

## Chapter 10

# Capital markets

## 1. General

Capital market regulations underwent an important evolution after 1994, when the first law regarding securities and stock exchanges was adopted. This law was preceded, one year before, by a Government ordinance on open-end investment funds and investment companies.

With that occasion, the National Securities Commission, an autonomous administrative authority under Parliament control, was established and vested with the competence of regulating and overseeing the Romanian capital market.

Several capital market crises, mainly consisting in the collapse of some investment funds in the '90s, as well as of the sharpening of conflicts between the majority shareholders and minority ones within the publicly owned companies, entailed re-examination of the primary and secondary legal framework in the field, along with the strengthening of the National Securities Commission's powers.

Consequently, based on the built experience and the corresponding regulations in force in the European Union member states, new enactments were adopted in 2002 aiming to govern the legal regime of the stock exchanges, of any transaction unfolding within the stock exchange, as well as the activity carried out by the capital market specific institutions.

The legal framework established in 2002 lasted for only two years. To cope with the constraints related to Romania's admission into the European Union, as well as the constant evolution of EU directives in the field of capital markets, especially concerning public offerings and passport requirements, the Parliament passed Capital Markets Law no. 297/2004.

## 2. Main regulations

- Law no. 297/2004 regarding the capital market, published in the Official Gazette, Part I, no. 571 of June 29, 2004, with subsequent amendments;
- Emergency Government Ordinance no. 25/2002 approving the National Securities Commission's Statutes, published in the Official Gazette, Part I, no. 226 of April 4, 2002, further approved and amended by the Law no. 514/2002, with subsequent amendments.

## 3. Capital market structure

The main players on the capital market are all private legal entities having specific functions and purposes. Such entities are as it follows:

- a) regulated markets and their operators, as well as alternative transaction systems and their operators;
- b) issuers of financial instruments;
- c) financial investment services companies;
- d) investment consultants;
- e) rating agencies for issuers and their securities;
- f) the Central Depository;
- g) clearinghouses, central counterparts and settlement agents;
- h) the Investors' Compensation Fund;
- i) undertakings for collective investment in transferable securities ("UCITS"):
  - (I) open-end investment funds;
  - (II) investment companies;
  - (III) investment management companies;
  - (IV) depositories.

## 4. The National Securities Commission ("NCS")

As mentioned above, NCS is an autonomous administrative authority, having legal personality, which oversees and regulates the capital market, the commodities and derivatives regulated market and whose fundamental objectives are aiming to:

- a) establish and maintain the proper framework necessary for the development of regulated markets;
- b) promote trust in regulated markets and in financial instrument investments;
- c) ensure protection of operators and investors against unfair, abusive and fraudulent practices;
- d) promote fair and transparent operation of the regulated markets;
- e) prevent fraud, market manipulation and ensure the integrity of regulated markets;
- f) establish standards of financial soundness and honest practice in the regulated markets;
- g) adopt necessary measures meant to avoid systemic risk on the regulated markets;
- h) prevent any influence upon the equality in information and treatment of investors and their interests.

With a view to fulfilling its legal objectives, NCS adopts norms, issues individual acts and measures. NCS adopts norms by way of regulations and instructions, which are implemented by order of its chairman. The individual acts, issued by NCS are decisions, ordinances, certificates and notices.

Additionally, NCS may perform, upon request or *ex officio*, official interpretation of all regulations issued by it, which are applicable to regulated and supervised entities.

Distinctly from the prerogative of officially construing its own regulations, NCS is allowed to issue notices consisting of official answers in matters concerning the law and secondary legal

framework enforcement, or to formulate estimates with regard to the regulated markets and financial instruments. In case of disputes, the individual acts issued by NCS with reference to its official interpretations may be challenged with second-degree appeal before the Supreme Court of Justice, Administrative Division. Until the court renders a final and binding decision, the enforcement of NCS's act may not be suspended.

## 5. Regulated markets and their operators

In the beginning, soon after the enactment of the first piece of securities legislation, two regulated markets emerged. In 1995, the Bucharest Stock Exchange was the first regulated market established in Romania. Soon after, in 1996, the RASDAQ market had been established, as an over-the-counter (OTC) market, based on the American NASDAQ market pattern, and was destined to list the companies subject of the Mass Privatization Program.

In 2004, the Bucharest Stock Exchange and the RASDAQ market agreed on a merger and started a merger process that ended on December 28, 2005. The result was the establishment of the Bucharest Stock Exchange (*Bursa de Valori Bucuresti S.A.*), acting as a joint-stock company under the supervision of NCS.

Further regulated markets can be established based on a NCS authorization, managed by a market operator organized as a joint-stock company. The shareholders of a market operator are not allowed to hold each more than 5% of the voting rights. Each member of the market operator's board of directors must be validated by the NCS before entering their office.

The market operator is entitled to issue its own regulations regarding the organization and operation of that market, approved by the general shareholders meeting of that operator, and afterwards endorsed by NCS.

The market operator can also establish an arbitration court meant to settle disputes between brokers and/or issuers.

## 6. Supervision of regulated markets

The regulated markets are supervised by NCS, which may appoint an inspector for such purposes. The inspector's main tasks refer to overseeing the securities operations carried out on the regulated markets, having free access to all premises and documents, information and records. The inspector participates in the meetings held by the market operator's corporate bodies, and may propose NCS to request the amendment of the regulations issued by the market operator, suspend part or all of the operations with financial instruments on the regulated markets or cancel the authorization granted to a market operator.

## 7. Listing of securities

The regulated markets are listing securities and other financial instruments only based on a prospectus drafted by the issuer and approved by NCS.

An issuer whose securities are admitted on a regulated market should observe the market transparency requirements.

In order to be listed on a stock exchange, publicly owned companies must fulfill basically the following minimal requirements:

- a) to have an anticipated stock exchange capitalization of minimum EUR 1,000,000, denominated in RON, or a share capital representing the RON equivalent of at least EUR 1,000,000, to the extent that the stock exchange capitalization value may not be anticipated;

- b) to have operated during the latest 3 years prior to its listing, and to have published its annual financial reports for the same period;
- c) at least 25% of its shares must be publicly owned.

## 8. Public offerings

Any public offering of securities must be authorized by NCS prior to the publication of the announcement and/or the prospectus.

The validity term of a public offering is the one stipulated in the announcement and the prospectus, but may not exceed certain periods prescribed by law (ex: 12 months in case of the public sale offering). The law regulates the following types of public offerings:

- a) the public sale offering;
- b) the public purchase offering (i.e. the offer of a person to purchase securities, publicly made to all existing shareholders);
- c) the public voluntary takeover offering (i.e. the offer of a person who is not legally compelled to perform such offer, which is made to all existing shareholders, for all their stock, with the purpose to acquire more than 33% of the voting rights of a listed company);
- d) the public compulsory takeover offering (i.e. the offer of a person who, subsequent to its prior acquiring operations, holds more than 33% of the voting rights and must therefore launch a public offering to all existing shareholders for their entire stock, no later than 2 months after reaching the 33% threshold);
- e) the public offering made in order to allow the squeeze-out or sell-out of minority shareholders.

In a public voluntary takeover offering it is important to emphasize that, starting with the moment when the offeror's preliminary notice is received, the board of directors of the target company may not conclude any acts or deeds or take any measure that might materially affect the company's assets or the objectives of the takeover, except for acts entered in the ordinary course of the business and for those expressly approved by the extraordinary general meeting of shareholders.

## 9. Special governance rules for listed companies

In order to protect investors, the law sets up rules departing from the companies' customary legal framework, applicable to the publicly owned companies, among which the following are the most important:

- a) shareholders holding individually or together with other persons at least 5% of the shares issued by the publicly owned companies may require the company's financial auditors to present reports on the company's management status and operations;
- b) the general shareholders meeting of publicly owned companies is convened by publishing the convening notice and by notifying both NCS and the regulated market where the company is listed;
- c) the members of the board of directors of publicly owned companies may be elected by cumulative voting. Upon request of a significant shareholder, election based on such a method is mandatory;

- d) the auditors of publicly owned companies shall supervise and check upon the company's bookkeeping as well as the accuracy and opportunity of the transactions or acts concluded by such a company with its affiliated persons or persons involved therewith;
- e) the term for dividend payment to shareholders cannot exceed 6 months from the date when the general shareholder meeting establishes such dividends;
- f) the decision of the general shareholder meeting for dividend establishment will be filed with the trade registry, for registration purposes, and published in the Official Gazette, Part IV. The decision shall constitute executory title, based on which the shareholders may start forced execution proceedings against the company;
- g) any acts meant to acquire, alienate, exchange or create encumbrances over fixed assets of the company whose value exceeds either individually or cumulated, throughout a financial year, 20% of the total fixed assets, except for receivables, may be concluded by the company's directors only based on the prior approval of the shareholders' extraordinary general meeting;
- h) any increase of the company's share capital by new contributions, either in cash or in kind, should observe the preference right to all the company's shareholders.

## 10. Market transparency and investor equality

The investors have the right to access information that is accurate, sufficient and made public at the appropriate time on securities, their issuers and activity thereof, financial investment services companies, regulated markets, institutions and persons that are professionally involved in securities business.

Publicly owned companies shall draft and make available to NCS, the market operator and the public quarter, biannual and annual reports. In the event of a material event, publicly owned companies shall prepare current reports in 48 hours.

The law forbids any action meant to manipulate the market, and any transactions based on privileged information.

No holder of privileged information will be allowed to acquire or transfer, for himself or for other persons, either directly or indirectly, securities or other related rights, on which he holds such privileged information, or to value such privileged information in any other way, or to transmit the same, or facilitate their publication for his personal benefit or for the benefit of any third party.

## 11. Investors' Compensation Fund

The Investors Compensation Fund (the "**Fund**") is a legal entity organized as a joint-stock company, based on a constitutive act approved by NCS.

The purpose of the Fund is to compensate the investors in such cases when the financial investment services company is unable to return the proceeds or financial instruments owed to or belonging to the investors, which were managed in their name for financial investment services purposes.

## 12. Financial investment services companies

The financial investment services companies may provide, *inter alia*, the following services:

- a) Main services:

- (I) sale or purchase of securities and other financial instruments, on the clients' account;
  - (II) sale or purchase of securities and other financial instruments on their own account;
  - (III) management of the clients' individual portfolio accounts, under the mandate given by such clients;
- b) Related services:
- (I) holding funds and/or securities and other financial instruments;
  - (II) granting loans in cash or in financial instruments to investors;
  - (III) advisory services granted in relation with capital structure, industrial strategy, mergers and takeovers.

The type of authorization issued by NCS to the financial investment services company shall expressly stipulate the financial investment services that the company may provide.

The minimum subscribed and paid-up capital of the financial investment services companies varies depending on the category of services each company is authorized to provide.

Financial investment services companies carry out brokerage activity through individuals, employees or representatives, acting as financial investment agents, authorized by NCS.

An internal control department operates within each financial investment services company, whose personnel, authorized by NCS, is responsible for the compliance by the company and its employees with the law and the capital market regulations, as well as the company's internal regulations.

Financial investment services companies are bound to strictly observe market conduct rules, as required by law and NCS regulations. To meet this goal, the companies and their agents should:

- a) act with due professional diligence and honesty in order to protect their clients' interests and the market integrity;
- b) develop all internal resources and procedures necessary to provide financial investment services;
- c) require from their clients information on their financial status, investment expertise and specific objectives of the required service, in order to provide the best services possible;
- d) in dealings with the clients, make adequate disclosure of all material information relevant for the investment decision;
- e) comply with all rules and customs applicable to the provision of financial investment services so as to protect the best interests of the clients and the market integrity;
- f) avoid to fulfill their functions and powers in cases of conflict of interests as regards the clients.

Based on the freedom to provide services within European Union, financial investment service companies headquartered in a member state of European Union may provide financial investment services on Romanian territory either directly under free provision of services or through branches established for this purpose under the right of free establishment, within the

limits of the authorization issued by the competent authority in the Member State of origin, no prior authorization of NCS being required in this respect.

Under reciprocity conditions, by departure from the provisions of the existing legal framework, financial investment service companies headquartered outside the European Union may provide financial investment services on Romanian territory through subsidiaries established for this purpose. Nevertheless, the establishment of such subsidiaries is subject to NCS's authorization.

### **13. Investment consultancy services**

The investment consultancy services include, inter alia:

- a) analysis of financial instruments;
- b) analysis of regulated markets;
- c) consultancy services in relation with mergers, acquisitions, take-overs, capital structure, economic strategies, financing schemes and the like.

Professional investment consultancy services may be carried out by investment consultants, individuals or legal persons, only based on NCS authorization.

### **14. The Central Depository**

The Central Depository is a joint-stock company, authorized and acting under the supervision of NCS, which performs securities transactions clearing and settlement operations, securities depositing operations, as well as related operations.

The shareholders of the Central Depository are not allowed to hold each more than 5% of the voting rights, except for the market operators who may hold up to 75% of the voting rights. Each member of the market operator's board of directors must be validated by the NCS before entering its office.

The Central Depository serves also as a vehicle for the security interests.

The financial instrument accounts kept in open accounts by the Central Depository must be recorded in such a manner so as to clearly distinguish them from assets held on the Central Depository's own account and cannot be subject to any claims made by the Central Depository's creditors.

### **15. Financial auditors**

The financial and operational reports of each entity subject to NCS authorization, supervision and control must be prepared in accordance with the legal framework in force and the specific regulations issued by the Ministry of Public Finance and NCS.

Financial reports shall be audited and certified by duly authorized financial auditors, members of the Romanian Financial Auditors Chamber.

### **16. Undertakings for Collective Investments in Transferable Securities**

The undertakings for collective investments in transferable securities are open-end investment funds and investment companies, which mainly streamline their resources towards investments in securities.

These two types of bodies authorised and monitored by NCS feature the following:

- a) have as sole goal to mobilize collective savings through continuous public offering of participation titles and to place such resources based on risk-diversification and prudential management principles;
- b) ensure continuous redeemable status of the participation titles from the assets of such entities, upon the holders request.

An **open-end investment fund** is set up based on an association contract and consists of all proceeds raised under continuous public offering of fund units, of purchased assets and of benefits resulting from placing such resources in a diversified securities portfolio.

The open-end investment funds may not issue other financial instruments, except for fund units. The investors may subscribe fund units or fractions of them. Any holder of fund units is bound to permanently own at least one fund unit.

Investors may purchase fund units at the issue price, computed against the net assets value and valid on the purchase day. The fund units are redeemed upon request against a price reflecting the value computed by the depository, with strict observance of NCS regulations.

An **investment company** is set up as a joint stock company, with minimum 100 shareholders, acting solely to invest in securities the financial resources obtained exclusively through issuance and sale of its own shares to the public.

**The investment management companies**, authorized by NCS, act mainly for:

- a) analyzing the securities and the financial markets, as well as selecting the investment portfolio for the securities of undertakings for collective investments in transferable securities, under their management;
- b) purchasing securities on account of the undertakings for collective investments in transferable securities under its management, by using the financial resources raised from the participation title holders;
- c) exercising the rights attached to the securities on the account of the securities of undertakings for collective investments in transferable securities under its management;
- d) distributing participation titles of the securities of undertakings for collective investments in transferable securities under its management.

A company may not be, at the same time, an investment management company and a depository. The investment management company and the depository should act independently, and exclusively in the interest of the participation title holders.

The investment management companies must:

- a) operate with full professional diligence, correctness and transparency in the exclusive interest of the participation title holders;
- b) organize so as to minimize the risk of conflict of interests, including the conflicts between the various undertakings for collective investments in transferable securities under its management;
- c) take steps for the protection of the participation title holder rights;
- d) strictly comply with the prudential regulations issued by NCS.

**Depositories** are credit institutions, authorized by NCS, whom are entrusted the assets of undertakings for collective investments in transferable securities, for their safekeeping and which oversee the operations of investment management companies.

A depository may be a Romanian banking company, or the branch of a European credit institution, providing that it may display sufficient professional guarantees, an adequate share capital and management structure to carry out in proper conditions its depository activity to meet the commitments incumbent on it.

The depositories shall mandatory carry out at least the following activities:

- a) keeping in custody the financial assets belonging to the undertakings for collective investments in transferable securities;
- b) safekeeping the physical financial assets belonging to such undertakings;
- c) recording the applications for subscription and redemption of participation titles and of the related operations;
- d) recording the number of investors and participation titles held by them based on the information transmitted by the distributors or the investment management company;
- e) computing and certifying the net asset value, of the net asset unitary value, the investors number and submitting such information to the investment management companies and to NCS, within the terms and in the form, conditions and dates provided under law and NCS regulations.