. Studiu privind segmentarea IMM, UIPAC, 2015;
92. Surse de Finanțare DCFTA, Expert-Grup, 2016;
93. Strategia Națională de Dezvoltare Moldova 20202020;
94. Strategia Națională pentru dezvoltare agricolă și rurală 2014-2020;
95. Strategia Națională pentru atragerea investițiilor și promovarea exporturilor 2016-2020;
96. Raportul anual BNM pentru anii 2014, 2015 și 2016;
97. Raportul anual CNPF pentru anii 2014, 2015 și 2016;
98. Tudor Bajura, Piața funciara autohtona: dimensiuni actuale si tendințe de dezvoltare, INCE;
99. Worldwide Governance Indicators, the WB Group;

100. <http://www.allmoldova.com/ro/news/vesti-proaste-pentru-fermieri-dobanzile-la-creditul-polonez-ar-putea-ajunge-pana-la-10>, visited on 04.07.2016;
101. „Аграрии не могут получить польский кредит в 100 миллионов евро из-за отсутствия соглашения с молдавскими банками”, Allmoldova, July 07, 2016;
102. „Банкам поправили прозрачность и управление рисками”, Infomarket July 29, 2016;
103. „Директивы ЕС для улучшения финансовой ситуации банков будут внедряться в РМ досрочно”, Infomarket, July 01, 2016;
104. „Депутаты одобрили два закона для стабилизации банковско-финансового сектора”, Allmoldova, July 22, 2016;
105. „Кабмин утвердил проект, который приведет к консолидации банковской системы”, Allmoldova, June 22, 2016;
106. „Надзор крепчал: НБМ получит больше полномочий по контролю за банками”, Noi.md, July 22, 2016;
107. „Нацбанк уполномочен контролировать: Правительство согласно расширить функции регулятора”, June 22, 2016;
108. „Отобраны кандидаты на места в надзорном совете Нацбанка”, Newsmaker, July 06, 2016;
109. „Парламент принял в первом чтении поправки, расширяющие полномочия Нацбанка”, Allmoldova, July 07, 2016;
110. „Правительство одобрило проект Закона о Центральном депозитарии ценных бумаг”, Infomarket, July 28, 2016;
111. „Проект «Сады Молдовы» запускается при поддержке фондов ЕС”, Allmoldova, July 13, 2016;
112. „Свели счета: Власть отчиталась о выполнении дорожной карты приоритетных действий”, Allmoldova, August 01, 2016;
113. „Управление польским кредитом для аграриев будет отдано банкам”, Infotag, June 30, 2016;
114. http://fgc.odimm.md/index.php?option=com_k2&view=item&id=12:garan%C8%9Bii-la-credite-pentru-imm-uri, visited on June 25, 2016;
115. www.amp.gov.md, visited on June 29 and December 17, 2016
116. www.bnm.md, visited in June-August 2016
117. <http://data.worldbank.org>, visited in June-August, 2016
118. www.ebrd.com/moldova, visited on July 05, 2016
119. <http://www.eib.org/infocentre/press/releases/all/2014/2014-197-eu-supports-development-of-moldovas-agriculture-with-eur-120-million.htm>, visited on July 20, 2016
120. <http://www.garantininvest.md/about.html>, visited on June 25, 2016
121. www.statistica.md, visited in June-December 2016 and June-November 2017;
122. <https://deschide.md/ro/stiri/economic/13334/61-din-Foaia-de-parcurs-pentru-ameliorarea-competitivit%C4%83%C8%9Bii-R-Moldova---realizat%C4%83.htm>, visited on October 16, 2017.

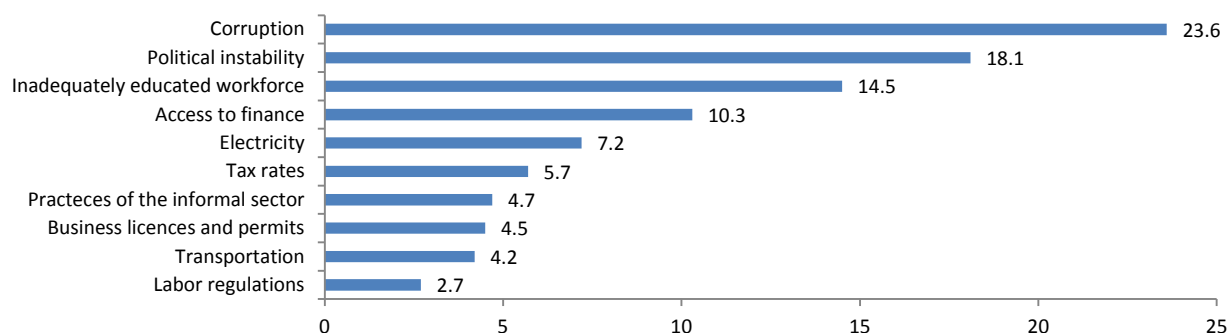
ANNEXES

Annex 1: Constraints to doing business in Moldova according to international surveys

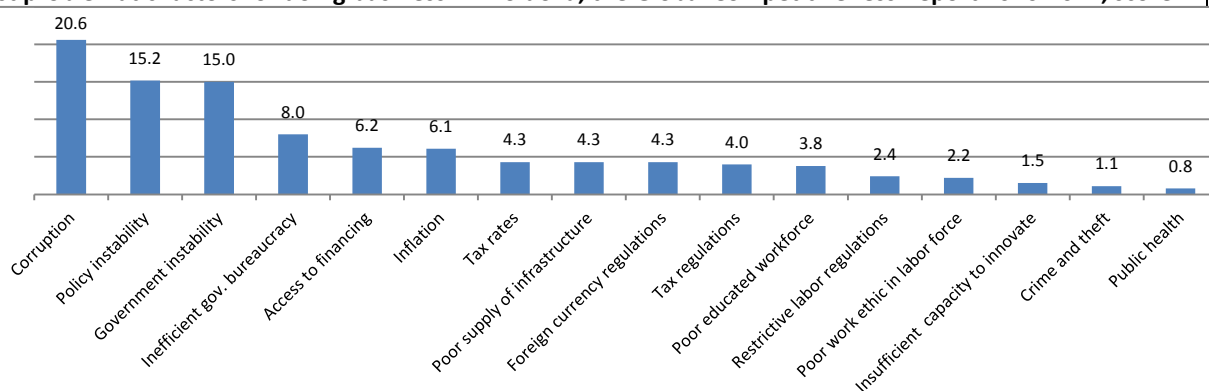
Moldova positioning in Doing Business 2017, place no.



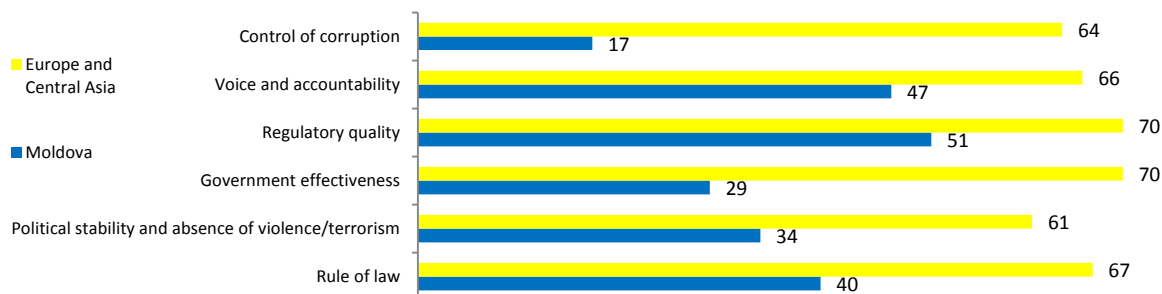
Obstacles for firms in Moldova, Enterprise Surveys 2013, % of firms identifying constraints



Most problematic factors for doing business in Moldova, the Global Competitiveness Report 2016-2017, score

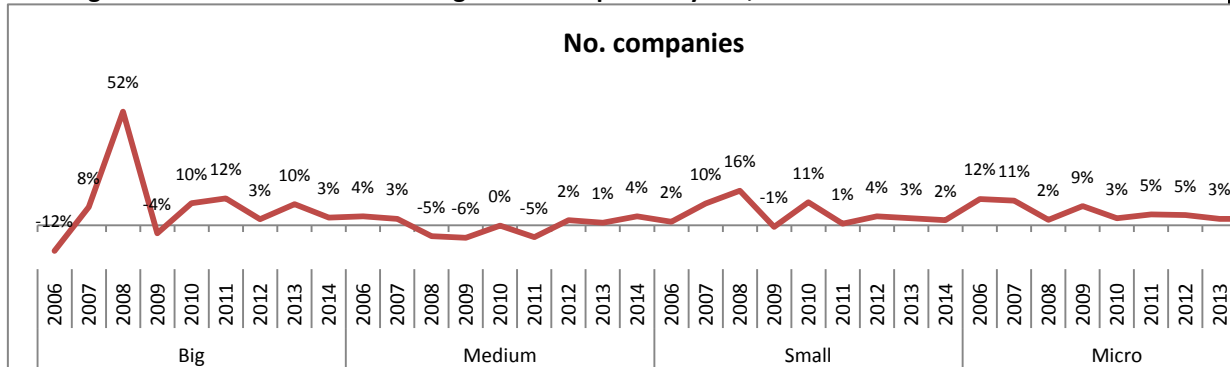


Moldova in comparison to ECA countries in Worldwide Governance Indicators 2015, the WB Group, percentile rank

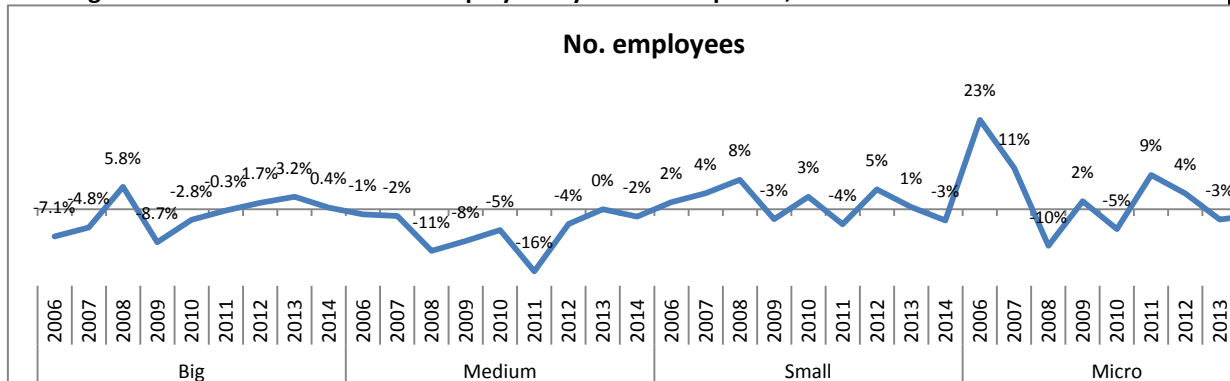


Annex 2: Growth rates of enterprises by size

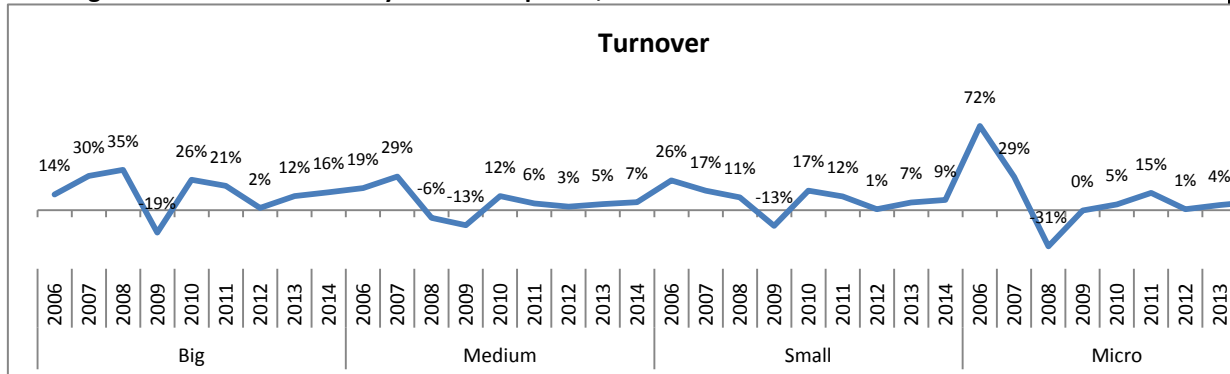
Annual growth rates of the number of registered companies by size, 2006-2014



Annual growth rates of the number of employees by size of companies, 2006-2014



Annual growth rates of turnover by size of companies, 2006-2014



Annex 3: Transactions with agricultural land in Moldova

Market turnover of agricultural land in Moldova

Year	Area of agricultural land sold, ha	Number of transactions	Market price, MDL/ha	Average area of a land plot sold, ha	Share of sold land in the total area of agricultural land, %
2000	7338	9753	3687	0,75	0,35
2005	21825	47382	4778	0,46	1,05
2006	28096	51484	6965	0,55	1,42
2007	34101	62487	9539	0,55	1,73
2008	35949	73193	8511	0,49	1,82
2009	25214	67109	8911	0,38	1,28
2010	19021	69072	16502	0,28	0,96
2011	19930	71035	13444	0,28	1,01
2012	10159	52138	13719	0,20	0,52
2013	12906	37710	16785	0,34	0,65
2014	15653	23282	19851	0,67	0,79

Source: Tudor Bajura, Piata funciara autohtona: dimensiuni actuale si tendinte de dezvoltare, INCE.

Market price for agricultural land by geographical regions, 2014

	Geographical regions			
	North	Centre	South	UTA Găgăuzia
1. Area of land sold, ha	6059,7	5006,8	3992,8	593,4
2. Number of transactions	8435	7770	6474	603
3. Market price of agricultural land, MDL/ha	21884,1	20073,1	17113,7	16302,7

Source: Tudor Bajura, Piata funciara autohtona: dimensiuni actuale si tendinte de dezvoltare, INCE.

Annex 4: Progress in the implementation of RPRA in the financial sector

*Progress in the implementation of RPRA in the financial sector as of end October 2016**

Action	Period	Progress
7.1. The NBM to consult with the IMF on measures to be undertaken as result of audit reports of two of the banks under special supervision.	March-April 2016	The NBM held consultations with the IMF on results of the audit of VB and MAIB, to coordinate further actions in relation to these banks. The conclusions of the audit reports have not been made public, however from the NBM statement, the audit didn't reveal risks for the financial stability of these banks, but identified areas that need strengthening: corporate governance, internal control, transparency of shareholders and affiliated persons, lending activity.
7.2. NBM to elaborate an Action Plan as result of recommendations of the audit of the two banks under special supervision, after consultations with the IMF.	March-April 2016	The Action Plan (AP) has been developed by the NBM. As in the case with the audit reports, its content is not known, as the Action Plan hasn't been made public.
7.3. Finalizing the audit for the 3 rd bank under special supervision.	March-April 2016	The audit of the 3 rd bank under special supervision (MICB) has been finalized, however is not available, either.
7.4. NBM to elaborate an Action Plan after recommendations/conclusions of the audit for the 3 rd bank under special supervision.	April 2016	The action Plan is being developed, however its content is not subject to public availability.
8.1. Parliament to finalize the selection of a candidate to the position of NBM Governor in a transparent way and to designate the new Governor.	March 2016	In March 2016 the Parliament named Sergiu Cioclea as the new Governor of the NBM, chosen as result of a public contest. The new Governor started his mandate on April 11, 2016. The contest seemed fairly transparent, however there some of the interviewed stakeholders expressed concerns about the lack of previous experience of the new Governor in bank supervision and regulation.
8.2. Parliament to name new members in the management of the NBM to fulfill the vacant positions (two deputy governors and four independent members in the NBM Supervision Council (SC))	March-April 2016	On July 29, 2016 the Parliament approved the 4 members of the SC, designated by the Parliamentary Commission for the economy, budget and finance. Even if the 4 members have been nominated in a public contest, there are concerns about the independence of the SC. 3 of its members are from the NBM executive body (the Governor and 2 Deputy governors), which apparently creates conflicts of interest. Not all of the 4 newly selected members of the SC have relevant experience in bank supervision, while the selection itself was closed from the public, and this adds to the concerns for the independence and effectiveness of the SC. On September 23, 2016 the Parliament approved also the 2 deputy governors of the NBM.
8.3. Parliament to adopt the financial-banking law package (amendments to the Law on NBM and NCFM, project # 14) agreed with the WB and IMF.	March 2016	The financial-banking law package (project # 14) has been voted on 08.04.2016 (Law no. 62). It envisages amendments to several laws, providing for the strengthening of independence of regulators (NBM) and (NCFM), increasing of the level of protection of their employees and the establishment of the single central depository, to be regulated and supervised by the NBM.
8.4. NBM and Parliament (with support from IMF) will ensure contracting of an independent international evaluation of the banking supervision by the NBM.	July 2016	Excluded by agreement with the IMF.
8.5. NBM to elaborate an action plan for implementing FSAP recommendations.	March 2016	As already stated in Section 5.1. "5.1. Implemented and Failed/Delayed Reform Efforts", the NBM developed an Action Plan (AP) for the implementation of FSAP recommendations. Most of the envisaged actions have already been implemented, as described in the sections above.
8.6. The NBM to elaborate and consult with the IMF the legal, institutional and regulatory framework for financial	March-May 2016	According to the speaker of the Parliament Andrian Candu, in the process of negotiations, the IMF technical mission and the NBM decided to change the approach and speed up the implementation of the EU directives on systemic banking crises (bridge bank legislation).

stability–legal tools for systemic banking crises (bridge bank legislation).		Earlier, Moldova undertook in the frame of AA with the EU to implement the respective directives in 5 years. With support from the WB and IMF, a draft law on the recovery and resolution of banks has been developed.
8.7. Parliament to adopt legislation on tools for systemic banking crises (bridge bank legislation).	June-July 2016	On September 26, 2016 the GoM assumed responsibility for the adoption of the Law on the recovery and resolution of banks, which partially transposes Directive 2014/59/EU of the European Parliament and of the Council on the recovery and resolution of credit institutions and investment firms. It was approved by the Parliament on October 03, 2016.
8.8. NBM to elaborate (with support from IMF) special legislation on single central securities depository (SCSD).	May 2016	On September 26, 2016 the GoM assumed responsibility for the adoption of the SCSD Law, which was approved on October 03, 2016 and entered into force on October 04, 2016.

*- The RPRA expired on July 31 2016. Actions that went beyond this date had been included in the Memorandum of Economic Policies with the IMF, signed on November 07, 2016.

Source: Own compilation based on RPRA and monitoring of the mass-media.

Annex 5: Main on-going official development assistance programmes relevant to the AF

Main on-going ODA programmes in Moldova relevant to the AF as of end June 2016

Programme	Beneficiaries	Start date	Close date	Donor	Commitments, EUR
BUSINESS AND OTHER SERVICES					
Development Credit Authority (DCA) Loan Portfolio Guarantee Agreement	Prime Capital	27/09/2011	26/09/2018	USAID	117,838
Filière-du-vin Upgrading	Small and medium sized enterprises	23/11/2010	22/11/2016	EIB; EU	77,000,000
Development Credit Authority (DCA) Loan Portfolio Guarantee Agreement	Comertbank	27/09/2011	27/09/2018	USAID	271,609
DCA Loan Portfolio Guarantee Agreement with Rural Finance Corporation	Rural Finance Corporation	27/09/2011	26/09/2018	USAID	135,805
DCA Loan Portfolio Guarantee Agreement (2 nd Agreement)	Prime Capital	30/09/2013	29/12/2028	USAID	145,529
Second Competitiveness Enhancement Project (CEP II)	The government of Moldova; SMEs	15/09/2014	15/10/2020	WB	33,078,506
Innovative business development for local sustainable economic growth	Small and mid-sized business start-ups; local public Authorities (LPA)	01/11/2014	31/12/2016	Norway	1,325,490
Assistance Agreement for the Economic Growth	Private sector	06/07/2010	30/09/2017	USA	5,029,796
Government Advice on Economic Development (II phase)	GoM, the Parliamentary Committee for economy, budget and finance, the State Chancellery, MEI, MIEPO	01/03/2016	31/12/2018	Germany	2,800,000
AGRICULTURE					
Agriculture Competitiveness (MACP)	Moldovan farmers	28/05/2012	28/05/2017	GEF; SIDA; WB	19,547,586
Emergency Agriculture Support	Moldovan farmers	29/05/2013	29/05/2028	IDA, WB	3,888,666
Improvement of production and market access for farmers in North Moldova	Farmers, input suppliers and dairy processors	01/01/2014	31/12/2016	Switzerland	350,000
Support of fruit and vegetable production with added market value	Moldovan farmers	15/09/2014	30/11/2016	Czech Rep.	230,000
Increasing small scale farmers' resilience to drought by adopting best irrigation practices and modern irrigation technologies	Water Users Associations, farmers, local extension specialists	15/10/2014	30/09/2016	Hungary	314,544
Support the Project Implementation Unit (PIU) for the "Filière du vin" operation and the beneficiary SMEs	Technical Assistance for the Filière-du-Vin's stakeholders	01/07/2014	01/07/2016	EIB	1,706,500
Inclusive Rural Economic and Climate Resilience Programme (IFAD VI)	Rural entrepreneurs	01/10/2014	31/12/2019	Denmark; GEF; UN	18,970,567
Support for adaptation and implementation of Integrated Pest Management in Moldova.	Ministry of Agriculture and Food Industry (MARDE) and Phytosanitary Service of the National Food Safety Agency (ANSA)	01/01/2015	31/12/2016	UN	343,727
Development of the National Strategy and Action Plan for animal genetic resources and dairy cattle genetic improvement programme	MARDE	01/01/2015	31/10/2016	UN	261,887
Inclusive Rural Economic and Climate Resilience Programme	Young entrepreneurs in rural areas	01/05/2015	31/12/2017	Denmark	4,699,064
ENPARD Moldova Program - Support to Agriculture and Rural Development	Government of Moldova, agricultural and rural business	01/07/2015	01/07/2022	EU	64,075,000
The Irrigated High Value Agriculture 2KR Hire-Purchase Program of the Millennium Challenge Account Moldova	Small and medium farmers	31/03/2015	31/03/2025	USA	4,587,252
Fruit garden of Moldova	Horticultural sector businesses	03/11/2014	02/11/2020	EIB	120,000,000
Creating an integrated system for sustainable development of the agrarian sector in the North Development Region of Moldova	Centre for processing and storage of honey and Marketing Information Centre for bee products	01/01/2015	31/12/2016	Romania	157,382
Additional Financing Agreement for Agriculture Competitiveness Project between Moldova and International Development Association (IDA)	Producers of fruits with plantations less than or equal to 15 ha	01/07/2015	01/07/2017	IDA, WB	10,810,811
Rural Financial Services and Agribusiness Development Project (IFAD V)	Agricultural and rural businesses, producers associations	04/07/2011	03/07/2016	Denmark; UN	16,348,445
Support to Agriculture and Rural Development through promotion of confidence building measures	Businesses and local communities from ATU Gagauzia, Taraclia district and neighboring communities			EU	1,744,224
GOVERNMENT AND CIVIL SOCIETY					
Comprehensive Institution Building (CIB) Programme	State Chancellery, Ministry of Finance, MEI, MARDE, etc.	14/05/2010	31/12/2016	EU	9,000,000
Framework Agreement in support of the current and new agreements between the EU and Moldova	State Chancellery, Ministry of Finance, MEI, MARDE, Competition Council, etc.	14/06/2013	14/06/2018	EU	32,540,000
Financing Agreement between the EU and Moldova on Framework Programme in support of EU -RM agreements	Twinning projects for state institutions	23/04/2014	23/04/2018	EU	26,000,000
Support to the implementation of DCFTA process in Moldova	Quality infrastructure and market surveillance institutions, SMEs	05/11/2014	05/11/2017	EU	30,000,000

Source: State Chancellery, Aid Management Platform.

LIST OF INTERVIEWEES

#	Date	Time	Name	Organization	Position
1.	14.06.16	15:30	Tudor Lupașcu	ODIMM (Center for Support & Consultations in Business)	Director
2.	23.06.16	13:00	Iulia Iabanji	ODIMM	Director General
3.	17.06.16	11:00	Roger Gladei	Gladei&Partners Legal Consultants	Managing Partner
4.	22.06.16	16:00	Oleg Paingu	Moldova-Agroindbank (MAIB)	Vice-Chairman
			Ghenadie Beldiga		Head of SME Credit Department
5.	16.06.16	09:00	Victor Girleanu	Moldindconbank	Head of Loan Department
6.	17.06.16	15:00	Alexandra Lacusta	Mobiasbanca	Head of Financial Institutions and Correspondent Banks Section Legal Expert
			Victoria Arhiliuc		
7.	22.06.16	11:00	Carmina Vicol	Prime Capital	Director General
8.	14.06.16	11:00	Marcel Tonu	Corporația de Finanțare Rurală	President
9.	15.06.16	16:00	Angela Gladei	Total Leasing&Finance	Director General
10.	24.06.16	15:00	Petru Antonov	MAIB Leasing	Chief Executive Officer
11.	20.06.16	10:00	Vladimir Turcanu	The National Bank of Moldova	Director, Bank Regulation Department
12.	16.06.16	10:30	Alina Cebotariov	The National Commission for the Financial Market	Head of Department Collective Placements and Micro Financing
13.	14.06.16	09:00	Elena Burlacu Victor Rosca	IFAD	Loan Manager Director
14.	15.06.16	11:00	Galina Cicanci	World Bank office in Moldova	Financial & Private Sector Consultant
15.	24.06.16	11:30	Alexandru Cosovan	EBRD office in Moldova	Senior banker
16.	21.06.16	11:00	Corneliu Rusnac	USAID Moldova	Specialist Economic Growth
17.	23.06.16	09:00	Iurie Fala	Moldova Fruct	Executive Director
18.	16.06.16	14:00	Viorica Jurminschi	Credit Line Directorate	Deputy Director
19.	27.06.16	16:00	Iurie Usurelu	MAFI	Deputy Minister
20.	17.06.16	13:00	Vlad Loghin	UIAPCPA (2KR)	Technical Director
21.	23.06.16	11:00	Dumitru Ursu	Moldova Bankers' League	President
22.	15.06.16	17:15	Anatolie Palade	Pro-Consulting	Director
23.	21.06.16	09:00	Ion Chilianu	Codru ST	Director
24.	21.06.16	14:00	Vlad Railean	Mocan Com	Director
25.	20.06.16	12:30	Vedrasco Maria	Ved-Mar-Agro,	Director
26.	22.06.16	14:00	Nicolae Ciubuc	AIPA	Deputy Director
27.	20.06.16	14:00	Aurel Casian	CEP II, WB	Executive Director
28.	27.06.16	09:00	Srichander Ramaswamy	EU High Level Advisers' Mission to Moldova	EU High-Level Adviser on Financial System Governance
29.	28.06.16	14:00	Aldona Josiene	EU High Level Advisers' Mission to Moldova	EU High-Level Adviser on Banking sector
30.	28.06.16	11:30	Larisa Rudenco	Fincombank	Vice-President
			Ala Vidrasco		Head Credit Department
31.	24.06.16	13:30	Oleg Inculet	TOP Leasing	Ex-Director General
32.	25.06.16	10:00	Matei Dohotaru	NBM	Director, Bank Supervision Department
33.	28.06.16	09:00	Artur Munteanu	Alianta de Microfinantare	Founder & member
34.	18.07.16	14:00	Speranta Olaru	EU Delegation	Project Manager Trade and Private Sector Development
			Ecaterina Yakovleva		Project Manager Public Finance Management
35.	06.06.17	10:00	Silviu Foca	Credit Bureau	Director
36.	19.06.17	15:00	Constantin Bragoi	Legal Information Centre, Ministry of Justice	Director

PART 2. ACTION PLAN

Recommendations

Increase access to information on company constraints to growth, including in AF

236. To deepen the understanding of constraints faced by private sector, including in the AF, **a baseline periodical survey for enterprises should be established.** It should provide data on companies' AF by size of enterprises, purpose of financing, sources and term of financing, reasons for rejection of loans application and incidence of credit denial, financing needs of companies by size and term, reasons and incidence of companies' failures, etc. These data will not only allow to objectively assess the status quo in AF, but also follow evolution in time and serve as an useful input for designing/correction of reform agendas in the AF and broader private sector development. Useful benchmark would serve the European Commission/European Central Bank survey on the access to finance of enterprises (SAFE), made each 6 months (partial studies) and each 2 years (complete studies). These are based on questioning of enterprises from the EU in respect to the evolution of the most prevalent constraints in the development of enterprises in the EU, the structure of enterprise financing in the EU, financing needs and gaps, financing conditions, ease of AF, incidence of acceptance and denial of loan applications, etc. **(NBM, MEI) – medium term¹¹⁰.**

Support emergence and growth of enterprises

237. **Foster linkages between local companies and foreign investors and integration of local firms into international VC (MEI, MIEPO) - short to medium term.** By promoting such linkages in a proactive manner, relevant authorities would:

- Stimulate local acquisitions (of goods and services) by foreign investor companies, establishing efficient linkages between local suppliers and international investor companies, with mutual benefits for local industries/sectors and investors, contributing alongside to the rooting of foreign investors in Moldova;
- Promote linkages between major supermarket chains/exporters and domestic producers/food processors.
- Increase availability of local suppliers capable to meet needs of foreign investors, which is also an important factor for the attraction of more FDI and a determinant of the quality of investment climate. Some countries (Czech Republic, Ireland, and Hungary) have been especially active and efficient in building such linkages.

MIEPO should encourage and stimulate establishing of linkages between local companies (in principal SMEs) and existing/potential major foreign investors. It should also elaborate a Program similar to other countries (Czech Republic, Ireland) to assist local companies in increasing their capacities to meet quality and safety requirements of foreign/multinational companies (MNC) and would identify financing from development partners. The Program would have as an objective to increase the standards of Moldovan suppliers to a level making them attractive as suppliers for foreign companies/MNCs.

¹¹⁰ Here and further on, "short term" refers to periods between 1-3 years, "medium term" - 3-5 years and "long term" – more than 5 years.

Box 2. After identifying key Czech suppliers, a similar program by CzechInvest closely connected policies to promote linkages by matching foreign MNCs to local firms, with efforts to upgrade reliability and quality in local suppliers. Selected based on their potential to become suppliers of MNC subsidiaries and on their interest in the program, a group of around 50 Czech companies was provided with technical assistance and training support in areas such as technology management, quality control, and organizational change. These selected companies were audited in accordance with EFQM methodology (www.efqm.org/efqm-model/efqm-model-in-action-0), and corporate action plans was then drawn up based on these audits. After six months, these plans were assessed to determine how much they have been fulfilled, and the best companies were entered into the intensive support phase, where they received consulting in preparation to meet the demanding criteria of future customers. The aim was to provide the firms with the information and skills needed to meet MNCs' requirements and establish more and higher value-added contracts. A key priority, for example, was to support suppliers in the process of obtaining ISO-9000 quality certifications.

238. Apparently, there is a large group of SMEs, particularly from the middle segment not covered by programs and support services of ODIMM. The companies from this group generally have the best growth potential within the SME category, and yet don't have a support agency actively promoting them (see examples of Enterprise Ireland and CzechInvest in box 1 under paragraph 23 of the Study). **There is a need for a specialized unit within ODIMM to target medium sized companies and high growth companies, most notably to support them grow to export markets.** Specific support would include: product support (product quality, innovation, etc.); market support (sales, distribution, certification); human resource support (skills, management training); export markets targeting (preparation of export plans, distribution channels, quality certification, participation in international events, preparation of high quality promotional materials); training in key aspects of export marketing; specific training/consultancy for key sectors; providing market contacts, etc (**MEI, ODIMM**) – **medium term**

239. Business development services are lacking in quantity and quality. The public authorities mandated to facilitate exports, investment attraction and SME competitiveness (MIEPO and ODIMM) have been under-resourced, need organizational development and their range of services is limited. Programs like PNAET, PARE 1+1 have proved successful and should continue, but at much larger scale to reach a systemic impact on the AF in Moldova. There is still an unmet absorption capacity, as for each MDL of grant money by PARE 1+1, beneficiaries provided 3 MDL of own investments. The efficient business management Program (GEA) by ODIMM has about 3 - 4 thou beneficiaries per year. **Increased human resource base and financing for the specialized agency (ODIMM) is needed to make an impact in meeting existing demand for support services and support programs (MEI, ODIMM) – short to medium term.** Both organizations (MIEPO and ODIMM) have benefitted from new organizational strategies developed with support from WB that provide a good basis for effective transformation of both organizations roles. Close monitoring, evaluation and prompt corrective/remedy actions to ensure effective implementation of both strategy actions (**MEI, MIEPO**) – **short to medium term**.

240. Business support services at regional level are limited. Neither ODIMM nor MIEPO have internal regional representation. The economic divisions of local regional (rayon) Councils lack capacities and expertise to provide such services. There is a need **for more support initiatives/programs for SME competitiveness, innovation and internationalization** to help Moldovan companies to compete internally and internationally, and for more **efforts to enhance business sophistication and skills of SMEs through business support infrastructure and services in the regions** (either by extending regional outreach of ODIMM and MIEPO, either by designing and implementing more business support programs at local/regional level and building capacities of economic divisions of local Councils and/or other local counterparts) (**MEI, ODIMM, MIEPO**) – **short to medium term**.

241. Besides the new organizational strategies for MIEPO and ODIMM, Moldova benefited from a new national investment attraction and export promotion strategy, developed with support from the World Bank, addressing many of the weaknesses and constraints in increasing FDI inflows and export volumes. **There is a need however for effective implementation of this strategy**, monitoring and evaluation of intermediary results, as well as for prompt corrective actions to ensure attainment of the strategy's objectives and duly implementation of the envisaged actions (MEI, MIEPO) – **short to medium term**.

242. As the capacities of the existing public business support institutions to effectively serve the private sector (estimative more than 35 thousand enterprises) are limited and their regional outreach is inexistent, while private market for business support services is largely underdeveloped, **there is a need to stimulate the provision of business support services by private entities**. For this, accreditation and quality certification of business service providers is needed, facilitation for the creation of an association of professional consultants, technical assistance programs for the business development service providers themselves. The private market for business support services could be further stimulated by the launched of voucher schemes for business consultancy, legal changes to enact consulting as a listed profession, which would in turn facilitate the contracting of such services by public entities as well as firms¹¹¹ (MEI) – **medium to long term**.

243. Increased internalization of SMEs is needed in light of constraint internal market and poor exploitation of opportunities offered by the DCFTA. Improved compliance with the EU technical and safety regulation is needed for the Moldovan companies to export to the EU. This would require **improved capacities for the national quality infrastructure, food safety and trade facilitation framework**. In spite of some degree of harmonization with the EU standards, there is still a need for the strengthening of the capacities of institutions in charge of the quality infrastructure (metrology, standardization, market surveillance, conformity assessment and accreditation) and for food safety systems to further align to the EU norms and efficiently implement them (MEI, National Food Safety Agency) – **short to medium term**.

244. Despite the fact that Moldova's informal sector is big, there are no comprehensive plans to address this problem. The GoM undertook specific, isolated actions to reduce informal economy under different strategies and actions plans. However, these actions were sporadic and not part of a complex approach. It is generally perceived that addressing constraints in business regulation and environment would automatically reduce barriers to formalization. However given the slow progress of reforms and the scale of the informal economy, proactive measures are needed to bring companies operating in the informal sector into the formal economy, thus reducing barriers to growth for already formally operating businesses. A first step in this direction would be **the elaboration of a long-term Strategy and comprehensive plan with specific SMART objectives, and proactive actions to ensure transition from informal economy to the formal sector**. For this:

- Prior studies, reports on shadow economy need to be updated; specific reasons, methods, operations, scopes, actions, incentives, phenomena, that make the companies enter/stay in the shadow, have to be better learned and understood, trends be identified and forecasted (MEI) – **short to medium term**.
- A long-term Strategy should be developed and approved that would provide for a "shadow economy" filtration mechanism on a permanent basis; a supervision/monitoring agency/institution(s) identified. This mechanism would get a "mandatory step" status when drafting/coordinating new legislation and standards/recommendations (including tax, labor, customs, payments) before approval

¹¹¹ SME Policy Index: Eastern Partnership Countries 2016, OECD.

(similar to anti-corruption review) (MEI, GoM, Parliament) – **short to medium term.**

- Suitable actions need to be developed in a comprehensive Action Plan, including review all existent legislation and standards/recommendations, development & approval amendments in order to reach the Strategy objectives (MEI, GoM, Parliament) – **short to medium term.**

245. **Address low business intensity in the regions** by increasing investments in public infrastructure (first of all roads), improving the infrastructure of free economic zones and industrial parks, establishment of industrial platforms to serve as attractive points for foreign direct investors and multinational companies, streamlining procedures for getting construction permits and connecting to electricity and providing special incentives for starting up business in the regions (MEI) – **short to medium term.**

246. **Establishment of regional business development centers** to facilitate access to business support services, such as business and investment planning, financial management, marketing, support in setting up collaboration and strategic alliances between enterprise, facilitation of linkages with donor and governmental business support programs, facilitation of access to information on markets and market related analyses, available financial services and products, etc. (MEI, ODIMM, donors) – **short to medium term.** For this, lessons from a former TACIS project on SME development in the regions (which established 3 business centers in Soroca, Causeni and Comrat) have to be learned and measures that would ensure sustainability of these centers have to be developed before pursuing to their setting up. Alternatively, a partnership of different business support organizations active in regions (ODIMM, ACSA, AGROinfrom, other associations, other business service providers) could be established. Joining efforts, bringing all services (in different sectors) under one roof might help ensuring long-term sustainability of these centers.

247. **Address shortage of workforce in certain sectors and increase quality of professional education and training** to meet the needs of the labor market (MEI, Ministry of Education, Culture and Research) – **medium to long term.**

Enhance business environment

248. Improving the business environment is among the 8 priorities of the National Development Strategy Moldova 2020. This is to be attained by enhancing competitiveness policies, optimizing the regulatory framework for business, improving physical infrastructure, etc. Better conditions for doing business in Moldova would serve as facilitators of increased competitiveness, productivity and profitability. However, strengthening of government efforts across the policy cycle is needed to ensure effective implementation of the envisaged reforms. While policy design is generally strong, as demonstrated by numerous existing strategies, programs, action plans and roadmaps, **more attention should be paid to the implementation of these policy documents and initiatives in practice, as well as to monitoring and evaluation, collecting feedback and achievement of actual results.** There is also a need to periodically review and adjust the policy documents in order to ensure the actuality/realism of their path, scopes and objectives. This is especially important for the medium to long term strategies and plans (MEI) – **short to medium term.**

249. Also, many strategies and action plans need more exact formulation of envisaged actions and quantifiable targeted results. Moreover, alongside needed legal and regulatory changes, **these should target more practical and proactive actions with tangible results** (MEI) - **short, medium and long term.** Business environment reform actions that need strengthening of efforts include:

- **Improving of legal mechanisms for the protection of investors and ensuring effective protection of ownership rights**, contract enforcement and precluding of tentative business takeovers (MEI, Ministry of Justice) – **short to medium term.**

- **Compliance, by all state authorities, with the legislation on transparency in decision-making process and regulatory impact analysis** for all decisions that introduce new norms (or modify/supplement the existing norms) for business activity regulation. Inevitable sanction of authorities and those responsible for the violation of these rules (GoM) – **short, medium and long term.**
- **Exclusion of political interferences from the activity of state supervision and control bodies**, of the judiciary, as well as consolidation of the supervision and control capacities of the respective bodies, and independence of the judiciary (MEI, Ministry of Justice) – **short to medium term.**
- **Speed up reform of the judiciary.** Tightening of sanctions against judges and prosecutors that admitted breaches of law and arbitrary and ill-intentioned decisions. Ensure efficient supervision of the judiciary by an independent Superior Council of Magistracy (Ministry of Justice) – **short to medium term.**
- **Combat shadow economy, corruption, develop enforce and largely promote standards of transparency, ethics and integrity in business.** Include representatives of business community/civil society in the monitoring of economic policy reforms and of anti-corruption reforms, and effective consultation with these communities on reform corrective measures (MEI, Ministry of Justice) – **short to medium term.**
- **Effective promotion, through free market instruments, of a stable monetary policy targeting low inflation rate (within the limits targeted by the NBM), relatively stable (without major fluctuations) exchange rate.** This, in turn, would increase confidence from depositors and stimulate more long-term placements with banks, development of alternative saving tools, such as pension funds, insurance products, etc. and emergence of institutional investors (NBM, MEI, Ministry of Finance) – **short, medium and long term.**
- **Elimination of restrictions/barriers for the entry on markets**, which allow for the creation of monopolies or dominant positions in different sectors. **Ensure correct and impartial application of legislation for all market participants**, including by means of effective enforcement of powers of regulators and independent judiciary (Competition Council, Ministry of Justice) – **short to medium term.**
- **Optimization and streamlining of customs procedures in accordance with the EU practices that would include:** elimination of unofficial payment practices, ensuring the necessary informational infrastructure for quick exchange of data among different institutions involved in the issuance of documentation for the performing of import-export operations; diminishing the time required for the processing of documentation by implementing the customs single window, which would include representatives of different state authorities involved in the issuance and processing of relevant documentation; establishment of a single joint customs post instead of two on different sides of the border (Customs Service) – **short to medium term.**
- **Optimization and streamlining of tax administration**, by simplifying reporting requirements, especially in relation to SMEs. **Changing the focus of the actual fiscal policies and practices from maximization of tax collection to the economic stimulatory functions** that will bring more rewards in the medium and long term (Ministry of Finance, MEI, State Fiscal Inspectorate) – **short to medium term.**
- **Ensure full implementation of the Regulatory Reform Strategy, Competitiveness Roadmap and EU harmonization agenda (GoM)** – **short to medium term.**

Improve risk evaluation practices by banks and streamline loan application procedures

250. Risk evaluation practices by banks are not an area that would require institutional intervention or amendments to the legal or regulatory framework. However, in the absence of a truly competitive banking market, **capacity building in risk evaluation practices might be considered for targeted technical assistance programs by international donors/development partners** for increasing stability of the banking sector/improving access to finance (**Development partners, banks, MFOs**) – **short to medium term**. Major issues to be addressed, among others, include:

- Training/Encourage frequent updates of business plans and use of plans to make business decisions; use of business plans by banks to monitor borrowers' ability to repay.
- Using VC's to verify ability of borrowers to repay; using value chain terms of lending and member histories in credit analysis; using VC information to verify applicants who don't have bank relationships.
- Structuring of VC information in tables or flow charts for each borrower.
- Use of receipts to validate income statements and other estimates; supplement tax/financial statements information with validation & verification methods.
- Capital budgeting training (investment analysis).
- Training how to review and measure risks; using of score-cards, assigning weights, using models for matching expected losses at risk levels to calculate risk-based pricing.
- Training in reducing collateral losses by coaching troubled borrowers, efficient loan monitoring and early identification of trouble.
- Training in prediction of the extent and frequency of worst case scenarios; getting more specific risk estimates; using precise verification methods and value chain information to confirm values of accounts receivable and inventories.
- Calculation of benefits of diversification and knowing the frequency and extent of income volatility from weather; training on contract terms and timing; deciding on appropriate percentages of forward crop sales in various stages of crop growth, using of forward crop sales; calculation of risks from under- and over-selling of crops or production.
- Training in calculation and charting impacts on various customers and market segments; quantifying risk reduction when borrowers sell production into several markets, etc.

251. Many small businesses that are in need of loans are discouraged from applying for credit by cumbersome and lengthy application procedures. The streamlining of loan application procedures, as in the case of risk evaluation practices, is mostly within the remit of banks themselves. However the process may be accelerated by **creating an informational system involving state authorities responsible for the issuance of documentation required in the credit application process and delivery to financial institutions, in real terms, of the information concerning the applicants for credit (Development partners, Electronic Governance Center)** – **short to medium term**.

252. **Encourage strategic investments in the banking sector.** Attracting more (true) foreign investments in the financial sector from strategic investors with interest in developing the banking and lending business would increase competition in the banking sector and would bring advanced lending technologies, sound banking risk and management practices, more long-term resources (**NBM, MIEPO**) – **medium term**.

Improve legal framework for creditors' rights and financial market infrastructure

253. Effective lending to SMEs can also be stimulated by **institutional improvements at the financial infrastructure level**. Well-functioning credit registries – through which banks and other lenders are required to share information about the quality of borrowers – have the potential to improve companies' access to credit over time. Banks that can easily access trustworthy “hard” data on borrowers will also be incentivized to invest more in building up proprietary “inside” information about borrowers¹¹². The IFC has been assisting in improving the legal framework for the functioning of the CHB and its operational capabilities for the last several years, as well as has ongoing activities in this respect. Therefore, it is advisable that additional assistance for enhancing the functionality of this component of the financial infrastructure be coordinated with IFC/WB Group. **Further improvements of the functionality of the CHB (CHB, NCFM, donors) – short to medium term**, would include:

- **Broadening the scope of information covered by the credit bureau (by including all MFOs, SCAs, leasing companies, insurance companies, trade credit and utility companies)** would improve the quality of credit referencing and decrease costs of information asymmetry. The bringing of MFOs, SCAs and leasing companies under regulation **could be achieved by providing stricter provisioning clauses for borrowers of these organizations without credit bureau histories** (like in the case of banks, which make 30% provisions for such borrowers) – **short term**.
- **Increasing the range of products delivered to lenders**, including credit scores, industry data, portfolio monitoring, etc. and improving the technical solution (soft) for the operation of the CHB - **medium term**.
- **Enhancing oversight over the CHB operation by the regulator, accuracy and comprehensiveness of the information provided to the bureau – short term**.
- **VAT exemption of CHB products, to make them more attractive for smaller lenders – short term**.

254. **Reinforce the legal framework for creditor rights and address legal and regulatory gaps in the insolvency regime (Ministry of Justice, donors) – short term**. The WB report on the observance of standards and codes (from December 2014) provides comprehensive recommendations on enhancing the legal framework for creditor rights and insolvency regime, risk management and corporate workouts, institutional and regulatory frameworks for the creditor/debtor and insolvency regimes¹¹³. Among these:

- Reforming of the ordinance (executive title) procedure, by introducing a limited list of admissible defenses, focused on procedural issues relating to the enforcement itself, instead of the current non-exclusive approach. Limitation of the right for courts to cancel ordinances to a set or very concrete circumstances; introduction of the right for creditors to appeal against court decisions cancelling ordinances.
- Eliminating legal provisions and practices that allows restricting the grant of a further mortgage/pledge over the same asset;
- Designing of training programs for lenders on secured transaction practice to promote taking full advantage of the possibilities that the law affords, including better use of the pledge over inventory and receivables.

¹¹² EBRD transition report 2015-2016

¹¹³ Moldova Financial Sector Assessment Program, Report on the Observance of Standards and Codes, WB, Dec. 2014

- Increasing sanctions for the alienation/destruction of movable property pledged up to a discouraging amount (equivalent, for example, to the initial amount of the loan) to prevent such actions;
- Design and implement continuous and mandatory training programs for first instance judges on enforcement of judgments in creditor claim cases and cases in ordinance procedure, encouraging judges to strictly enforce rules against bad faith litigations.
- Assign insolvency cases to designated members of the court who are trained in the management of insolvency cases.
- Enhance the training of judges handling insolvency cases to include knowledge of economics, and specialized case management skills for insolvency cases. Training of judges in the enforcement of the insolvency Law.
- Monitoring for the discipline of judges to verify their effectiveness.
- Training, monitoring of the observance of certification terms/requirements and evaluation of insolvency administrators.

255. Ensure a fully functional online registry for pledges over movables (ministry of Justice, donors) – short term. The use of movable collateral could be strengthened by refining the functioning of the online registry, which would improve reliability of records and ease of use.

256. Removing NPLs from the balance sheets of banks and companies (NBM, Ministry of Finance, MEI) could help reinvigorate credit growth by creating space for the growth of new credit. Decisive actions to deal with NPLs, which have been weighting heavy on balance sheets of many banks for the last 7 years, are needed. Effective measures to deal with overhangs of NPLs in the international practice include:

- Facilitating out-of-court restructuring and simplifying insolvency procedures for firms.
- Providing for favorable tax treatment of NPL write-offs (favorable VAT treatment, etc.).
- Developing a market for NPLs involving specialized asset management companies.

257. While the last 2 measures to reduce NPLs may be associated with certain fiscal costs in the short term, in the longer term reviving financial intermediation and corporate investment will support growth and fiscal revenues. Specialized private-owned asset management companies can accelerate corporate reorganization. There is generally a need for the government to coordinate the resolution of systemic NPL problems, bringing together the financial sector, banking supervisors and tax authorities¹¹⁴.

258. Increase effectiveness of the public guarantee scheme (ODIMM LGF). Existing bottlenecks should be addressed, to increase interest from banks in using LGF guarantees. Among the needed reforms are:

- **Address together with the NBM and the Government the status of LGF guarantees.** To be considered as diminishing the bank net exposure for provisioning purposes, these have to correspond to the categories of loan securities recognized by the NBM for this scope (p. 2, art. 5 of the NBM Regulation on large exposure, approved by the Administrative Council of the NBM no. 240 of December 9, 2013) **(NBM, MEI, Ministry of Finance, ODIMM) –short term.**

¹¹⁴.EBRD Transition Report 2015-2016.

- **Capitalize the Loan Guarantee Fund, after conceptually reforming the LGF approach (Ministry of Finance, ODIMM, donors) – medium to long term.** At the current level of operations, the LGF is sufficient to meet slack demand from banks. However, compared to the overall bank and SME loan portfolio, and in an international comparison, its size is insignificant. In European countries, guarantees outstanding amounts range from 0.1% to 2.1% of GDP¹¹⁵. To reach the minimum European level of 0.1% of GDP, the LGF's size should increase at least twice, given that the whole amount is utilized. However, to reach its full utilization, bottlenecks hampering its effectiveness should be addressed. The WB made an evaluation of the performance of the LGF and formulated recommendations to overcome its low attractiveness for banks. It is also providing assistance for the technical part (soft, connectivity, etc.).
- **Include in the LGF scheme other lenders - MFO, SCA, leasing companies (ODIMM) – short term.** To increase utilization of the fund by lenders and outreach for SMEs, the LGF should expand its services to other lenders (MFO, SCA, leasing companies). In order to achieve this, art.13 (6) of the new Law 550 on SMEs has to be changed by replacing the word “financial institutions” with other words that would comprise all lenders, not only banks.
- **Develop new products for beneficiaries (e.g. portable guarantees, etc.) that would contribute to diminishing the financial institutions’ “appetite” for collateral/pledge, taking into consideration the international experience and practice of some donor and/or similar funds from other countries (ODIMM) – short to medium term.**

259. **Increase the amount of guaranteed deposits** from the actual 6,000 MDL (20,000 MDL beginning with 01.01.2018), to channel more savings into the banking sector, including from remittances. According to the AA, Moldova shall harmonize its legislation on deposits guarantee with Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit guarantee schemes (replaced in the meantime by Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit-guarantee schemes) until July 01, 2021, with the exception of the provision related to the minimum level of compensation, for each depositor, which shall be implemented until July 01, 2026. In order to gradually converge with the latter provisions, the amount of guaranteed deposits of the DGFBS should increase with approximately EUR12 thousand each year. There is already at least one ready plan to reform the DGFBS – the draft law developed by the EU High Level Advisers. Another one - the inter-ministerial plan, in accordance with FSAP recommendations, was reportedly being developed at the moment of investigations. **The two plans should be agreed and integrated, to incorporate the optimal solutions for increasing the effectiveness of the DGFBS, in line with Directive 2014/59/EU (DGF, DGFBS, Ministry of Finance, NBM) – short term.** Alternatively, to encourage long – term deposits: (a) different guarantee levels for deposits from population could be provided, depending on the terms of deposits: 6,000 MDL for term deposits of less than 3 years; 100 thousand MDL for those between 3- 5 years; 300 thousand MDL – 5-7 years and 500 thousand MDL for those with a term of more than 7 years and (b) legal persons could be exempted (totally or partially) of the tax on interest earned from deposits with longer than 5 years. For foundation, reasoning and decision purposes, the proposed alternatives could be preceded by surveys and/or impact analysis (NBM, FGDSB, MF) – **medium term.**

260. In order to attract more long-term resources into the banking system, it is necessary to **develop a set of measures that would allow for the increasing of long-term liquidity to finance investments, such as encouraging and stimulating the issuance, by banks, of**

¹¹⁵Ivan Koriakin, Robert Kirchner, Establishing a SME Credit Guarantee Fund in Ukraine: Analysis and Recommendations, June 2016

long-term bonds (longer than 5 years) and investments in these. For this purpose, it would be useful to conduct a study for highlighting the existing regulatory and market constraints with the identification of viable solutions (NBM, NCFM, MF, MEI) - **medium term**.

261. **Develop and approve the legal framework regulating the insolvency of debtors-natural persons**, which would strike a reasonable balance between the interests of debtors and those of creditors. The similar law in Romania provides a good benchmark, while some donors have extensive experience in evaluation different insolvency for individuals regimes and/or providing assistance for the establishment of such regimes worldwide (the World Bank). Build up effective institutional framework for the implementation of the regulations (insolvency commissions, qualified judges and courts, judicial receivers, etc.) (Ministry of Justice, donors) – **medium term**.

262. In order to improve the collateral evaluation practices and remove the identified, in the present study, deficiencies it is necessary to **adjust the legal and normative framework concerning the evaluation activities to the international evaluation standards** (Land and Cadaster Agency , NCFM, MF, MEI) - **medium term**.

263. The financial education (FE) is a very important issue for improving the quality of financial services and improving AF. The NBM has launched activities for the elaboration of a National FE Strategy which should, however, **be preceded by a comprehensive study of this issue**. However, this should involve efforts and activities from a larger number of stakeholders: NCFM, MF, MEI, etc. Such a study should start from identifying current constraints in FE and propose lucrative solutions to improve AF, which would underpin the new Strategy (NBM, NCFM, MF, MEI) - **short term**.

Strengthen independence and enforcement powers of the NBM

264. **Ensure greater independence of the NBM** by eliminating possibilities of political or influential private group interferences/pressure on the NBM, both through dismissing/nominalization of the NBM board members and in the operation of the NBM. In particular:

- Dismissal of members of the NBM executive board should be made possible only with the vote of minimum 2/3 of the deputies, as in the case of the NBM Governor.
- Criteria for the nomination/selection of the members of the executive board and Supervision Council should be more clearly defined. These should include beside general experience in the “financial”, “legal” or “monetary” area, specific extensive experience in banking supervision/regulation or bank management (**the NBM, Parliament**) – **short term**.

265. **Ensure sufficient governance capacities/resources for the regulators to carry out enforcement of prudential regulation, including non-financial**. For this, in addition to ensuring full independence of the NBM and sufficient powers, its capacities to perform increased supervision activities should be strengthened, by providing sufficient staff for bank regulating and supervision activities (in the middle of 2016, the deficit of staff in the supervision department was 40%) (NBM) – **short term**

Crises coordination and resolution mechanisms

266. **Implement the Law on recovery and resolution of banks, harmonized with Directive 2014/59/EU of the European Parliament and of the Council on the recovery and resolution of credit institutions and investment firms**. As already discussed in Part 1 of this Study, on September 26, 2016 the Government assumed responsibility for the adoption of a law package, among which the Law on the recovery and resolution of banks (approved on October 03, 2016). Some of the provisions of the Law enter into force gradually, starting with July 01, 2017, January 01, 2020 and January 01, 2024. Effective implementation of the Law will require creation of the necessary institutional structure (resolution authority, banking

resolution fund) and of the regulatory framework for the application of the resolution and recovery mechanisms (NBM, Ministry of Finance) – **short, medium and long term.**

267. **Develop and perform public outreach activities in relation to the provisions of the new Law on recovery and resolution of banks** addressed to general public, business, NGOs, bank experts and staff, relevant public sector via diverse communication channels. These would contribute to better managing the expectations, avoiding risks, exposing the current and future depositors' behavior to less stress, avoiding outflow of deposits, increasing financial literacy, catalyzing efficiency of NBM driven mechanisms and tools in managing bank crises (NBM) – **short to medium term.**

268. **Establish the financial crises prevention and coordination authority, which should replace the NCFS.** The same law on the recovery and resolution of banks adopted on October 03, 2016 provides for a period of 6 months for the GoM to draft and send to the Parliament the law for the setting up of the national macro-prudential authority. There is already a proposal, developed by the EU High Level Adviser on Financial System, providing for the creation of a macro-prudential authority within the NBM, in charge of financial crises prevention and coordination. The GoM should take it as the basis for the elaboration of the draft law on the establishment of the national macro-prudential authority, providing for its effective coordination with relevant state authorities involved, ensuring strict delimitation of competences and capacity to react quickly to potential risks and adverse events, avoiding its political bias and providing for the strengthening of capacities of potential member agencies to effectively exert crises prevention, coordination and resolution functions (NBM, NCFM, Ministry of Finance, donors) – **short term.**

Ensure transparency of banks' ownership structures and improve corporate governance in banks

269. The NBM lacks effective tools to verify information about foreign shareholders of banks, which impedes the disclosure of ultimate beneficial owners (UBO) of banks' shares, compliance to fit and proper criteria and revealing of possible concerted actions below the specified threshold. **There is a need for increased cooperation with foreign regulators, supervisors and intelligence units, to enable effective verification of UBO assessment of fit and proper conditions, enforcement of requirements regarding related party lending, capital adequacy ratio (CAR) and anti-money laundering legislation, ensure systemic access to information on criminal records and ongoing investigation on UBO (NBM) – short to medium term.**

270. The lack of shareholder transparency in banks affects also corporate governance. **The NBM should address corporate governance by providing binding specific regulations for corporate governance in accordance with Basel III core principles (independent risk management and compliance functions, specialized committees at the level of the Administrative Board, etc.) (NBM) – short to medium term**

271. Ensure the independence and professionalism of banks' boards, executive management and internal control structures by following strictly the separation of roles and responsibilities of the management bodies, executive management and internal control, integrity standards, qualification, experience and risk management for the members of the councils, the executive management and internal control bodies, stipulated in the Regulation on the Bank's Activity Management Framework (Decision of the Executive Committee of the NBM No. 146 of 07.06.2017) and the Regulation on Exigencies towards Managers (Decision of the Executive Committee of NBM No. 203 of 27.07.2017) (NBM) - **short, medium and long term.**

272. **Extend the category of executive functions in banks that need prior approval by the NBM, based on fit-and-proper standards** (heads of internal control and internal audit, risk management, etc.) (NBM) – **short term**

273. **Define more exactly in the corporate governance Code for banks** the rules for bank corporate governance, responsibilities for their observance and penalties for breaches, **delimitate more clearly the powers and responsibilities of bank shareholder, management and control structures** (administrative board, executive board, internal control and audit), by elaborating unique minimum standards and strict monitoring of the observance by banks of these standards (NBM, banks) – **short term**.

274. **Tightening of pecuniary and penal responsibilities and penalties for improper and ill-suited bank governance practices**, breach of general prudential norms and risk management standards (NBM) – **short term**. These would include (but not limited to):

- Increasing significantly the pecuniary liability for bank managers and shareholders for the failure and/or significant prejudice to a bank (commensurable to the size of the prejudice), including for approval of loans in breach of existing regulations.

Stimulate the development of private equity financing

275. Given the significant benefits that private equity entails in terms of investment, job creation and company growth, encouraging more private equity investment in the country could help to increase investments and stimulate economic growth. Because of the long-term and low-liquid nature of private equity as an asset class, investors need to be given a transparent and reliable legal framework, especially as regards the rights of minority shareholders and enforcement of contracts. Also, the development of public equity markets/stock exchanges tailored to small and medium-sized enterprises can provide private equity funds with more opportunities to exit investments. **Policy actions to support private equity flows** could include:

- **Developing, approval and entering into force of the legal and regulatory framework for venture capital funds**, corresponding to the EU norms (Regulation no. 345/2013 of the European Parliament EU Council of April 17, 2013 on European venture capital funds) (MEI) – **short term**.
- **Strengthening legal protection of minority shareholders and enforcement** that would increase private equity capital's ability to assert control over the management of investee companies. Concerns regarding the quality of enforcement and weak legal protection of minority shareholders highly discourage the operation of private equity investors. These tend to obtain majority control, which significantly reduces the number of potential private equity deals, as many entrepreneurs may be reluctant to hang over majority controls at early stages when the valuation of their company is still low. It also makes it difficult for funds to diversify their portfolios by targeting a large number of companies¹¹⁶ (Ministry of Justice, MEI) – **short to medium term**.
- **Improving corporate governance in firms**. This relate mainly to the ability of minority shareholders that want to play an active role in the company, such as private equity funds, to: (i) conclude shareholder agreements and rely on their enforceability; (ii) have the option to appoint a board member; and (iii) rely on the disclosure offered by companies (MEI, Ministry of Justice) – **medium term**.
- **Fostering the development of public equity markets**. Efficient equity markets make it easier for private equity funds to exit investments through public equity markets. Also, more developed and liquid capital markets may increase the expected returns from an investment. In contrast, poorly developed capital markets discourage private equity activity. Increasing the depth of capital markets should be a priority for attracting more private equity investment into the country. Stricter enforcement

¹¹⁶ EBRD transition report 2015-2016

of insider trading rules is also crucial drivers of stock market development (NCFM) – **medium term**.

- Another option to facilitate the development of public equity markets can be **establishing of a specialist stock exchanges for SMEs** that would reduce listing costs and the regulatory burden. The latter can also make SMEs more attractive as investment targets for private equity funds, as they increase the likelihood of private equity funds exiting their investments with higher valuations. A SME „growth market” allows smaller companies to place shares under a more flexible regulatory system at a lower cost. Successful examples of such markets are in the United Kingdom, Romania, Poland, Turkey (NCFM) – **medium term**.
- **Improving the enforcement of information disclosure rules in firms**, including audit standards, which can increase shareholders’ trust in the financial reports of companies (MEI, Ministry of Finance) – **medium term**.
- **Providing for favorable tax treatment for investment income** can also play an important role in stimulating private equity investment (MEI, Ministry of Finance) – **medium term**.

276. **Developing, approval and entering into force of the legal, regulatory and institutional framework on participative financing (crowdfunding)**, as an alternative collective financing of projects, which could lead to better AF for start-ups and SMEs that cannot access traditional finance. At the same time, it would allow the development of crowdfunding stakeholders in a proper legal and fiscal framework (MEI, the Parliament).

Increase savings rate and channeling of remittance into the productive sectors

277. A number of policies can help both **boost domestic savings** and **accelerate the development of domestic equity markets**. Pension reform can strengthen individuals’ incentives to save for retirement and catalyze the development of pension funds and collective investment in transferable securities¹¹⁷ – institutional investors with a long-term approach. As already mentioned in the body of this study, pension reform in Moldova is ongoing, albeit very slowly. Addressing the issue of institutional investors’ base in Moldova would entail first of all adoption of legal and regulatory framework aligned with the EU norms and efforts for the development of the sector:

- **Development and adoption of the legal and regulatory framework on facultative pension funds**, fully harmonized with the EU regulations (Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision) (NCFM, the Parliament) – **medium term**.
- **Fostering the development of the facultative pensions sector** through increasing its attractiveness and trust from population (implementation of policy dialog activities, awareness raising campaigns, training activities, etc.) (NCFM) – **medium to long term**.
- **Approval of the legal and regulatory framework on undertakings for collective investment in transferable securities, fostering of the development of the sector for collective investments** (NCFM, the Parliament) – **medium to long term**.
- **Encouraging the development of the insurance sector** (NCFM) – **short, medium and long term**.

¹¹⁷ “Transferable securities”: (i) shares in companies and other securities equivalent to shares in companies (shares); (ii) bonds and other forms of securitized debt (debt securities); (iii) any other negotiable securities which carry the right to acquire any such transferable securities by subscription or exchange (Directive 2009/65/EC of July 13, 2009)

278. For the economy as a whole, having a larger percentage of remittances channeled through the banking sector would make it easier to redirect those unused savings to firms and individuals that need finance for their business projects. In order to increase the percentage of remittances that are placed in savings accounts, **initiatives to introduce recipients of remittances to banking services and provide them with financial literacy training should be elaborated and implemented.** These initiatives could contribute to encouraging savings via the formal banking system and teaching potential bank customers how to plan their budgets. Such initiatives have been launched by the EBRD in Moldova and other post-soviet countries (Armenia, Azerbaijan, Georgia, the Kyrgyz Republic, and Tajikistan) through a financial inclusion project financed by the EBRD's multi-donor Early Transition Countries Fund. Staffs of participating banks have also been made aware of the importance of providing financial education to recipients of remittances, having been advised on how to make their banks' products more attractive. Similar initiatives should be replicated and expanded further (MEI, banks, bank associations, SCAs, central Association of SCA, donors) – short to medium term.

279. **Scale up remittances attraction program PARE 1+1**, by providing more matching funds (ODIMM, donors) – short to medium term.

280. **Encourage and support partnerships of banking and SCA sectors with NGOs** working with migrants, development/promotion of financial services/financial education in order to focus on more savings and remittances in savings accounts (GoM, NBM, NCFM, MEI, development partners) – short, medium and long term.

281. **Avoid measures, which might have a discouraging effect on savings and remittances** (e.g. taxation of interest on savings and taxation of remittances) (GoM) - short, medium and long term.

282. **Take more actions to bring payment facilities at cash holders' door and enlarge significantly the specter of services and goods to be bought by electronic payment.** Payment facilities relate to bank cards, internet banking, payment terminals, ATMs; some of these need training and it should be easily available (GoM, NBM, MARDE) – short to medium term.

Facilitating access to finance in agriculture

283. **Evaluation of land resources and development of a database of available land, quality of land, transactions with land made, existing bids**, open to all interested parties: land owners, agricultural companies, investors, etc. (Land and Cadaster Agency, MARDE) –short to medium term.

284. Making more transparent the land market should be accompanied by **reducing complexity of registration procedures and diminishing of land transaction costs** (for registration of lease, selling/buying, inheritance, exchange, and donation of agricultural land, notary fees, etc.) (Land and Cadaster Agency Ministry of Justice) – short to medium term.

285. **Develop and enforce the legislation allowing for the use of innovative financing instruments in agriculture, such as crop receipts**, taking into consideration best international practice and the experience on countries in the region (MARDE, Ministry of Justice) – short to medium term.

Box 3. Various countries have been exploring different ways of overcoming constraints in agriculture financing. One such initiative involves an innovative pre-harvest instrument called “crop receipts”, which originated in Brazil and encourages the commercial financing of agricultural activities by the private sector. It currently supports financing operations with a total value of approximately US\$ 20 billion a year. A crop receipt system, which is structured around a dedicated law, establishes a standardized obligation to supply agricultural products or make future payments (to the holder of the receipt) in return for pre-harvest finance (either monetary or a payment in kind). This obligation cannot be altered or revoked under any circumstances (including force majeure) and can be incorporated in a tradable paper, further increasing its market value. The obligation is also secured by collateral, particularly in the form of future agricultural products. Serbia and Ukraine have recently been working on introducing crop receipt systems. The two countries’ authorities needed to ensure that the relevant legislation was drafted in a way that reflected international best practices but also corresponded well to the specifics of the local legal systems. All major stakeholders (banks, insurance companies and agribusiness firms) provided input during the drafting of the legislation, which served as a starting point for the development of certain solutions. This legislation governs agricultural pre-harvest financing contracts, as well as the registration of such agreements, the settlement of creditors’ claims (using future agricultural products as a form of non-possessory security) and special rights and obligations of the contracting parties (for example, rights and obligations relating to specific financing and enforcement mechanisms tailored to the Serbian and Ukrainian markets) (EBRD transition report 2015-2016).

286. **Warehouse receipts** are another useful tool, particularly for hedging against volatility in agricultural commodity prices after the harvest and alleviating collateral constraints. Moldova passed already in 2006 the law on warehouse receipts, however as discussed in the AF study, their effective use is constrained by low awareness among market participants, opaque behavior of agricultural producers and lack of incentives from warehouse operators. At the same time, the special legal framework (Law no. 33 on the storage of cereals and the regime of warehouse receipts for cereals) needs to be adjusted, by excluding the compulsoriness of the license for the warehouse operators, after the respective amendment has been introduced in the Law no. 451 on the regulation of licensing. Effective laws and regulations and their implementation **need to be complemented by policy dialogue aimed at raising awareness of key issues in using warehouse receipts among major stakeholders.** This should help to increase trust in warehouse receipt system. Also, use of this instrument could be **incentivized by providing various forms of facilitation of its use** (inclusion in the state subsidy program, tax incentives, etc.) For this purpose, but also with a view for identifying other possible ways of stimulating this instrument of boosting financing in agriculture, as well as the new tool proposed above (crop receipts), it is advisable **to conduct a study analyzing the existing constraints in the use of WRs and formulation of measures to stimulate the use of WRs and the crop receipts (MARDE, AIPA) – short to medium term.**

287. **Enhance efficiency of the state subsidy system by:**

- Changing its approach from distribution of public money to support against measurable and tangible results (by setting concrete post disbursement performance criteria in exchange for subsidies or other result-based tools). This could be done after performing a comprehensive evaluation of the impact of state subsidies on the agricultural sector so far (**GoM) – short term to medium term.**
- Subsidizing of investments in machines, equipment and agricultural machinery from the secondary market, provided these are procured through financing from credit **institutions (GoM) - short and medium term.**

288. Expansion of crediting in agriculture (also in other sectors) and reduction of the NPL and the development of alternative banking credit instruments can be boosted by stimulating the development of the secondary markets for machinery and equipment. In this respect, it is necessary **to launch a study on the issue of the non-liquidity of secondary markets for machinery and equipment (especially agricultural ones)** in order to establish existing constraints, identify solutions and formulate recommendations to stimulate the development of these markets (**MARDE, MEI, NBM, NCFM, MF) - short and medium term.**

Increase role of the microfinance and leasing sectors

289. **Improve information and transparency requirements** (ownership and price transparency), for MFOs (NCFM) - **short to medium term**.

290. Establishing **quarterly reporting requirements of financial statements for leasing companies**, publishing them at least in the format available for MFO and SCA (NCFM) - **short-term and medium-term**.

291. The lack of full and accurate statistical information regarding the leasing market represents a constraint for the processes of analysis and strategic development of this type of financial service as an alternative to banking - it would be useful to **provide separate statistics for banks' and MFO leasing portfolios**, for strategic analysis and planning purposes (NCFM, NBM) - **short term**.

292. Some provisions of the draft laws on the NBCO and of the amendments to the Law on NCFM No.192/2008 have the potential to create new constraints in the sector (such as the introduction of the capital adequacy rate and the supervisory fee in the proposed amount and format). In order to avoid their negative effects on the sector (increase of interest rates, reduction of competition), the draft law on the NBCO and, respectively, the draft amendments to the Law on NCFM no.192/2008, **the provision regarding the minimum capital adequacy rate should be removed and the supervisory fee should be set as a basic fee (NCFM) - short term**.

293. **Support consolidation of SCAs into larger saving and credit associations**, including by providing technical assistance by donors and necessary regulatory incentives by the NCFM (NCFM, donors) – **medium to long term**.

294. **Create a level playing field in subsidizing by the state of investments in movable and immovable property acquired in leasing and intended for the agro-industrial sector** -allowing companies purchasing assets in leasing to benefit from state subventions during the active lease period, not after the full redemption of the leased assets (AIPA) – **short term**.

295. **Ensure a level playing field for the VAT regime of fixed assets purchased on leasing terms and included in the statutory capital** – such equipment should be exempted from VAT, alongside with similar equipment purchased by any other financing method (Ministry of Finance) – **short term**.

296. **Remove the limitation for leasing companies to deduct provisions for losses to only 5% of their average annual outstanding leasing portfolio**. Regulate the creation of provisions for losses for fiscal purposes by unique rules for MFO and leasing companies (Ministry of Finance, NCFM) – **short term**.

297. **Streamline the repossession of lease by leasing companies upon default of lessees**, by limiting the reasons for appeal against simplified ordinances (executive titles) issued by courts at request of leasing companies (Ministry of Justice) – **short term**.

Regulatory and institutional strengthening

298. **Consolidate regulatory and supervision of the lending market under a „single umbrella”**. For this, regulation and supervision of the non-bank lending organizations (including MFO, SCA and leasing companies) should be given to the NBM, alongside with increasing the capacities of the NBM to perform extended regulation and supervision functions. At the same time, the NCFM would be responsible for regulating and supervising the non-lending financial sector (capital market, insurance sector, etc.) **(the Parliament) – medium term**.

299. It is also important to reasonably **balance the prudential norms, including the provisioning ones, for different types of credit institutions**, in order to avoid regulatory

arbitrage through cross-holdings or provision of funding for on-lending (NBM, NCFM) – **medium term**.

300. In order to broaden the banks' room for maneuver in issuing new loans, it would be useful to extend **the credit classification categories** (for the purpose of creation of reserves for loan losses), or to **adopt sectorial criteria / approaches** that would take into account the sectorial specificity of the activity credited for the purpose of formation of reserves for loan losses (NBM) – **short term**.

301. **There is a need for an institutional and regulatory framework for consumer protection (in financial services)**, including regulations and specialized structures for the examination of complaints, appeals, and/or litigations that would allow clients to complain about lenders' practices, resolve disputes, or provide feedback on actual practices. Existing regulations do not fully address this issue, leaving large part of the borrowers (corporate) outside the realm of the Law no. 202 of July 20, 2013 on credit agreements for consumers and Law no. 157 of 18.07.2014 on the conclusion and enforcement of distance contracts for financial service consumers. At the same time, the NBM Regulation on the disclosure by banks of the information pertaining to their activity (no. 52 of March 20, 2014) obliging banks to disclosure information on their products, corporate governance, financial situation, effective interest rates, etc., relates only to banks. There is a need to fill these gaps by **expanding consumer protection on corporate (including microloans) and by providing information disclosure norms for other participants of the credit market (MFO, SCA, leasing companies)**. At the same time the existing institutional structures for consumer protection (the Consumer Protection Agency – CPA) lack capacities, competence and abilities to deal with consumer protection in the financial sector, except for the supervision of compliance to the legislation on consumer credit and on distance contracts for financial service consumers (natural persons). **Specialized units should be established within the NBM and NCFM which would be delegated current functions in the protection of consumers of financial services and empowered with competences for the non-addressed areas (for example, corporate lending)**. These units would be responsible for the protection of all consumers in the financial sector, financial literacy, establishing and monitoring compliance of banks and non-bank financial institutions with norms on disclosure of information, establishing and managing feedback and complaint mechanisms for the financial services market (a similar authority by the National Bank of Georgia would serve as a good benchmark) (NBM, NCFM, MEI, donors) – **short term**.

302. **Set norms for participants of the credit market to promote ethics and minimum standards for client servicing**. The Clients Protection Principles (CPPs) promoted by the Smart Campaign in microfinance can be a good benchmark (<http://www.smartcampaign.org/about/smart-microfinance-and-the-client-protection-principles>) (NCFM, NBM) – **short to medium term**.

303. In many cases political will, leadership and initiative at country level are insufficient to be able to advance the reform agenda. A significant proportion of assistance continues to be supply-driven with an overall low level of ownership and involvement on the part of local institutions. In such circumstances the role of coordination among various donors increases. Many donors have been active in providing assistance directly or indirectly relating to the AF, which often lead to overlapping of activities and inefficient allocation of resources. Also, the support delivered by development partners targeted often only a few segments of AF, while many other sectors with a direct or indirect impact over AF have not been covered. Under the circumstances above, lacking strategic inter-sector actions and synergy, the overall impact in the AF for businesses is difficult to be increased without a continuous efficiently coordinated multi-sector development assistance in facilitation of AF. **Creation of a donor coordination mechanism for activities relating to the AF would therefore be advisable to increase impact and effectiveness of such activities (donors)** – **short to medium term**.

304. The majority of donor assistance projects rely on their own PIUs because of organizational arrangements that favor the goal of safeguarding project fiduciary and performance objectives. At the same time, they were not designed to systematically foster more sustainable capacity development through greater use of and support for country systems and institutions. The result is that there are no reliable organizational structures at the governmental level capable of implementing potentially big assistance projects/programs in the AF that would ensure timely project implementation and disbursement without the risk of creating contingent public financial liabilities. Alongside with better coordination efforts, donors active in providing assistance for improving AF should also consider support for the **establishing of a project implementation unit (PIU) that would implement international concessional financing projects and programs in the area of AF (donors) – short to medium term.**

305. To maximize the efficiency and effectiveness of the reforms in the AF, **there is a need for a coordinating body at the national level.** This could be a unit within the MEI (or other authority / institution, at GoM's decision) that would be responsible for monitoring efforts to enhance companies' AF and fostering collaboration between different entities at the national level (**GoM**) – **short term.** It would be responsible for¹¹⁸:

- Assessing data gaps, and coordinating/initiating data collection;
- Bringing the various stakeholders and donors together to coordinate and consolidate the ongoing reform efforts into larger and well-communicated initiatives;
- Monitoring reform results, and revising reforms as needed;
- Identifying gaps, and bringing stakeholders (including donors and the private sector) together to fill them.

According to the GoM Decision no. 879 of 21.10.2014 "On the national Commission for the monitoring and coordination of activities for the improvement of access to finance", a similar body was established, empowered with competences for the monitoring and coordination of activities for improving the AF, aimed at fulfilling the objectives of the National Development Strategy "Moldova 2020". However, it didn't prove to be functional. The National Commission for Monitoring and Coordination of Activities for Improvement of Access to Finance does not meet and issue decisions at the moment, according to the objectives it was established.

¹¹⁸ Republic of Moldova: Enterprise Access to Finance/Background Notice, the WB, 2013.

Summary of recommendations

Recommendations and actions	Time horizon	Lead authority
<i>Increase access to information on companies' constraints in AF</i>		
1. Establish a baseline periodical survey for enterprises, providing data on companies' AF by size, purpose of financing and maturities, reasons for rejection of loan application and incidence of credit denial, financing needs and gaps, reasons and incidence of companies' failures, etc. Useful benchmark - the European Commission/European Central Bank survey on the access to finance of enterprises (SAFE).	Medium term (MT)	NBM, MEI
<i>Support growth and emergence of enterprises</i>		
2. Elaborate a Program to assist local companies in increasing capacities to meet quality requirements of foreign/multinational companies (MNC) with the objective of increasing the standards of Moldovan suppliers to a level making them attractive as suppliers for foreign companies/MNCs.	ST - MT	MEI, MIEPO
3. Establish a specialized unit within ODIMM targeting medium sized/high growth companies, to support them grow to export markets (product support - product quality, innovation, etc.; market support - sales, distribution, certification; human resource support - skills, management training; export markets targeting - preparation of export plans, distribution channels, quality certification, participation in international events, preparation of high quality promotional materials; training in key aspects of export marketing; specific training/consultancy for key sectors; providing market contacts), etc.	MT	MEI, ODIMM
4. Increased human resource base and financing for the specialized agency (ODIMM) to make an impact in meeting existing demand for support services and support programs. Effective implementation of organizational strategy. Close monitoring, evaluation and prompt remedy actions.	ST - MT	MEI, ODIMM
5. Effective implementation of MIEPO organizational strategy. Close monitoring, evaluation and prompt remedy actions.	ST - MT	MEI, MIEPO
6. Extend regional outreach of ODIMM and MIEPO, or design and implementing more business support programs at local/regional level and build capacities of economic divisions of local Councils and other local counterparts).	ST - MT	MEI, ODIMM, MIEPO
7. Establishment of regional business development centers to facilitate access to business support services. For this, lessons from a former similar TACIS project have to be learned and measures to ensure sustainability of the centers have to be developed. Alternatively, establish a partnership of different business support organizations active in regions (ODIMM, ACSA, AGROinform, other associations and business service providers) under one roof to ensure long-term sustainability of the centers.	ST-MT	MEI, ODIMM, donors
8. Effective implementation of the National Strategy for investment attraction and export promotion, to ensure attainment of the strategy's objectives and duly realization of the envisaged actions.	ST - MT	MEI, MIEPO

9. Stimulate the development of the private market for business support services (accreditation and quality certification of business service providers, facilitation for the creation of an association of professional consultants, technical assistance programs for business development service providers, voucher schemes for business consultancy, legal changes to consider consulting as a listed profession).	(MT-LT)	MEI
10. Strengthen the capacities of institutions in charge of the quality infrastructure (metrology, standardization, market surveillance, conformity assessment and accreditation) and for food safety systems to further align to the EU norms and efficiently implement them.	ST - MT	MEI, ANSA
11-13. Elaboration and implementation of a long-term Strategy and comprehensive plan with specific SMART objectives, and proactive actions to reduce the scale of informal economy and ensure integration of informal businesses into the formal sector. For this: <ul style="list-style-type: none"> • Better learn and understood specific reasons, methods, operations/actions, incentives and phenomena that make the companies enter/stay in the shadow, identify trends and forecasts. • Develop and approve a long-term Strategy that would provide for a “shadow economy” filtration mechanism on a permanent basis, and implementation agency/institution(s). It would get a “mandatory step” status when drafting new legislation and standards/regulations (including tax, labor, customs, payments, etc.) before approval. • Develop suitable actions in a comprehensive Action Plan, including review all existent legislation and standards/regulations, develop & approve amendments in order to reach the Strategy objectives. 	ST-MT	MEI, GoM, Parliament
14. Address low business intensity in the regions by increasing investments in public infrastructure , industrial parks and free economic zones, establishing of industrial platforms, streamlining procedures for getting construction permits and connecting to electricity and providing special incentives for starting up business in the regions.	MT-LT	MEI
15. Address shortage of workforce in certain sectors and increase quality of professional education and training.	MT-LT	MEI, Ministry of Education, Culture and Research
<i>Enhance business environment</i>		
16. More focus on effective implementation of existing body of policy documents and initiatives in practice, monitoring, evaluation, feedback and achieving of actual results. Periodically review and adjust policy documents to ensure the actuality/realism of their path, scopes and objectives.	ST-MT	MEI
17. Strategies and action plans need more exact formulation of envisaged measures with quantifiable targeted results, practical and proactive actions.	ST, MT, LT	MEI
18. Improve legal mechanisms for the protection of investors and ensure effective protection of ownership rights, contract enforcement and precluding tentative of business takeover.	ST-MT	MEI, Ministry of Justice
19. Observance by all state authorities of the legislation on the transparency on the decision making process and on the regulatory impact analysis for all the decisions that introduce new norms (or change the existing norms) for the regulation of the business activity. Impose strict sanctions upon the authorities breaking these rules.	ST, MT, LT	GoM

20. Exclusion of political interferences in the activity of state supervision and control bodies, of the judiciary, consolidation of the capacities of the respective bodies and of the independence of the judiciary.	ST-MT	MEI, Ministry of Justice
21. Speed up reform of the judiciary, tightening of sanctions against judges and prosecutors that admitted breaches of law and arbitrary and ill-intentioned decisions. Ensure efficient supervision of the judiciary by an independent Superior Council of Magistracy.	ST-MT	MEI, Ministry of Justice
22. Combat shadow economy, corruption, develop enforce and largely promote standards of transparency, ethics and integrity in business.	ST-MT	MEI, Ministry of Justice
23. Effective promotion, through free market instruments, of a stable monetary policy targeting low inflation rate (within the limits targeted by the NBM), relatively stable (without major fluctuations) exchange rate.	ST, MT, LT	NBM, MEI, MF
24. Eliminate restrictions/barriers for the entry on markets, ensure correct and impartial application of legislation for all market participants, including by effective enforcement of powers of regulators and independent judiciary.	ST-MT	Competitiveness Council, Ministry of Justice
25. Optimization and streamlining of customs procedures in accordance with the EU practices: elimination of unofficial payments, ensuring the necessary informational infrastructure for quick exchange of data among different institutions involved, implementing the customs single window, establishment of single joint customs posts.	ST-MT	Customs Service MF
26. Optimization and streamlining of tax administration, by simplifying reporting requirements, especially in relation to SMEs, changing the focus of the actual fiscal policies and practices from maximization of tax collection to the economic stimulatory functions.	ST-MT	MF, MEI,
27. Ensure full implementation of the Regulatory Reform Strategy, Competitiveness Roadmap and EU harmonization agenda	ST-MT	GoM
<i>Improve risk evaluation practices by banks and streamline loan application process</i>		
28-35. Develop and implement programmes for capacity building in risk evaluation practices by banks/microfinance organizations through targeted technical assistance. Major issues to be addressed include: <ul style="list-style-type: none"> • Updates and use of business plans to monitor borrowers' ability to repay; • Using VC to verify ability of borrowers to repay; Using VC terms of lending and member histories in credit analysis; structuring of VC information; • Use of receipts to validate income statements and other estimates; • Capital budgeting training (investment analysis); • Assigning weights, using models for matching expected losses at risk levels to calculate risk-based pricing; • Training in reducing collateral losses, efficient loan monitoring and early identification of trouble; • Training in prediction of the extent and frequency of worst case scenarios, frequency and extent of income volatility, calculation of benefits and quantifying risk reduction from diversification; • Training on contract terms and timing, etc. 	ST-MT	Donors, banks, MFOs
36. Establishment of a single window for the issuance of confirmation documentation for loan applications.	ST-MT	Donors, Electronic Governance Center

37. Encourage strategic investments in the banking sector to increase competition and bring advanced lending technologies, sound banking risk management practices, more long-term resources.	MT	NBM, MIEPO
<i>Improve legal framework for creditors' rights and financial market infrastructure</i>		
38-41. Further improving the functionality of the CHB, by: <ul style="list-style-type: none"> • Broadening the scope of information covered by the credit bureau (including all MFOs, SCAs, leasing companies, insurance companies, trade credit and utility companies); • Increasing the range of products delivered to lenders (credit scores, industry data, portfolio monitoring, etc.); • Improving oversight over the CHB by the NCFM, accuracy and comprehensiveness of the information provided to the CHB; • VAT exemption of the CHB products, to make them more attractive to smaller lenders. 	ST-MT	CHB, NCFM, donors
42. Ensure a fully functional online registry for pledges over movables, by refining the functioning of the online registry, which would improve reliability of records and ease of use.	ST	Ministry of Justice, donors
43-45 Undertake decisive actions to deal with NPLs, which have been weighting heavy on balance sheets of many banks by: <ul style="list-style-type: none"> • Facilitating out-of-court restructuring and simplifying bankruptcy procedures for firms; • Providing for favorable tax treatment of NPL write-offs (favorable VAT treatment, etc.); • Developing a market for NPLs involving specialized private-owned asset management companies. 	ST	NBM, MEI, MF, Ministry of Justice
46 – 54. Reinforce the legal framework for creditor rights and address legal and regulatory gaps in the insolvency regime, by: <ul style="list-style-type: none"> • Reforming the ordinance (executive title) procedure by introducing a limited list of admissible defenses focused on procedural issues relating to the enforcement, instead of the current non-exclusive approach. Limiting the right for courts to cancel ordinances to a set of specific circumstances; allowing the right for creditors to appeal against court decisions cancelling ordinances; • Eliminating legal provisions and practices that allows restricting the grant of a further mortgage/pledge over the same asset; • Designing of training programs for lenders on secured transaction practice to promote taking full advantage of the possibilities that the law affords, including better use of the pledge over inventory and receivables; • Increasing sanctions for the selling/destroying of movables pledges up to an amount discouraging such deeds (equivalent, for example, with the initial amount of the loan); • Designing and implementing continuous and mandatory training programs for first instance judges on enforcement of judgments in creditor claim cases and cases in ordinance procedure, encouraging judges to strictly enforce rules against bad faith litigations; • Assigning insolvency cases to designated members of the court who are trained in the management of insolvency cases; • Enhancing the training of judges handling insolvency cases to include knowledge of economics, and specialized case management skills for insolvency cases. Training of judges in the enforcement of the insolvency Law; • Monitoring for the discipline of judges to verify their effectiveness; • Implementing training, monitoring of the observance of certification terms and evaluation for insolvency administrators. 	ST	Ministry of Justice, donors

55. Increase effectiveness of the public guarantee scheme (ODIMM LGF), by rising the status of LGF guarantees (to diminish banks' net exposure for provisioning purposes).	ST	NBM, MEI, MF, ODIMM
56. Exclude borrowers from negotiation of the guarantees (agree them with the partner - credit institutions), in order not to create moral hazards for clients.	ST	ODIMM
57. Capitalize the ODIMM LGF, to increase its amount at least twice (to minimum 0.1% of the GDP), along with the development of new guarantee products and increase of the attractiveness of LGF for creditors.	MT-LT	MF, ODIMM, donors
58. Include in the LGF scheme other lenders (MFO, SCA, leasing companies). For this, art.13.(6) of the new Law no. 179 of 21.07.16 on SMEs has to be changed by replacing the words "financial institutions" with another term that would comprise all lenders, not only banks.	ST	ODIMM
59. Develop new products for beneficiaries (e.g. portable guarantees, etc.) that would contribute to diminishing the financial institutions' "appetite" for collateral/pledge, taking into consideration the international experience and practice of other countries.	ST-MT	ODIMM
60. Increase the amount of guaranteed deposits from the actual 6,000 MDL, to channel more savings into the banking sector (by about EUR 12,000 per year) during 8 years.	ST, MT, LT	MF, DGFBS, NBM
61. Reform the DGFBS in line with Directive 2014/59/EU (agree and integrate the existing draft plans to incorporate the optimal solutions).	ST-MT	MF, DGFBS, NBM
62. As an alternative solution to the previous recommendation, different guarantee thresholds for deposits from population might be provided, depending on their terms, for example: 6,000 MDL for deposits shorter than 3 years; 100,000 MDL for those between 3 and 5 years; 300,000 MDL - between 5 and 7 years, and 500,000 MDL for deposits longer than 7 years. In order to stimulate long term deposits from legal entities, partial or full exemption of tax on interest earned on deposits longer than 5 years could be applied.	MT	NBM, DGFBS, MF
63. Elaborate a set of measures for increasing the availability of long term liquidities for the financing of investments, such as fostering and stimulation of the issuance by banks of long term bonds (longer than 5 years) and of investments into such tools. A first step in this direction would be the elaboration of a study for the highlighting of the existing regulatory and market constraints and identification of viable solutions.	MT	NBM, NCFM, MF, MEI
64. Develop and approve the legal framework for the insolvency of debtors-natural persons, which would strike a reasonable balance between the interests of debtors and those of creditors (the similar law in Romania provides a good benchmark). Build up effective institutional framework for the implementation of the regulations (insolvency commissions, qualified judges and courts, judicial receivers, etc.).	MT	Ministry of Justice, donors
65. Adjust the legal and normative framework on evaluation activities to the international evaluation standards.	ST	Land and Cadaster Agency, NCFM, MEI, MF

66. Launch an ample study, involving all stakeholders (NBM, NCFM, MF, MEI, etc.) that would address the financial literacy and would identify measures for its increasing, and which would lay foundation for the new financial literacy Strategy that the NBM is working on.	ST	NBM, NCFM, MF, MEI
<i>Strengthen independence and enforcement powers of the NBM</i>		
67-68. Ensure greater independence of the NBM by eliminating possibilities of political or influential group interferences/pressure on the NBM, by: <ul style="list-style-type: none"> • Providing for the dismissal of members of the NBM executive board by vote of minimum 2/3 of the deputies, as in the case of the NBM Governor; • Criteria for the nomination/selection of the members of the executive board and Supervision Council should be more clearly defined and include specific extensive banking experience. 	ST	NBM, the Parliament
69. Ensure sufficient governance capacities/resources for the bank regulator to carry out enforcement of prudential regulation.	ST	NBM, the Parliament
<i>Crises coordination and resolution mechanisms</i>		
70. Implement the Law on recovery and resolution of banks, adopted on September 26, 2016, harmonized with Directive 2014/59/EU of the European Parliament and of the Council on the recovery and resolution of credit institutions and investment firms. Effective implementation of the Law will require creation of the necessary institutional structure (resolution authority, banking resolution fund) and of the regulatory framework for the application of the resolution and recovery mechanisms.	ST, MT, LT	NBM, MF
71. Develop and perform public outreach activities in relation to the provisions of the new Law on recovery and resolution of banks addressed to general public, business, NGOs, bank experts and staff, relevant public sector via diverse communication channels.	ST-MT	NBM
72. Establish the banking crises prevention and coordination authority, which should replace the NCFS, taking as a basis the proposal developed by the EU High Level Adviser on Financial System, providing for the creation of a macro-prudential authority within the NBM.	ST	NBM, MF, donors
<i>Ensure transparency of banks' ownership structures and improve corporate governance in banks</i>		
73. Increased cooperation with foreign regulators, supervisors and intelligence units, to enable effective verification of UBO of banks, assessment of fit and proper conditions, enforcement of requirements on related party lending, capital adequacy ratio and anti-money laundering legislation, ensure systemic access to information on criminal records and ongoing investigation on UBO of banks.	ST-MT	NBM
74. Address corporate governance in banks by providing binding specific regulations in accordance with Basel III core principles (independent risk management and compliance functions, specialized committees at the level of the Administrative Board, etc.).	ST-MT	NBM

75.Ensure independence and professionalism of banks' boards, executive management and internal control structures, by ensuring strict observance of the separation of roles and responsibilities of the governing, executive and internal control bodies, of integrity, qualification, experience and risk management standards for the members of the boards, of executive management and internal control bodies, as provided by the Regulation on the administration of bank activity (Decision of the Executive Committee of the NBM no. 146 of 07.06.2017) and by the Regulation on the requirements toward administrators (Decision of the Executive Committee of the NBM no. 203 of 27.07.2017).	ST, MT, LT	NBM
76. Extend the category of executive functions in banks that need prior approval by the NBM, based on fit-and-proper standards (heads of internal control and internal audit, risk management, etc.).	ST	NBM
77. Define more exactly in the corporate governance Codes for banks, the rules for bank corporate governance, responsibilities for their observance and penalties for breaches, delimitate more clearly the powers and responsibilities of bank shareholder, management and control structures (administrative board, executive board, internal control and audit), by elaborating unique minimum standards and strict monitoring of the observance by banks of these standards.	ST	NBM, banks
78. Tightening of pecuniary and penal responsibilities and penalties for improper and ill-suited bank governance practices, breach of general prudential norms and risk management standards. These would include increasing significantly the pecuniary liability for bank managers and shareholders for the failure and/or significant prejudice to a bank (up to 3 or 5-fold the size of the prejudice), including for approval of loans in breach of existing regulations.	ST	NBM
<i>Stimulate the development of private equity financing</i>		
79. Developing, approval and entering into force of the legal and regulatory framework for venture capital funds, corresponding to the EU norms (Regulation no. 345/2013 of the European Parliament EU Council of April 17, 2013 on European venture capital funds).	ST	MEI, Parliament
80.Strengthen legal protection of minority shareholders and enforcement.	ST-MT	Ministry of Justice, MEI
81. Improve corporate governance in firms, relating to the ability of minority shareholders to: (i) conclude shareholder agreements and rely on their enforceability; (ii) have the option to appoint a board member; and (iii) rely on the disclosure offered by companies.	MT	ME, Ministry of Justice
82. Foster the development of public equity markets.	MT	NCFM
83. Consider establishing a specialized stock exchange for SMEs that would reduce listing costs and the regulatory burden.	MT	NCFM
84. Improve the enforcement of information disclosure rules in firms, including audit standards, which can increase shareholders' trust in the financial reports.	MT	MEI
85. Provide for favorable tax treatment for investment income.	MT	MEI, MF
86. Developing, approval and entering into force of the legal, regulatory and institutional framework on participative financing (crowdfunding), as an alternative collective financing of projects.	MT	MEI, Parliament

<i>Increase savings rate and channeling of remittance into the productive sectors</i>		
87. Develop and adopt legal and regulatory framework on facultative pension funds, harmonized with the EU regulations (Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003);	MT	NCFM, Parliament
88. Foster the development of facultative pensions sector through increasing its attractiveness and trust from population (implementation of policy dialog activities, awareness raising campaigns, training, etc.);	MT-LT	NCFM
89. Approval of the legal and regulatory framework on undertakings for collective investment in transferable securities, fostering of the development of the sector for collective investments.	MT, LT	NCFM
90. Encourage the development of insurance sector;	ST, MT, LT	NCFM
91. Implement initiatives to introduce recipients of remittances to banking services, provide them with financial literacy training and advise staffs of banks on how to make their products more attractive.	ST-MT	Donors, banks, bank associations, SCAs
92. Scale-up remittances attraction program PARE 1+1, by providing more matching funds.	ST-MT	MEI, ODIMM, donors
93. Encourage partnerships of the banking and SCA sectors with NGOs working with migrants, development/promotion of financial services/education in order to facilitate more savings and remittances in savings accounts.	ST, MT, LT	GoM, NBM, NCFM, MEI, donors
94. Avoid measures, which might have a discouraging effect on savings and remittances (e.g. taxation of interest on savings, of remittances, etc.).	ST, MT, LT	GoM
95. Take more actions (including easily available training) to bring payment facilities at cash holders' door and enlarge significantly the spectrum of services and goods to be bought by bank transfer (bank cards, internet banking, payment terminals, ATMs, etc.).	ST-MT	GoM, NBM
<i>Facilitate access to finance in agriculture</i>		
96. Evaluate land resources and develop a database of available land, quality of land, transactions with land made, and existing bids, open to all interested parties (land owners, agricultural companies, and investors).	ST-MT	Land and Cadaster Agency (LCA), MARDE
97. Reduce complexity of registration and diminish the land transaction costs (for registration of lease, selling/buying, inheritance, exchange, and donation of agricultural land, notary fees, etc.).	ST-MT	LCA Ministry of Justice
98. Develop and enforce legislation allowing for the use of innovative financing in agriculture, such as crop receipts, taking into consideration best international practice and that of countries in the region.	ST-MT	MARDE, Ministry of Justice
99. Complement effective laws and regulations by policy dialogue aimed at raising awareness of key issues in using warehouse receipts (WR) among major stakeholders and increase trust in warehouse receipt system. For this, but also in order to identify other possible solutions to trigger the use of this tool for the stimulation of financing in agriculture, as well as of the new one proposed above (crop receipts-CR), there is a need for a study that would investigate in more details the constraints in the use of the WR and would formulate solutions for fostering the use of WR and CR;	ST-MT	MARDE

100. Incentivize the use of warehouse receipts by providing various forms of facilitation (the state subsidies, tax incentives, etc.).	ST-MT	MARDE, AIPA, MF
101-102. Enhance efficiency of the state subsidy system by: <ul style="list-style-type: none"> Changing its approach from distribution of public money to support against measurable and tangible results (setting concrete post-disbursement performance criteria or other result-based tools). Perform comprehensive evaluation of the impact of state subsidies on the agricultural sector so far. Subsidizing of investments in agricultural machinery and equipment from the secondary market provided these are financed by lending institutions. 	ST-MT	GoM
103. Launch a study for researching the problem of illiquid secondary markets for the machinery and equipment (in particular, the agricultural one), in order to reveal existing constraints, identify solutions and formulate recommendations for stimulating the development of these markets.	TS-TM	MARDE, MEI, NBM, NCFM
<i>Increase role of the microfinance and leasing sectors</i>		
104. Improve information and transparency requirements (ownership and price transparency) for MFOs.	ST-MT	NCFM
105. Set up quarterly financial reporting for leasing companies, publishing of the respective financial reports at least in the format available for the MFO and SCA.	ST-MT	NCFM
106. Provide for a separate statistics for the bank and MFO leasing portfolios, for analysis and strategic planning purposes.	ST	NCFM, NBM
107. Exclude from the draft law on NBCO the provisions relating to the minimal capital adequacy ratio and provide, in the draft for the amending of the Law on the NCFM no.192/2008, for a basic supervision fee, instead of that linked to the amount of the lending/leasing portfolio.	ST-MT	NCFM
108. Support consolidation of SCAs into larger savings and credit associations, including by providing technical assistance by donors and necessary regulatory incentives by the NCFM.	MT-LT	NCFM, donors
109. Create a level playing field in subsidizing by the state of the acquisition of agricultural equipment - allow companies purchasing equipment in leasing to benefit from state subventions during the active lease period, and not after the leased equipment was paid in full.	ST	AIPA
110. Ensure a level playing field (as compared to other forms of financing) for the VAT regime of fixed assets purchased in leasing, as well as of those purchased in leasing and included in the statutory capital, by dissociating the deduction of VAT from the moment of effective pass of the ownership right to the lessee.	ST	MF
111. Remove the limitation for leasing companies to deduct provisions for losses of only 5% of the average annual outstanding amount of leasing portfolio. Regulate the creation of provisions for losses by unique rules for MFOs and leasing companies.	ST	MF, NCFM
112. Streamline the repossession of lease by leasing companies upon default of lessees on leasing contracts, by limiting the reasons of appeal against simplified ordinances (executive titles) issued by courts at request of leasing companies.	ST	Ministry of Justice

<i>Regulatory and institutional strengthening</i>		
113. Consolidate regulatory and supervision of the lending market under a “single umbrella”. For this, regulation and supervision of the non-bank lending organizations (including MFO, SCA and leasing companies) should be given to the NBM, alongside with increasing the capacities of the NBM to perform extended regulation and supervision functions.	MT	The Parliament
114. Maintain maximally a level playing field for different types of credit institutions in respect to prudential and provisioning norms to avoid regulatory arbitrage through cross-holdings or provision of funding for on-lending.	MT	NBM, NCFM
115. Extend the credit classification categories (for the purpose of creation of reserves for loan losses) or to adopt sectorial criteria / approaches that would take into account the sectorial specificity of the activity credited for the purpose of formation of reserves for loan losses.	ST	NBM
116. Expand legal framework for consumer protection on corporate loans and regulations for the disclosure of information to the rest of participants of the credit market (MFO, SCA, leasing companies). Delegate/Empower specialized unities within the NBM and NCFM with competencies in consumer protection, which would deal with consumer protection in the banking and, correspondingly, non-bank financial sectors, financial literacy issues, establishing and monitoring compliance of banks and non-bank financial institutions with norms on disclosure of information, establishing and managing feedback and complaint mechanisms for the financial services market (a good benchmark would serve the similar authority by the National Bank of Georgia).	ST	NBM, NCFM, MEI, donors
117. Set norms for participants of the credit market to promote ethics and minimum standards for client servicing (the Clients Protection Principles by the Smart Campaign in microfinance can be a good benchmark).	ST-MT	NCFM, NBM
118. Establish a donor coordination mechanism for activities relating to the AF in Moldova to increase impact and effectiveness of such activities, and to avoid duplication of efforts/more efficient allocation of resources.	ST-MT	Donors
119. Set up a project implementation unit (PIU) with support from donors that would implement international concessional financing projects in the AF.	ST-MT	Donors
120. Establish a coordinating body at the national level (a unit within the MEI or another authority/institution) that would be responsible for monitoring efforts to enhance companies’ AF and fostering collaboration between different entities at the national level (assessing data gaps, and coordinating data collection, including that mentioned at p. 234 of this Action Plan; bringing the various stakeholders and donors together; monitoring reform results, and revising reforms as needed; identifying gaps, and bringing stakeholders together to fill them, etc.	ST	GoM