Annex
to the Decision of the Executive Board
of the National Bank of Moldova
no. 94 of 7 April 2016,
amended by the Decision of the Executive Board
of the National Bank of Moldova
no. 148 of 7 June 2017

STRATEGY FOR IMPLEMENTING THE BASEL III STANDARDS IN THE REPUBLIC OF MOLDOVA UNDER THE LEGAL FRAMEWORK OF EUROPEAN LEGISLATION (CRD IV)

Chapter I. Current situation of the banking sector of the Republic of Moldova. NBM's role in regulating and supervising the banking system.

The National Bank of Moldova (NBM) is the central bank of the Republic of Moldova, which according to the Law on the National Bank of Moldova no.548-XIII of 21 July 1995 shall ensure and maintain price stability as its fundamental objective.

According to the Law on the National Bank of Moldova, the NBM is the public authority that regulates, supervises and licenses financial[1] institutions' activity, including banks[2]. For this purpose, the NBM is empowered to issue necessary regulations and take necessary measures to exercise its powers and duties arising from legislation by licensing banks and setting standards for their supervision, request information necessary to exercise its powers, carry out banks'activity controls through its inspectors, in order to eliminate all found non-compliances and implement remedial measures and sanctions set forth in the Law on Financial Institutions.

The legal framework under which the National Bank of Moldova regulates currently banks' activity is determined by the Law on Financial Institutions no.550-XII of 21 July 1995 (LFI) and a set of normative acts (regulations, instructions) issued by the NBM. This Law sets out the requirements applied by the NBM in the process of banks' licensing, their organization and administration, carrying out operations, reports and inspections, application of remedial measures, sanctions and windup of banks.

Most of the banking regulations currently in place in the Republic of Moldova reflect the rules set out in the original set of international standards (Basel I), which was introduced worldwide in the 1980s. Basel I was aiming to introduce the notion of "regulated capital" and to establish the capital requirement for banks. The capital requirement at that time was the capital requirement to absorb possible losses from a bank's exposures (assets). The Basel I provisions were relatively simple and covered only the credit risk associated with the bank's business. At the same time, Basel I introduced the concept of banking supervision and determined that all banks, not just those active on international markets, should be supervised.

Financial sector and Basel I regulations

In late 2015 - when the NBM initiated the implementation of the Basel III package - the banking sector of the Republic of Moldova had some features, such as assets accounting for MDL 69.1

---

[1] *financial institution* – a legal entity that accepts deposits or their equivalent, non-transferable by any payment instrument and uses all or part of these funds to lend or invest on its own account and risk

[2] *bank* – a financial institution that accepts deposits or their equivalents from individual or legal entities, transferable by different payment instruments and that uses all or part of these funds to lend or invest on its own account and risk

billion (December 2015), or 56.7 percent of GDP and indicating a low degree of financial intermediation (Chart 1). The structure of this sector comprised 11 active banks, including 4 banks - branches of foreign banks and financial groups (2015). In October 2015, the NBM withdrew the operating license of three banks. Starting June 2015, the NBM established special supervision over three[3] out of 11 banks, which held a total of 66.7% of the banking sector's assets. The reasoning related to the non-transparent structure of shareholders and engagement in high-risk lending operations.

The banking sector comprised, by late 2015, 814 banking subdivisions employing 7621 persons, each employee managing an average of MDL 9.1 million.

Banks showed dominant foreign capital, 82.9 percent of the share capital coming from foreign investors. Among the foreign investors participating in the capital formation of the banks of the Republic of Moldova are the European Bank for Reconstruction and Development, banks from Italy, France, Romania, as well as corporate investors from Germany, Austria, United Kingdom, Ukraine, Cyprus, Russia, Greece, Iraq, USA, Netherlands, Liechtenstein, Switzerland, the Czech Republic.

Chart 1 - Degree of financial intermediation

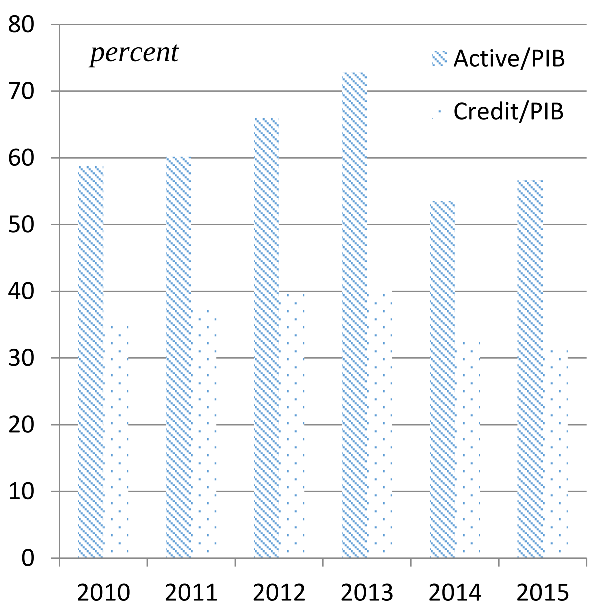
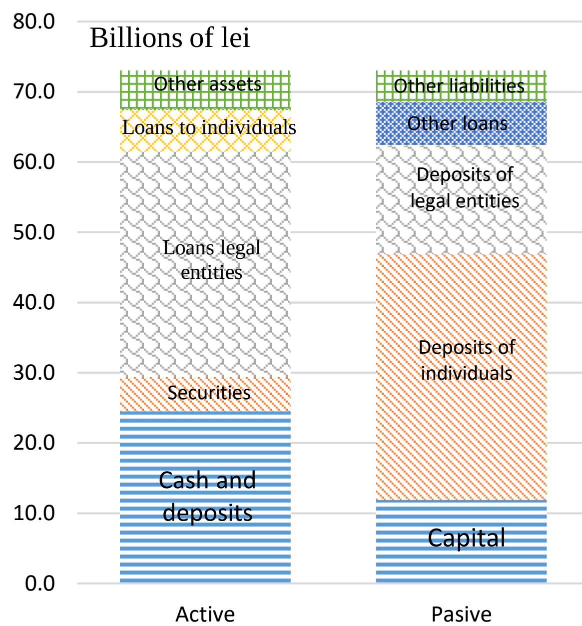


Chart 2 - Balance Sheet of the Banking Sector (December 2015)



Total assets were predominantly structured in loans (around 52.3 percent) and cash and deposits (33.1 percent, Chart 2). The share of loans in total assets denotes a reserved lending activity of banks, most of them preferring to maintain a significant portion of cash assets and cash equivalents. Total bank lending accounted for about 31 percent of GDP, marking a decrease over the course of 2015 (Chart 1).

Banks promote lending in national currency (58%, December 2015), and the share of euro and dollar loans had a slight upward trend compared with 2014 (from 40% to 42% in December 2015). The structure of lending by category of activity and borrowers reveals the dominant orientation towards

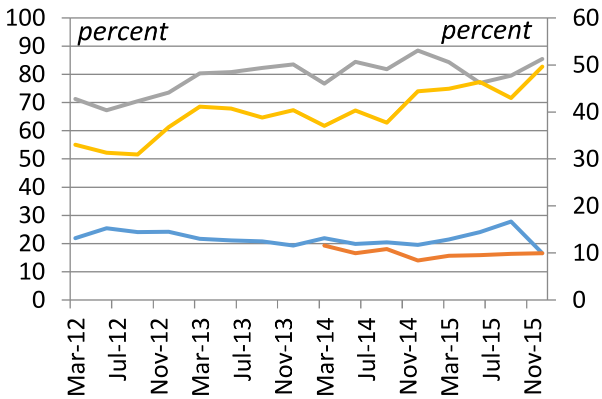
[3] CB "Moldindconbank" S.A., CB "Victoriabank" S.A., CB "Moldova-Agroindbank" S.A.

trade funding (30.5%). Food industry credit (9.3%) and consumer credit (8%) are the following categories targeted by banks.
Assets and liabilities denominated in foreign currency had a large share in banks' balance sheet (44.0% of total assets, respectively 43.8% of total liabilities in December 2015).
In December 2015, banking liabilities constituted 48% of the population's deposits, with 21% being held by companies. Banks' capital represents 16.3% of liabilities and its contribution has been decreasing over the past 3 years, registering a significant increase in 2015 following the withdrawal of the license of three banks with a low capitalization rate. Moldovan banks focus on attracting local resources, in this case from resident individuals. The share of large[4] banks' debt in total banking sector debt amounted to 68% (December 2015).

Asset quality
The rate of non-performing loans for banks in the Republic of Moldova was 10% (11 banks, December 2015, Chart 3) and had relatively stable values over the past three years. At the aggregate level of the system, bad loans (substandard, dubious and compromised) amounted to MDL 3.8 billion, while the total prudential reductions were MDL 4.4 billion. Reducing the default rate by the end of 2015 was due to the withdrawal of the license of three banks in October 2015. The coverage of non-performing loans with prudential provisions was 85%.

Creditworthiness

Chart 3 - Asset quality indicators



The risk-weighted capital adequacy ratio reveals a high and growing solvency in the banking sector, with its value being 26.1 percent in December 2015 (Chart 5). All banks have values above the minimum threshold regulated by the NBM on the solvency ratio (16 percent).
The total regulatory capital amounted to MDL 9.3 billion (December 2015) and included Tier I capital and Tier II capital (Tier II capital limited to a maximum of 100% of Tier I capital) from

[4] Banks with assets over MDL 7500 million

which the participation holdings in other banks' capital licensed by the National Bank of Moldova are deducted. The dominant component was Tier I (97%) capital, the other segments being marginal. Tier I capital was concentrated in large banks, its share in the Tier capital of the entire banking sector being 58.1%.
Currently, prudential regulations provide for asset weights of 0%, 20%, 50%, 75%, 100%[5]. Assets are allocated predominantly in the 0% and 100% categories (Chart 4). In late 2015, risk-weighted assets accounted for MDL 35.5 billion (December 2015), which gave an average risk weight of 51 percent.

Chart 4 - Asset structure by risk weighting category (December 2015)

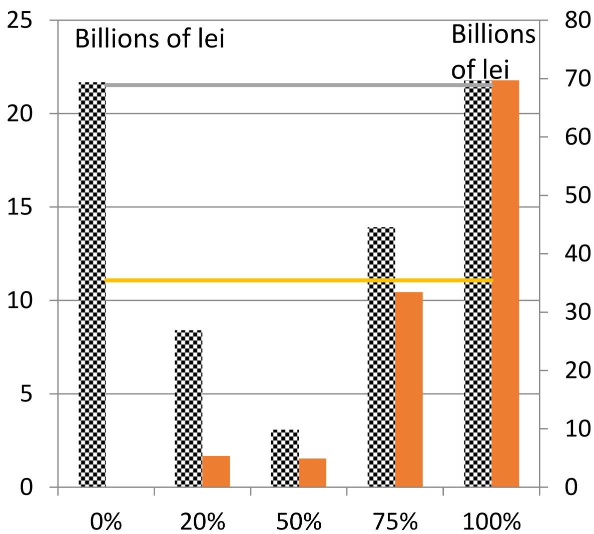
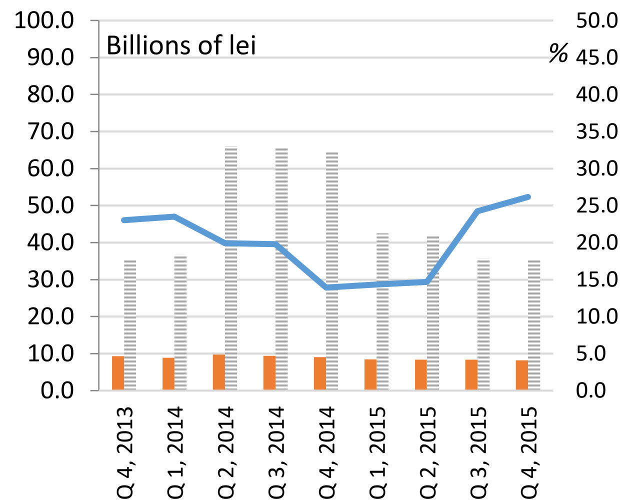


Chart 5 - Solvency ratios



Profitability
The profitability of the banking sector was on the rise, with all banks making profit in 2015 (MDL 1.44 billion). The return on assets and the return on bank capital recorded some upward dynamics throughout the year, reaching 5.2% and 12.8% respectively (December 2015).

Liquidity
All banks presented values of liquidity indicators within the regulated limits. The average of the

[5] 0% are weighted: cash, state securities, others. 20% are weighted: Cash - instruments in the process of collection, Balance of correspondent accounts and funds placed in banks in the Republic of Moldova and OECD countries, Balance of correspondent accounts and funds placed with the term of up to one year in banks of other countries with the exception of the OECD and the Republic of Moldova). 50% are weighted: Loans secured by the debtor's first residential mortgage, Loans granted to the public sector except for the central government and loans secured or secured by securities issued by him. 75% are weighted: Other loans secured by residential mortgage, Loans secured by commercial and industrial mortgage. 100% weighted: Land, buildings, machinery, Balance of correspondent accounts and funds placed over one year in banks of other countries (except OECD and Republic of Moldova), Others.

long-term liquidity indicator (principle I of liquidity, assets with a repayment term of more than two years / financial resources with a potential withdrawal period of more than two years) was 0.7. The regulated limit of the indicator is ≤1.

The value of the current liquidity indicator by sector - principle II of liquidity accounted for 41.5%, increasing in the course of 2015 by 8.6 percentage points. The indicator has a regulated minimum threshold of 20 percent. Liquid assets recorded MDL 28.7 billion (December 2015), accounting for 42 percent of total assets, and a growing trend (45.2 percent up compared with 2014)."

Chapter II. BASEL III standards of the Basel Committee on Banking Supervision

A sound and robust banking system provides a sustainable economic growth, taking into account the role of local banks as financial intermediary in the lending process. Moreover, banks provide significant services to consumers, small and medium-sized enterprises, large companies and public authorities, which have great confidence in bank when carrying out their activities at the national and international level. Sustainability and resistance to shocks and seizures of banks and the banking system as a whole are also important given that these institutions operate with financial sources drawn from the population, and these economies constitute the majority of banks' balance sheets. Accordingly, the basic functions of a banking supervisor include both the need to maintain financial stability and the security of deposits of individuals through a coherent regulatory and supervisory framework.

<u>Basel II requirements and the transition to Basel III</u>
In 2004, given the developments in banking products and services, as well as the significant development of banking institutions and their influence on national and international economies, the Basel Committee on Banking Supervision issued the Capital Accord (Basel II). Basel II aimed to create a substantial basis for the prudential regulation of capital, supervision and the discipline on the market, as well as to improve the risk management and financial stability. A key objective of Basel II was to promote the improvement of risk management through the usage of the 3 basic pillars:

1) **Pillar no.1 "Capital Requirements"** – provides rules to set up the capital requirements for the credit risk, market risk and operational risk – quantitative approach;
2) **Pillar no.2 "Adequacy capital supervision" –** supervises the evaluation process of the banks' internal procedures on the capital adequacy to the risk profile, the maintenance of the prescribed capital requirements at the minimum level provided by Pillar no.1, the achievement of the early intervention mechanisms of the supervisory authority – qualitative approach;
3) **Pillar no.3 "Market discipline" –** provides reporting requirements to the supervisory authority – tool required for prudential supervision, as well as publication requirements for banks - in order to ensure market discipline. Pillar 3 also emphasizes the importance of effective co-operation between supervisors and the exchange of information for this purpose.
   Like Basel I, the Basel II Capital Accord was an internationally recognized regulatory framework applied in most countries of the world, being used as a reference source for the requirements and practices needed to be present at banks and banking supervisors' level.
   Basel III provisions represent an improvement of risk-based approach of Basel II. The main emphasis is to enhance the capital level of the loss absorption in correlation with the risk of banks' business models.

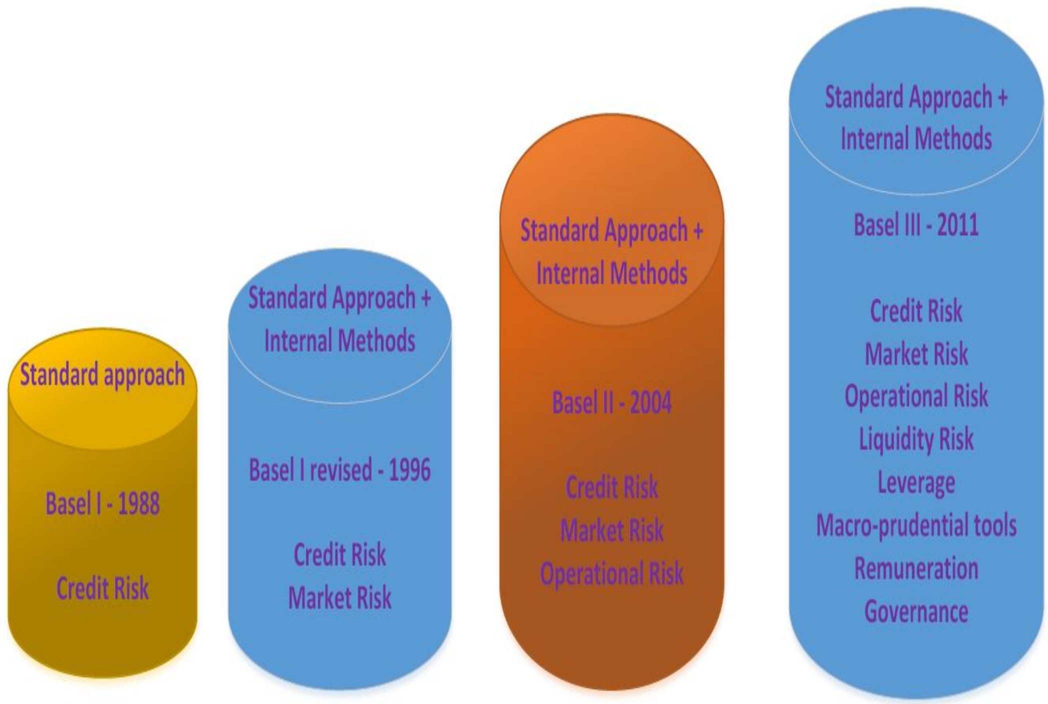


Fig. 1: Evolution of Basel Committee's regulation framework

The Basel Committee on Banking Supervision has created new measures for the global financial system consolidation, published as Basel III in 2010 (***see Fig. no.1***), and subsequently amended, as a response to several shortcomings in the framework of Basel II, brought to light by the global financial crisis in 2008-2009. The structure of the capital has been improved: the ability of the capital to absorb losses has increased. Thus, it has been improved the capital structure and other capital elements in the form of debts, such as subordinated and hybrid debts that are to be excluded in case of non-compliance with the criteria covered by Basel III, which will be gradually eliminated from the structure of the own funds, should such instruments exist in the structure of the share capital of the bank.

In accordance with Basel III requirements, the capital of a high quality and quantity, which consists of the paid-up capital and accumulated reserves, shall be maintained and be able to cover the risks assumed by the bank, and respectively be subject to gradually annual increase. In order to ensure the maintenance of a capital level in line with the assumed risks, it is necessary to have additional capital reserves in the form of the capital buffers, introduced by the new regulations of the Basel Committee:

1) capital conservation buffer that consists of the own Tier 1 funds equal to 2.5 % of the total value of the institution risk exposure, and
2) Countercyclical buffer is determined by the NBM decision – for the purpose of reducing the pro-cyclical movements.

At the same time, Basel III involves a more compound method for the calculation of the risk-weighted assets (RWA) size in comparison with Basel I and II.

The new amendments include the leverage ratio (rate of debt) – a new prudential instrument, which represents a maximum of transmission or lever regardless of the risk-weighting, which requires that the own Tier 1 capital to be equal to at least 3%of the total assets.

Although the significant leverage of banks, compared with other sectors of the economy, is an acceptable situation, given the type of activity carried out, the global financial crisis has demonstrated that this effect would, however, need to be monitored and possibly regulated jointly with the capital requirement. Thus, these prudential requirements are intended to strengthen bank capital both to cover losses from nonperforming assets and to ensure the bank's ability to honor its obligations to creditors within the terms and conditions set.

Basel III brings also for the first time uniform liquidity indicator calculation rules and standards on the international arena– involving two models of measurement – namely the requirement of the “Liquidity Coverage Ratio” (LCR) and “Net stable funding ratio” indicator (NSFR).

The LCR assumes that the stock of liquid assets should be available at any time to cover liquidity outflows. The level of liquidity needs in a short-term liquidity crisis should be determined in a standardized way, thus ensuring equal competition. The Basel Committee intended to ensure that such a standardized determination would not have undesirable consequences for financial markets, credit granting and economic growth, also taking into account different business and investment patterns and funding environments of banks in different states of the world. For these reasons, the implementation of the LCR regulations has been phased over many years.

“Net stable funding ratio” indicator is a key component of Basel III reforms for the promotion of a more vigorous banking sector. It will be necessary that banks maintain a firm profile of financing in relation to the activities of the balance sheet and off-balance sheet items. A rigorous structure of financing reduces the likelihood that the interruption from the common sources of funding of a bank will erode the position of liquidity in a manner that might increase the risk of liquidity collapse and eventually it would lead to a systematic stress of huge proportions. In particular, “Net stable funding ratio” indicator limits the exaggerated dependence on the short-term interbank financing, encourages the best assessment of the risk of financing on all the elements of the balance sheet and off-balance sheet items and promotes stability in the financing of the bank activity.

This indicator is currently one of the most discussed topics at the level of regulators and the Basel Committee has not communicated a final decision on how it is to be applied and calculated.

The capital requirement, leverage and liquidity indicators, being quantitative indicators for the most part, are the elements covered by Pillar 1. At the same time, Basel III also introduced some updates on the other two pillars to improve the internal governance framework, risk management, reporting and disclosure of information related to the banks' activity, and the supervision of banking institutions.

Thus, in order to successfully implement the new requirements by transposing the CRD IV/CRR (Package CRD IV / CRR includes Directive 2013/36 / EU of the European Parliament and of the Council on the taking-up of the business of credit institutions and the prudential supervision of credit institutions and investment firms and European Parliament Regulation No 575/2013 and the Council on prudential requirements for credit institutions and investment firms), the NBM shall be prepared to carry out the assessment of each supervised bank to determine the model of the methodology to be applied by banks as follows - standardized approaches and advanced approaches. The assimilation of the complexity of these methodologies and the achievement of confidence in relations with the leadership of the central banks will be a quite long time process and respectively, will not allow the practical application of advanced approaches during the effective transition to the new regulatory framework. Therefore, for a period of time, the National Bank of Moldova will allow to use only the basic models for the calculation of capital requirements, which is a sound practice used by the supervisory authorities of other countries.

It is also necessary to improve the knowledge of the NBM and local bank experts in the context of Pillars no.2 and no.3, which are oriented towards bank's policy of risk management and market discipline, which complements the minimum requirements of the capital of Pillar no.1. The NBM will emphasize its role of supervisor in order to assess the internal banks' policies regarding the internal capital and liquidity adequacy in the process of risk management used by banks.

In this context, the impact of the quantitative and qualitative requirements on the capital equity of the bank relating to the implementation of the Basel III in banks will be assessed. Each bank has its own specific activity, so the impact will be determined taking into account the circumstances of the banking system and of every bank in part, in correlation with its risk profile. The impact test will be carried out based on a questionnaire – model used for such purposes by other countries, which have implemented in its regulations both Basel II and subsequently Basel III.

Taking into account the fact that the Basel III, with incorporation of Basel II principles, which are more comprehensive than Basel I, the NBM should provide a more flexible framework for the establishment of capital requirements appropriate to banks' risk profile, should create suitable conditions to ensure financial system stability. The best method of Basel III implementation, as it was the case with Basel II, would be a phased approach, in order to improve both the banking legislation in force and the NBM staff training, including the staff of supervised banks.

The NBM starting point is Basel I regime rather than Basel II; thus, the task of adapting and approximation to Basel III regime by transposing the European framework CRD IV/CRR within a truly short period of time is much more difficult. Thus, Basel III aims to create a solid basis for regulating the prudential framework, including the capital adequacy, financial and liquidity leverage, developing of supervisory framework, market discipline, and to develop further the risk management principles and financial stability.

The NBM as the supervisory authority will need to identify an efficient balance between the implementation of Basel III and other supervisory priorities. This approach assumes that the objectives of Basel III means not just the requirement of compliance with the set of rules relating to capital and liquidity. This framework aims at developing adequate infrastructure, developing risk management systems, capital adequacy, market discipline and financial stability and at implementing new supervisory instruments comparable to those of the international banks.

Chapter III. Identifying issues and arguing the need for an implementation strategy

Taking into account the Republic of Moldova's commitments assumed under the Association Agreement with the European Union, in the context of CRD IV/CRR transposition, the NBM applied and contracted technical assistance from foreign donors. Thus, the European Union supports the NBM by financing a Twinning project related to strengthening the institutional capacity in the field of banking regulation and supervision, running from 30 June 2015, through which the NBM benefits from the central banks of Romania and Netherlands' technical support. The project aims to develop the legislative framework according to the European acquis and NBM' institutional strengthening in this regard.

The analyses performed within the NBM, especially the latest recommendations of the 2014 FSAP[6] mission, and with the support of foreign experts within the Twinning project, led to the current context and main issues identification, as follows:

1) *Adjustment requirements of the legal and normative framework to the best and modern European practices and standards in the field:* based on several external evaluations and taking into account the nature of amendments to the existing NBM' normative basis, it was noted that largely, it is not in accordance with the current European standards. At the same time, in order to cover the current unregulated fields and to solve the precedents in the banking sector, the NBM has attempted to amend and supplement the existing regulatory framework. These, respectively, although aim to prevent some issues and to promote sound practices in banks' activity, in most cases they appear like a late reaction to already expected results. Thus, a modern regulatory framework, similar to the European one, would create prerequisites for financial institutions' sustainable development, openness to foreign strategic investors and acknowledgment of the Republic of Moldova's framework equivalence by the relevant foreign authorities.
2) *Insufficient NBM's institutional capacity in exercising its banking supervision functions:* the NBM does not have all necessary instruments to prevent problems in banking system and the processes of modernization and development of the available supervisory instruments and techniques do not ensure a high quality of the activities performed in this regard and the promotion of a prudent behavior from supervised entities. Although in the course of 2016 the NBM has taken a number of actions to increase the capacity and functionality of its oversight function, the process is complex and needs to be continued to ensure the sustainable development of supervisors and the instruments available to them.
3) *Quality of banking institutions' organizational structure:* this field is negative assessed by specialized international organizations and in most cases, their recommendations aim to improve the situation. Given that international rules (Basel III) have already established certain risk control and risk management mechanisms and an appropriate governance model for a bank's business, the NBM believes that the development of the regulatory framework in this respect, which would include the best supervision techniques for the supervisor, would considerably improve the quality of the organization of banks in the Republic of Moldova.

   In the case of the Moldovan banking system, Basel III requirements have to be implemented by transposing the European Union's legal provisions in this regard (CRD IV/ CRR package).

   In this regard, the need and importance of developing a strategy, aimed to lead to the identification of measures required for the implementation of CRD IV / CRR package, a strategy to be communicated to the general public to prepare actions to address the issues raised is obvious.

[6] *FSAP mission* – the World Bank and International Monetary Fund mission related to financial sector assessment in the context of its compliance with international standard in this field.

Chapter III*. Twinning project to strengthen the institutional capacity of the NBM in the field of regulation and supervision

Twinning is an instrument of co-operation between the authorities of the EU Member States and those of a beneficiary country located outside of it. Actions initiated in this sense are related to the upgrade of the institution supported by training, reorganization, as well as the harmonization of the legal framework with the acquis communautaire.

The objective of the project that the NBM benefits from envisages the improvement of banks' prudential regulations aimed at asserting a solid and competitive banking sector. Thus, according to the commitments assumed by the Republic of Moldova under the Association Agreement with the European Union, 3 years since its signing the legislation of the Republic of Moldova is to be harmonized with the EU acts and the international standards related to Basel III. These exigencies relate mainly to capital, financial leverage, liquidity, large exposures, and disclosure of information. Their application will have a direct impact on the banking sector in terms of risk mitigation.

Within the framework of the Twinning project objectives, increased attention is also paid to the development of supervisory tools and the overall consolidation of the respective the NBM function by training the employees, exchanging experience with foreign experts, carrying out impact studies and other evaluations that allow both improving the knowledge in the field, as well as the analysis of the prospects of implementing the new legislative framework and its potential impact on the stability of the banking sector in the Republic of Moldova. In this respect, an important part of the Twinning project is dedicated to the development of human resources within the NBM by assessing the training needs of employees within the regulatory and supervisory functions, identifying development partners providing training in the given fields as well as knowledge management and transfer methods, already accumulated at the bank level.

Chapter IV. General and specific objectives

A supervision system based on the best practices, including through the compliance with Basel principals, is a key element to be taken into account before transitioning to Basel III.

Appropriate staff in the NBM is essential for the successful Basel III package implementation. This may involve strengthening of training programs for existing staff and employing new qualified staff. Especially in the case of Basel III advanced approaches implementation, there is a need to keep the staff with both quantitative banking and supervision expertise and with comprehension skills related to banks systems assessment, models and strategies for capital assessment before applying the CRD IV/ CRR package. In the context of applying standardized approaches, supervisory staff may need to increase their skills in business modeling, internal governance, credit risk, market risk and operational risk mitigation, as well as in the assessment of capital adequacy and liquidity adequacy in accordance with Pillar 2.

In order to support an effective supervision, a number of legal and regulatory preconditions must be met. These conditions are mostly provided by the Basel Committee Core Principles on independence, operational autonomy, adequate resources, regulation and appropriate remedial powers, including the supervisory staff protection.

Basel documents proposals provide for the establishment of an interaction between risk management system and a solid corporate governance in banks. In turn, it is expected that banks' management understands and acknowledges the importance of these major issues for a successful implementation of the new regulatory framework.

The primary role of the banking system is to ensure financial intermediation in a state, achieved under conditions of healthy competitiveness, independence.

In order to achieve efficiently and orderly the Strategy's goal, general and specific objectives are set, as follows:

1. Develop the primary and secondary legislative framework related to banks' activity for the implementation of Basel III through the European package in this field (CRD IV/ CRR package).
   1.1. *Promoting a new law related to banks' activity;*
   1.2. *Approval by the NBM of the new secondary framework for banks' activity under the new banking law.*
2. Develop the NBM's institutional capacity and on-site and off-site banking supervision instruments, in accordance with the new banking regulatory framework:
   2.1. *Strengthening the institutional capacity of supervision function of banks' activity by providing the ability to operate under the new legislative framework;*
   2.2. *Implementing the on-site and off-site banking supervision instruments in order to meet the new legal requirements.*
3. Supervise and coordinate the implementation of the new legislative framework in the banks of the Republic of Moldova by the NBM:
   3.1. *Requesting the preparation and presentation by banks of detailed plans to implement new requirements and identify the resources necessary for this process, as well as the NBM verification of the implementation of these plans;*
   3.2. *Monitoring and evaluating, using the available supervisory instruments, the preparedness of banks to implement the new banking regulatory framework at its entry into force.*

Chapter V. Necessary actions to take in order to achieve objectives and reach the expected results

In the context of the NBM strategy of Basel III implementation in the Republic of Moldova in terms of European legislative framework (CDR IV/ CRR package), the following detailed actions are proposed:

1. **Establish new requirements implementation schedule**:

The NBM has set the following stages for the implementation of Basel III standards, which are described in *Annex 1:*

Stage 1: Conducting a general assessment of existing shortcomings in the existing prudential regulation and supervision framework (January 2016 – June 2017), which comprises the following main activities:

1) Familiarization of the employees involved in the process with the Basel III package and the applicable European standards;
2) Assessment of existing shortcomings in the prudential regulation and supervisory framework in place of banks;
3) Assessment of the NBM training needs;
4) Initiation of dialogue and exchange of information with the banking sector.

Stage 2: Development of quantitative impact studies for the quantification of possible effects from the transition to new standards (November 2015 – January 2017). At this stage, the efforts will be focused simultaneously in the following fields:

1) Conducting quantitative impact study on CRD IV implementation effects regarding capital requirements and own funds;
2) Conducting quantitative impact study on new liquidity indicators implementation provided by the Basel III framework;
3) Conducting quantitative impact study on leverage ratio provided by the Basel III framework.

Stage 3: Transposition of CRD IV/ CRR package, including the reporting framework for COREP and FINREP, within the national legislative and regulatory framework (January 2016 - December 2018). The activities included in this stage and the terms of implementation are described in Annex 1. It is important to note that the data provided in Annex 1 on the entry into force are indicative and depend on the date the Parliament will pass the draft law on the activity of banks and the provisions of these Normative acts may be influenced by the results of impact studies conducted by the NBM both at the initial stage of implementation of the new framework and at a later stage.

Stage 4: Development of means for banking sector supervision to the Basel III and the applicable European standards (January 2016 – December 2018). At this stage, the efforts will be focused simultaneously in the following fields:
1) Activities on training and specialization of supervision staff, including through an active involvement in the process of drafting and consolidation of the new legal framework transposing the Basel III package;
2) Off-site supervisory activities: the NBM will examine banks' level of readiness for the implementation of the Basel III package;
3) Banks' detailed plans for implementing the new requirements and identifying the resources needed for this process;
4) Resuming capital and liquidity impact studies and conducting stress tests to complete the secondary legislative framework, calibrate and establish the order of introducing prudential requirements, and establish transitional arrangements;
5) Development of tools for recruitment, selection, motivation and training of the NBM qualified staff with regard to the regulatory and supervisory function.

Stage 5: Supervision and regulation of the banking sector in accordance with the New Capital Agreement – Basel III (*from the date of entry into force of the new legal and normative framework),* which will include at least the following activities:
1) Banks drafting the first ICAAP (Internal Capital Adequacy Assessment Process) report according to the deadlines set out in Annex 1;
2) Banks drafting the first ILAAP (Internal Liquidity Adaptation Process) report according to the deadlines set out in Annex 1;
3) The preparation by the NBM of the first SREP (Review and Review Process for Surveillance) and the first on-site inspection based on the SREP manual according to the deadlines set out in Annex 1;
4) Banks submitting COREP reports according to the deadlines set out in Annex 1;

the NBM carrying out thematic checks for banks to verify the application of the provisions of the new legislative and regulatory framework.

Stage 6: Monitor and update the legislative and regulatory framework taking into account developments in international and EU standards in the field of prudential regulation and supervision (*permanent since 1 January 2018*). At this stage, efforts will be channeled into the following areas:

1) Updating the FINREP reporting framework (individual and consolidated) taking into account the changes made to it at EU level and with reference to the COREP reporting framework adopted by the NBM;
2) Addenda of the secondary legislative framework with securitization provisions and the net stable financing indicator (NSFR);
3) Monitoring and analyzing regulatory needs stemming from regulatory and implementation standards issued at EU level or European Banking Authority guidelines approved after 31 December 2015;
4) In co-operation with the NCFM, monitoring and analysis of the regulatory needs deriving from the modification of Moldovan legislation in adjacent areas such as the capital market, which implies possible addenda of the primary and secondary legislative framework from a prudential perspective.

2. **Identification and selection of national options:**
The Basel III Capital requirements establish the domains where the NBM will have to determine specific definitions, approaches, or prudential limits which are intended to be applied while implementing the new framework, taking into account the existence in the international context of some options (national options) that state that a particular field or requirement may be regulated in one way or another as required by the Basel III package. When determining the criteria to be used by the NBM to make these national choices, the situation on the local market and the experience of the supervisory authorities and the banks and the fact that the options exercised must be consistent with the general objectives set by the European framework should be taken into account.
Additionally, to the identification of these options in various fields, the NBM will need dedicated resources for the process of developing national prudential standards and rules for the operation of different prudential requirements set by the package CRD IV/ CRR.
For example, in accordance with the standardized approach for credit risk, the supervisor may evaluate whether it is appropriate to apply a weighting of 35% for residential mortgages, taking into account the history of loss in that country, as well as taking into account the "strict prudential criteria", which are to be applied for weighting of 35%. The NBM will also draft and develop specific standards when applying IRB models and in the validation/ approval of those models.

3. **Assessing the impact of transition to the Basel III package on the banks of the Republic of Moldova:**
The NBM ought to quantify the impact of the package CRD IV on capital requirements on individual banks and on the entire banking system. Initially, an impact study (QIS) in the format used by the Basel Committee for this purpose will be conducted. Such an analysis is to achieve the following objectives:
   1) Provide banks with all operational rules and their versions, in case banks may choose one version or another;
   2) Assess the impact of the rules on capital ratios, especially focusing on those components that will contribute to significant changes;
   3) Allow banks to assess whether the modifications of the application of the new rules correspond to their risk profile, and

4) Allow banks to discuss any issues arising during the implementation of the new requirements with the NBM, as the supervisor, in order to ensure correct and consistent interpretation of the new rules.

If the impact study indicates that adopting new chosen approaches will change the aggregate level of capital (at the individual level/ per system), the NBM is to ensure that the capital requirements and other new prudential limits will be introduced gradually by transitional arrangements, set depending on the results of the impact assessment per system. The NBM will co-operate with banks in order to determine realistic timelines for adjusting the level of capital before adopting the new framework and identifying acceptable source of capital and will take into account the general opinion of the banking sector on other prudential limits set out in the new framework.

3¹. Entry into force of the new primary and secondary legislative framework:

Taking into account the commitments assumed under the Association Agreement with the European Union, the NBM will promote the entry into force of the new law and the secondary regulations as of 1 January 2018.

At the same time, in order to ensure a harmonious implementation at the level of the banking system, secondary regulations will provide for transitional provisions specific to each regulated area, which will allow for the timely distribution of regulatory pressure on banks. Transitional provisions will necessarily take into account the results of impact studies conducted both at the start of the transposition process and before the actual implementation phase.

To this end, prudential requirements for own funds, capital requirements, including the impact of credit, market and operational risks on them, as well as the requirements for large exposures, will be applicable from the date of entry into force of the new legislative framework, but the first COREP reporting to the NBM will be postponed until April 2018 for the situation on March 31, 2018, and December 31, 2017 (in these 4 months, to monitor the evolution of the banking sector, banks will continue to report the monthly bulk of the total regulatory capital).

At the same time, prudential requirements for current liquidity risk (CRL), settlement risk, capital requirements for credit assessment adjustment, leverage reporting requirements will be applicable within 6 months of the entry into force of the primary legislative framework with appropriate reporting under COREP for the situation on June 30, 2018.

The FINREP reporting framework will not be amended at the date of entry into force of the primary legislative framework and will continue to be applied as it is currently applied under the Law on Financial Institutions no. 550-XIII of 21.07.1995. At the same time, the NBM will take the necessary steps to update the FINREP reporting framework and link it to the COREP reporting framework.

4. Co-operation between the relevant authorities related to supervised institutions' activity:

The NBM will ensure communication of planned activities and actions that are to be taken for the implementation of the package CRD IV/ CRR by the NCFM, as the regulator and supervisory authority of investment companies, which are subject to the package along with banks.

The NBM will also tend for close co-operation in this regard with other authorities of the Republic Moldova in promoting this process.

5. Strengthening the dialogue with banks from the Republic of Moldova:

It is extremely important that banks and the NBM develop their knowledge in the field of banking activity and challenges of implementing the new framework, particularly in advanced approaches.

Thus, before taking a final decision in this regard, the NBM should undertake the following actions:

1) Require from banks to identify current techniques of risk management and internal assessment of capital in banks;
2) Raise awareness among both banks and supervisory staff on minimum capital requirements and their involvement in risk management processes – practical aspects in this regard;
3) Evaluate the level of readiness of banks to implement the package CRD IV;
4) Inform about the national transposing process of the requirements of the new framework into the national legislation;
5) Develop a section on the interbank page dedicated to questions asked by banks on the application of the new requirements.

The NBM shall continuously ensure a dialogue with banks in the process of implementation of the new requirements by various methods, including thematic inspections, self-assessments carried out by banks, regular meetings with the banking system, conferences, etc.

Communication strategy with banks will take into account the implementation of the CRD IV/ CRR package and it will aim to communicate the expectations of the NBM in a regular and efficient way.

6. Ensure transparency in implementation of the CRD IV/ CRR package requirements and the NBM decisions in this respect:

The NBM will properly inform the public and institutions involved about the progress, results, decisions and any other information that may be considered useful to external users on the process of drafting the new legislative framework and its implementation at the NBM and supervised entities level.

7. Development and training of staff in the banking sector

The existence of qualified and trained staff in Basel III not only within the NBM but also at the level of each bank is a mandatory precondition for the effective and qualitative implementation of the new requirements. Thus, in the communication with the banking system, the NBM will promote a policy of attracting qualified human resources and training of existing staff within the Moldovan banking sector, including by identifying additional training options for employees through meetings with the NBM experts, seminars and conferences organized by external donors of technical assistance, professional associations existing in the country.

At the same time, the NBM will assess banks' efforts and human resource development strategies by other means and methods identified by them, including the budget allocated for these purposes, because the options identified by the NBM will in most cases be short-term solutions and specialized only on some aspects related to the new legislative framework.

Chapter VI. Assessment of the implementation impact and cost (financial and non-financial)

The banking sector of the Republic of Moldova will be upgraded by implementing the Basel III requirements applied at international level in many countries, including by the European Union, namely CRD IV/ CRR, which will imply efficient use of resources, with the support of donors and external partners, optimal solutions for the development of internal risk management systems in banks, as well as providing relevant information on this process to banks.

Based on the aforementioned, it can be concluded that many of the actions planned for effective implementation of the new framework, will be covered financially and non-financially (experts, foreign expertise and knowledge) through Twinning project.
of the costs for the implementation of COREP reporting to the NBM and of the regulatory framework, will be borne by the banks at the level of each institution.
At the NBM level, there may be estimated an increase in personnel expenses in the case of organizational and institutional consolidation of the supervision function, which means an increase in the number of qualified staff and the creation of new directions of activity to cover all areas of activity.
At the banks' levels, the costs will be incurred by the respective institutions from own resources.

Chapter VII. Monitoring and reporting of performance indicators

A large part of the strategic objectives and specific activities planned are covered by the Twinning project. Correlation of objectives and stages of this strategy with the activities and purpose of the Twinning project are reflected in Annex no.1.
The totality of expected results and performance indicators to be achieved as a result of objectives and milestones are also reflected in Annex no.1.
The NBM will be responsible for the monitoring of implementation of this Strategy and will provide information to public on its website on a quarterly basis, including about the progress made on the Twinning project. These achievements will be communicated by the NBM under the mandatory reporting on the fulfillment of the commitments deriving from the Moldova-EU Association Agreement to relevant authorities, and in the case of Twinning project, it will be also reported to the EU Delegation as the donor.