

## COMPETITIVE ENVIRONMENT ON THE FINANCIAL - BANKING MARKET OF THE REPUBLIC OF MOLDOVA

**Elena FUIOR, Prof., PhD,**  
Trade Co-operative University of Moldova  
E-mail: elenafuior2003@yahoo.com

**Ion MAXIM, Prof., PhD,**  
Competition Council of the Republic of Moldova  
E-mail: ion.maxim@competition.md

### *Abstract*

*Banking and finance sectors of the Republic of Moldova the same as in other states are of great importance for sustainable development of the whole economy. The existence of normal competitive environment on the banking sector would provide the national economy with necessary inexpensive financial resources and would support the creation of banking and financial systems able to cope with competitive pressures from outside the country. Recent publications regarding the establishment of Moldovan banking sector highlighted several deficiencies in the relevant competitive environment. In this context, we propose an analysis of the competitive environment on the banking sector of the Republic of Moldova, identifying elements limiting competition and guidelines for the improvement of competitive aspects of Moldovan banking sector taking into account the experience of other countries. The analysis of EU countries experience together with suggested recommendations is expected to stimulate competition in the Moldovan finance sector as well as discourage anti-competitive practices.*

**Keywords:** competition, financial market, banks, insurance, merger.

**JEL classification:** G2

### **1. Introduction**

Integration in the European Union is a strategic objective for the Republic of Moldova. The integration process is very complex and represents a real challenge for our country. To achieve this goal the Republic of Moldova should achieve significant success regarding socio-economic development as well as in the creation of a competitive economy.

The analysis of Moldovan financial system conducted by EU experts [7, p.21] has found out that development of banking and non-banking financial institutions of Moldova showed small progress compared to its neighbours and countries of South-East Europe also aspiring to EU membership. The same study found that Moldovan financial system is centered on the banks with an improbable quick launch of the capital market, some of the main segments of the financial sector – insurance companies and pension funds – still remaining underdeveloped.

It is obvious that banking and financial sectors are of vital importance for the national economy and for these reasons they need special attention. The global financial crisis identified several deficiencies in the operation of these sectors. Thus, creation of an effective mechanism of supervision and regulation of the banking and financial sectors will create premises for their

development and harmonization with the Acquis Communautaire. The Republic of Moldova must develop its financial sector to ensure the progress of integration in the single financial market of the European Union. EU integration is a challenge for the national financial system; therefore creation of an efficient financial sector would help dealing with competitive pressures arising from liberalization of trade with EU in the area of financial services. At the same time, creating a competitive banking system would have beneficial effects on other sectors of national economy ensuring their access to financial resources and would also have to cope with competitive pressure from the EU.

Competition policy is a public policy with its own dynamics, influenced by the development of economic theory. However, while effective implementation of this policy is performed at sectorial level there are areas where it still needs to be harmonized with regulatory authorities' specific policies [9, p.2]. The financial sector is one such sector having particular relevance to the national economy and promotion of competition policy can be successful only in close collaboration with the National Commission for Financial Market and with the National Bank of Moldova.

It should be noted that financial sector is given special attention at Community level by means of periodical sector investigations [4] identifying symptoms that indicate lack of effective competition in certain areas of financial services. To this end, the experience of EU countries together with their best practices will help to identify and eliminate competitive constraints blocking the creation of a healthy environment in the financial sector of the Republic of Moldova.

## **2. General characteristic of banking and financial sectors of the Republic of Moldova**

Moldovan financial system consists of all financial intermediaries, financial markets and relationships arising in terms of accumulating and re-distributing funds to and from private individuals, government enterprises and financial infrastructure. Existence of a financial system able to direct available financial funds to their destinations in the most efficient way is an important criterion of economic development.

Financial sector development is necessary to satisfy the economy needs in the area of financial services and infrastructure quality and to ensure effective implementation of state economic and social policy.

Moldovan financial sector has three main features common for the first development stage of financial markets in transition countries of Central and Eastern Europe. These are:

- relatively low level of financial intermediation;
- powerful domination of the banking system in the financial sector as a result of specific underdevelopment of capital markets;
- degree of foreign participation in most industry segments [7, p.53].

Private financial sector, as part of the economic system, is composed of several financial subsystems that can be divided into two components: banking and non-banking sectors. With such division monitoring and regulatory functions are divided between the National Commission for Financial Market and the National Bank of Moldova.

Overall, Moldovan banking sector is steadily developing and its role in the economy is growing. Taking into account the pro-cyclical nature of the banking system, a relatively favorable macro-economic situation in Moldova was fully reflected through an increasing penetration of the banking sector into the national economy in 2000-2008. Thus, the share of bank credit to GDP increased from 25.2% in 2000 to 40.2% in 2007. It decreased in 2008 to 39.8% due to the fact that the powerful growth was slowed because of credit tightening as a result of severe monetary policy and of negative expectations associated with shaping of the first recessionary signals. The 2009-2010 development was based on a purely arithmetic effect: pronounced decrease of GDP; respectively, the denominator increased its weight to 41.7% in 2009 and in 2010 caused the opposite effect decreasing its weight to 33.9%. The average share of bank loans to GDP in 2004-2010 was 31.5%, the Republic of Moldova being surpassed by most countries from Central and Eastern Europe except for Albania and Georgia. Regional leaders - Latvia, Slovenia and Estonia – have provided loans whose average share in GDP ranged between 80% and 115% [1, p.8].

By 2013 the situation improved and credit process increased so that the share of bank credit to GDP increased to 42.2%. However, it should be noted that the share of net non-performing loans in the total regulatory capital decreased by 9.3% to 16.6 % on December 31, 2013, thus reducing the risk of capital loss.

Taking into account the association of the Republic of Moldova to EU, respectively the trends of a liberalized financial market, the penetration level of Moldovan banking system is expected to increase in the coming years.

Although the situation is slightly better in terms of bank deposits share to GDP - the main source of credit, however, in this respect the Republic of Moldova is characterized by an average share of bank deposits to GDP of 52%, ranking lower than countries such as Lithuania, Serbia, Romania, Belarus and Georgia, being positioned below the regional average.

The main function of the banking system and namely citizens' economic mergers and its orientation towards those in need of additional liquidity, is performed deficiently.

A reserve growth of lending volume of the real economic sector in parallel with the increase in the saving rate is provided by earnings from Moldovans working abroad. Empirical studies show that about half of the gains made in employment are transferred back to Moldova as remittances. Preference for placing savings in foreign banks, conditioned by the fact that the amount of guaranteed deposits in EU countries is considerably higher (50 000 Euro), does not allow full exploitation of this potential. On the other hand, the state takes actions to channel funds from remittances towards the small business development (PARE 1+1), but these measures need to be supported by sufficient funds in order to produce the desired effect.

Another relevant aspect for the analysis of Moldovan banking and financial sectors keeps available resource efficiency and the effectiveness of risk management. On one hand, Moldovan banks have excess liquidity of prudential norms recommended by international best practices. Thus, average liquidity reserves of bank assets reached 27.3% in 2004-2009. For an efficient intermediation the surplus liquidity would determine banks to increase their lending efforts, which would mean reducing the premium risk. In reality, economic entities in Moldova invoke limited access to financing sources, indicating high interest rate as one of major problems faced during their economic activity (14.2% of respondents to the questionnaire that served as basis for 2010-2011

Global Competitiveness Report indicated access to finance as the largest impediment in doing business [11]).

The same is confirmed by the fact that risk premiums applied in Moldova are highest in the region [10]. Risk premium is expressed as the difference (in percentage points) between the banks' interest rate on loans and interest rate on bonds. The fact that, during in the Republic of Moldova 2004-2010 period, risk premiums indicated 8.6% shows a lack of confidence of commercial banks in potential borrowers thus determining their preference for liquid assets.

Confidence crisis could be partly overcome by improving the credibility of borrowers' information. A recent reform in this area relates to the creation of national credit history bureaus to collect information on timely borrowers' loan payments, thus allowing commercial banks to adjust their interest rates based on borrower's profile. As a result of the implementation of this reform the Republic of Moldova significantly improved its ranking by the World Bank Doing Business 2012, rising from 96th to 40th position [5]. Also, after consolidating its secured transactions system and upgrading its legislation concerning insolvency and restructuring procedures, Moldovan ranking in World Bank Doing Business 2014 achieved 13th position for loans granting [6], surpassing such countries as Bulgaria, Czech Republic and Hungary.

Despite the positive trends in the banking system regional data shows that the integration level of the banking system is lowest in the region. This fact confirms low access level of economic entities and of the population to bank loans. However, modest integration of banking system into the national economy allowed banks to be more immune to macroeconomic shocks triggered by financial crisis. Banking sector is a particular sector of the economy; therefore banks are different from other business entities in terms of performing certain essential functions that depend on the entire economy and society. This was confirmed by the European Commission in the context of state intervention and aid to financial institutions so they could overcome global financial crisis.

The equity and foreign exchange markets are shallow and non-banking financial institutions are small. In 2014 non-banking financial institutions consisted of 2 stock exchanges, 16 insurance companies, 76 insurance brokers, 83 microfinance institutions and 338 savings and credit associations [3]. The National Commission for Financial Market performs supervision and control of non-banking financial market, particularly of insurance companies and of the National Bureau of Motor Vehicle Insurers.

By 2012 Moldovan insurance market completed its consolidation phase. Under new legal provisions the minimal amount of social capital for insurers practicing insurance activities was 15 million lei, and for those practicing life insurance activities - 22.5 million lei. However, full compliance with legislation in 2012 completed the stage of reorganization through transformation of insurance companies - from limited liability company into a limited company [3].

The evolution of insurance market operators' number and structure differs from country to country and depends on insurance policies and regulations, on political system capability, on economic and social development, on capitalization level and, in some cases, on external environmental factors relevant to the country. However, Moldovan insurance sector is less developed both in terms of its potential and in comparison with neighboring countries. Except for liability auto insurance all other aspects of the national insurance market are poorly developed. Several factors contribute to the low penetration of insurance sector, including low income population, low level of trust in the public sector and the lack of relevant prudential laws together with their implementation [7, p.35].

According to statistics, 19 insurance companies, 16 companies, or 79%, specialized in insurance segments (accident, property, auto, etc.) operated on Moldovan insurance market in 2012 [3].

By the end of 2002, on the market of service insurance 49 insurance companies, of these 14 with foreign participation in social capital operated. As a result of amendments to Law no. 1508-XII of 15.06.1993 on security reasons for increasing the share capital of insurance companies from 300 thousand lei to 2 million lei, by the end of 2005 the number of market operators decreased to 32 insurance companies with a total fixed capital of 207.7 million lei [3]. The new legal provisions that conditioned periodical raise of minimum capital together with reorganization of insurers from “limited liability” to “limited company” legal form repeatedly accelerated the decrease of the insurers and, respectively, strengthened the insurance market, from 33 companies in 2007 to only 19 in late 2012.

Table 1: Insurance operators market

| Indicators   | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|--|------|------|------|------|------|------|
| Number of insurance/reinsurance companies, of which:         | 28   | 24   | 24   | 24   | 19   | 16   |
| Insurance companies (exclusive)                              | 26   | 22   | 22   | 22   | 16   | 14   |
| Life insurance companies (exclusive)                         | -    | -    | -    | 1    | 1    | 1    |
| Simultaneous activity insurance companies (life and general) | 2    | 2    | 2    | 1    | 2    | 1    |
| Reinsurers (exclusive)                                       | -    | -    | -    | -    | -    | -    |
| Number of insurance brokers                                  | 32   | 45   | 59   | 69   | 71   | 76   |

Source: National Financial Market Commission ([www.cnpf.md](http://www.cnpf.md))

Under Law No. 407-XVI of 21.12.2006 insurance intermediaries are considered insurance agents, bank assurance agents and insurance and/or reinsurance agents. The insurance broker is a legal entity registered in the Republic of Moldova, entitled to negotiate on behalf of his clients or legal entities insurance (reinsurance) contracts as well as to assist contracts conclusion or damage settlements.

During 2000 – 2012 Moldovan insurance sector registered a growth trend except for 2009. The insurance sector tends to become a competitive one although not displaying performance yet. According to official data, after permanent yearly growth until 2008 when it reached the highest registered gross written premiums, in 2009 the insurance market reported a slight business volume decrease of 2.5%, in the next three years again recording growth trends [3].

Among all types of general insurance, the largest share in the entire period after 2004 was held by auto insurances (CASCO and auto civil liability insurances) that in 2012 accounted for more than 66% of the market (about 500 million lei). Moreover, insurances belonging to auto vehicles segment occupy three top positions in the “best-selling insurance policies” ranking, on the first place being compulsory insurance against internal civil liability auto internal - RCA (24% of total market), followed by external auto insurance policies – Green Card (19%) and CASCO (23%) [3]. Other insurance types like assets, health, accidents and general civil liability recorded low and extremely low shares of 12%, 5%, 4% and 1%.

Insurance contribution to the creation of income in Moldova’s economy shows that the intensity of insurance in the national economy registered a slow evolution over the last decade with slight variations in the last three years. This dynamic is supported by dynamic penetration of insurance in

GDP, expressed as the ratio between gross written premiums and GDP, the 2012 indicator displaying a 1.24% decrease compared to 2007 when the penetration into GDP was 1.36%, this being the highest value since 2000. The largest share of premiums in GDP was 1.5% recorded in 1997, although the annual amount of premiums collected that year, about 137.1 million lei, represented a high value compared to almost 19% of premiums in 2007 [3].

The amplification of the insurance market is evolving in Moldova. Recovery trends make possible new platforms for optimal protection offered, product diversification and capacity development of insured risks. In this context, the liberalization of insurance market and introduction of genuine market mechanisms would significantly contribute to growth of consumer welfare.

The bond market of Moldova is less developed; there are problems both with the placement of corporate bonds that are practically not issued and with the component bonds. There are very few bonds in the Republic of Moldova and there is no secondary market for them. Moldova's main securities are money market instruments in the form of NBM certificates and treasury bills of the Ministry of Finance with a maturity of up to one year, with increasing activity in the up to 90 days.

The capital market is also less developed in the Republic of Moldova. There is a complex stock market infrastructure, however almost all securities are dematerialized and there is no central registry for owners' evidence. National Security Depository operates as a compensation and custody exchange organization without having registrar's license. But 2013 was a remarkable year for the non-banking financial market from the Republic of Moldova due to the entry into force of Law on capital market that changed market infrastructure and established new rules.

The financial sector is a sector regulated with particular attention in most countries. Careful regulation of this sector in EU is determined by regulation objectives set for financial services and investments. A primary objective of financial market regulation is tracking macroeconomic and microeconomic stability that can be endangered by systemic risks. These are risks of financial institutions failure having a domino effect that may lead to collapse of the entire financial system. This form of regulation is referred to as prudential supervision and is implemented through capital adequacy rules which are supposed to withstand risks arising from financial activities. The second objective of financial regulation is market transparency and investors protection [7, p.76]. The third objective of financial market regulation, linked to overall efficiency, is maintaining and promoting competition in financial intermediation sector.

### **3. Analysis of the competitive environment on the banking and financial services market**

Inefficient use of resources and inadequate risk management are caused by lack of genuine competition in the banking segment of the financial market and the overall lack of viable alternatives for funding through non-banking financial sector. At the end of 2011 the share of assets of five largest Moldovan banks from the national banking system amounted to 70.12% [2]. In 2011 about three quarters of bank capital were represented by foreign investment and only 4 banks out of 15 active banks in Moldova were subsidiaries of Western banks. Another factor reducing efficient use of resources is the share of state in the bank capital of one of the 5 largest Moldovan banks.

Although National Bank data indicate that 71.7% of Moldovan bank capital belongs to foreign investors an analysis done by the International Monetary Fund identified that 10 out of 14

Moldovan banks operating in 2013 owned domestic capital and only Eximbank, Mobiasbank, BCR and Procreditbank have had foreign shareholders [8].

The activity of Moldovan commercial banks is characterized by a seemingly paradox phenomenon: although the level of liquidity in the system is one of the largest in the region, banks are extremely cautious in granting loans. On the one hand, it shows that lack of resources is not the essential cause of passive lending to the real sector, on the other hand, large volumes of liquidity may serve as one of consequences of this reluctance to give credits. Therefore, this paradox can be easily explained by systemic deficiencies related to the operation of national economy, macroeconomic instability and high uncertainty which determines both banks' reluctance to loan and population's reluctance to the placement of deposits.

Most Moldovan banks operate on universal basis addressing both individuals and legal entities. Therefore competition is achieved in several product categories. It should be noted that geographically all banks have their headquarters in Chisinau and 5 largest banks have representative offices and branches in almost all regional centers. Analyzing the experience of European Union banking market the following relevant product markets were identified:

- Consumer credit market - consumers represented by individuals,
- Commercial credit market - several types of credit, consumers represented mainly by businesses or individuals entrepreneurs,
- Mortgage market,
- Deposits market,
- Current account services market.

It is also necessary to mention specific financial and banking markets, market factoring, financial leasing market and the international monetary market. In the analysis of banking sector have been identified other relevant markets with banking services over which banks have a determined influence: market evaluation services and insurance market.

Depending on the expression manner, the indicators for evaluation of market concentration level can be divided into two categories: absolute and relative. Absolute indicators of market concentration level involve assessment of the number of companies on the market and their market share. In practice the use of absolute indicators regarding market concentration level reduces the use of concentration indicators (CR) and Herfindahl-Hirschman indicator (HHI).

**CR3 indicator** reflects the cumulative share of the market held by 3 largest companies and identifies the sum of market shares of the largest market operators.

**HHI indicator** takes into account both the number of enterprises and their market asymmetry, characterizing the level of monopolization. The importance of this coefficient decreases with growth of the number of enterprises and increases with growth of companies' inequality (asymmetric) regardless of their number.

With the growth of market shares power, HHI coefficient gives greater significance to large enterprises than to small ones, which means that if small business is missing then the final error will be insignificant.

HHI coefficient is calculated as the sum of squared market shares of all enterprises rated in terms of shares or %.

$$HHI = \sum_{i=1}^n q_i^2 \quad (1)$$

where: HHI –Herfindahl-Hirschman index;  
 $q_i$  –company share  $i$  in volumes the market;  
 $n$  – number of market operators.

The lower is HHI the lower is the concentration and the higher is competition and the lower is the market power of each particular economic entity. For a competitive market (number of companies > 100) HHI tends to 1 and for a monopolized market HHI tends to 10000. Depending on CR and HHI indicators there are three main market types: highly, medium and low concentrated.

Based on public information provided by commercial banks and by the National Bank of Moldova it is possible to appreciate the level of concentration on the relevant markets identified above.

Table 2: Concentration level indicators on the banking market

| Indicators | Deposits market | Commercial credit market | Consumer credit market | Mortgage market |
|------------|-----------------|--------------------------|------------------------|-----------------|
| HHI        | 1298            | 1289                     | 2749                   | 1602            |
| CR3        | 54.5            | 54.94                    | 75.4                   | 59.33           |

Source: calculated by authors

Data analysis allows us to conclude that Moldovan banking market shows a medium level of concentration. A high degree of concentration is observed on the consumer credit market, where CB “MOBIASBANCA-Groupe Societe Generale” JSC, “Moldindconbank” JSC and CB “Moldova – Agroindbank” JSC hold approximately 75.4% of the market. The largest commercial loan market value shows that about 86% of all loans are granted for commercial purposes. Commercial loan market and deposits market are concentrated markets being dominated by BC “Moldova – Agroindbank” JSC, CB “Moldindconbank” JSC and CB “VICTORIABANK” JSC. Mortgage market, although considered partially concentrated, is approaching high concentration dominated by CB “Eximbank - Gruppo Veneto Banca” JSC, CB “MOBIASBANCA - Groupe Societe Generale” JSC and CB “Moldova – Agroindbank” JSC, so there is a tendency for targeting banks with foreign capital to the mortgage market due to lower cost of resources attracted from abroad.

The tendency toward polarization of local insurance market, i.e. the activity of concentrating the market in the hands of a few companies is noticed as requiring more time, but after the entry into force of the Law on insurance it has become more pronounced. This is due, firstly, to the decrease of the number of underwriters as a result of increasing the bail and, secondly, to the presence of unfair competition factors.

Therefore, the concentration of insurance market recorded an average result showing gradual increase in recent years. In 2006 the top 5 insurance companies (out of 33) had cumulatively accounted for 65% of total gross written premiums while in 2009 the figure rose by 10 percentage points and was 75% (out of 24 companies). However, by 2012 the concentration of the top 5 insurance companies (out of 19) was 77% [3].

The data in the table shows high concentration of insurance companies in the Republic of Moldova. However, the auto segment has increased importance that generated to a great extent the ranking of insurance companies by gross premium volume criterion. More specifically, the first four insurance companies out of the top auto vehicle segment (MOLDASIG, ASITO, GRAWE CARAT and MOLDCARGO) are of the same size and dominate the insurance market.

Table 3: Insurance market concentration in 2012

| Nr. | Name of insurance company | Share  |
|-----|---------------------------|--------|
| 1.  | ASITO SA                  | 15.28% |
| 2.  | DONARIS-GROUP SA          | 7.84%  |
| 3.  | GRAWE CARAT ASIGURĂRI SA  | 10.91% |
| 4.  | MOLDASIG SA               | 30.75% |
| 5.  | MOLDCARGO SA              | 12.02% |
| 6.  | Others                    | 23.20% |

Source: National Commission for Financial Market ([www.cnpf.md](http://www.cnpf.md))

Although Moldovan insurance market is still at an early stage of development, the consumers of insurance products and services have access to a relatively wide range of insurance products. According to NCFM these can be classified into four basic categories:

- compulsory insurance by law, such as auto vehicle liability insurance;
- voluntary insurance (or voluntary) goods such as providing commercial, agricultural, financial and personal enterprises;
- voluntary insurance of individuals, such as pensions, annuities, life and health insurance;
- voluntary insurance liability, insurance in areas such as aviation and transport service providers and professional indemnity.

Auto vehicle liability insurances comprise over 43% of premiums on the national insurance market and represent the most important product offered by insurance companies. Due to its mandatory character this type of insurance guarantees companies a steady income with no efforts at all.

After the National Agency for Protection of Competition, presently called the Competition Council, started its activity, the first violations of insurance market competition were identified in 2007, particularly in the “Green Card” insurance market.

In 2013, more distortions of “Green Card” civil auto liability insurances on the external insurance market were discovered. The General Meeting of Motor Vehicle Insurers’ National Bureau decided to exclude insurance companies “Moldcargo” JSC and “Grawe Carat Insurance” JSC from the National Bureau. The particularities of “Green Card” certificates issued by “Moldcargo” JSC and “Grawe Carat Insurance” JSC requested intervention of the Competition Council.

Examining the external insurance market of “Green Card” civil auto liability insurances we found a highly regulated market. Prices for civil auto liability insurance are established and reviewed annually by NCFM. Prices applied by the regulating authority to civil auto liability insurance do not allow competition to develop. Taking into account the fact that insurance prices are set by NCFM and insurance companies cannot deviate from these prices, the final product (internal and external civil auto liability insurance “Green Card”) is a standardized one, competition among

insurance companies is reduced to competition for resources without any contribution to consumers' welfare. Such a competition among insurance companies is, at least, unproductive and does not stimulate insurance companies to reduce costs or improve the quality of services. Starting from the fact that competition is not a scope in itself, but should contribute to the growth of consumers' welfare, we consider appropriate to modify national legislation in terms of liberalizing compulsory civil liability insurance market.

#### 4. Conclusions

The analysis of Moldovan financial system has identified several issues, which need to be solved very carefully, namely, finding a balance between regulation and efficiency. Of course, the opening of financial markets for foreign financial institutions creates a favorable opportunity to attract more available financial funds, but one must keep in mind that this is a strategic area and any thoughtless step might affect the entire national economy. Thus, in order to avoid prejudice of the financial system, the national bank together with the Competition Council should promote state competition policy in close coordination with the National Bank of Moldova taking into account the experience of the European Union.

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