

REGULATION OF INSTITUTIONAL INVESTORS' ACTIVITY IN THE REPUBLIC OF MOLDOVA: PROBLEMS AND NEW CHALLENGES FOR THE DEVELOPMENT OF DOMESTIC CAPITAL MARKET

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Abstract

Legal framework is a key element for the development of the capital market that is why it is important for the regulation body to implement the best practices in order to ease the activity of market participants, but, at the same time, not to affect the secure functioning of the economy. The article analysis the role of the National Commission of Financial Market in regulating the activity of institutional investors on the capital market of Moldova and presents an estimation of the domestic legal and institutional framework from the point of view of main existent problems that negatively influence the activity of institutional investors. Also there are given some recommendations for the development of capital market regulation in the Republic of Moldova.

Keywords: securities market, stock exchange, Policy, Institutional Investors, Financial Intermediaries, joint-stock-company.

JEL classification: G1, G18, G23.

Role of National Commission of Financial Market in regulating the activity of institutional investors

Securities market of Moldova, as well as the activity of institutional investors on the capital market is regulated by the **National Commission of Financial Market** (NCFM - is the heiress of National Commission of Securities Market, State Inspectorate for Insurance Supervision, Private Pension Funds', Saving and Credit Association and is based on the new "Law on NCFM nr.129-XVI from 07.06.2007") [3], which is empowered to regulate, supervise and control the securities market and its participants, continuing to achieve its goals and strategies through the development and improvement the legal, administrative and financial framework.

The main purpose that led to the creation of NCFM in Moldova is the necessity of existing of an authority that regulates, authorizes and supervises the non-banking financial market, which therefore includes also the capital market.

The securities market in the Republic of Moldova is composed by primary and secondary market, which is regulated by a set of normative acts, regulations and laws created most of all after the start of privatization process of the state property, especially after 1998: "Law on securities Market", "Law on Joint Stock Companies", "Law on NCFM", "Stock Exchange Rules", "Regulation on dealers' and brokerages' activity", "Regulation on estimating activity and assets referred to them", "Instructions of public offers of securities on secondary market", "Instructions on mode of state registering of securities", "Instructions on reorganization steps of joint stock companies", and other regulations and normative acts [3].

The regulation of primary and secondary market refers to:

- The procedure of underwriting securities;
- The way of registration of securities;

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- The way of performing public offers;
- Determining types of securities that will be registered on Stock Exchange;
- Requirements of registration to Stock Exchange in listing and non-listing;
- Procedures of Stock Exchange transactions;
- General and specific requirements on each activity on securities market;
- Conditions of licensing of professional participants.

NCFM is continuously consolidating its regulation and supervision efforts for the development of a modern capital market, by implementing European directives and other foreign practices, ensuring a strict control of legislation observance.

In order to ensure long-term and continuous development of capital market and its transformation into an efficient instrument of attraction and redistribution of investments, the Parliament of Republic of Moldova adopted **Law nr. 171 from 11.07.2012 „ On capital market ”**.

The law provisions establish the legal basis for regulating relations in the field of capital market. Law rules govern the activities of investment firms, securities, public offerings, takeover bids, the capital market infrastructure, establish disclosure requirements in order to maintain high standards of capital market activity and the creation of conditions for financial investments. The law also stipulates the conditions regulating the licensing of capital market activities, surveillance and investigation activities in the market [1;2].

At the same time, elaboration of new law in the domain of capital market is determined by the following objectives:

- Creation and maintenance of some efficient and transparent markets;
- Reduction of systemic risks;
- Promotion of public bids of securities;
- Connecting categories of activities on the capital market towards European standards;
- Effectiveness of organized trading of financial instruments;
- Ensuring prudential administration and supervision of activities on the capital market;
- Creation of Investments Compensation Fund;
- Prevention and combating market abuse and other activities contrary to law;
- Achievement of a high level of protection of the rights of investors in securities and beneficiaries of financial services in the capital market;
- Defining the powers and functions of the regulatory authority, supervision and control of the capital market [1].

In the context of entry into force of the **new Law on capital markets**, market actors in leading role banks hope to change many things, in conditions in which the old rules limited the development of the market and there existed many barriers that hindered market intermediaries, as well as issuers of securities.

There is a risk that concomitant activation of two laws (the old and the new ones) during a period of one year and a half could disturb the capital market. During this period there will be elaborated new normative acts that will refer to the new law. So the new law will enter into force, but the rules will not be clear for market participants, that will not impulse the market to advance. In this order of ideas, the capital market regulator should carefully clarify new rules and estimate what will be the impact of measures before their implementation.

There are also opponents of the new law on capital market activity, as they consider this fact as a negative factor for the development of domestic capital market. But the law opponents don't want to recognize one fact: previous legislation was convenient only for some market operators, as it obliged joint stock companies and investors to use their services and to pay for these services. If the situation would not be catastrophic on the market, these privileges could have been omitted. But namely these privileges put on knees, as during 14 years of previous law existing, the market gradually degraded.

Issues and transactions on the capital market were performed because the law obliged market operators to do this. On the contrary, nobody would appeal for these mechanisms. The new last provisions come to exclude privileges for some categories of operators.

The new Law on capital market has as objective adjustment of national legal framework in the domain of capital market regulation towards European Union directives, principles of International

Organization of Securities Commission and implementing the best international practices for the development of national capital market infrastructure, supervision based on estimation of the risk degree, diversification of financial instruments, increasing the level of investors' protection and reducing systemic risks [1]. Law transpose 11 directives related to investment and financial services, including the main European directive applicable to the financial sector - 21.04.2004 Directive nr.2004/39/CE of the European Parliament and of the Council on markets in financial instruments (MiFID).

The law establishes the legal regulatory relations in the capital market, and activities of investment firms, securities, public offerings, takeover bids, capital market infrastructure, information disclosure and market abuse.

The new regulations provide a number of advantages that come with the implementation of a new model to ensure access and trading on the stock market, diversification of financial instruments and the creation of an appropriate mechanism for the protection of investors. Among the strengths of the law are noteworthy [4]:

- expanding the spectrum main services and activities that an investment company may undertake. For example, today the companies licensed to conduct the business of a dealer in the securities market are not entitled to lend to customers to carry out transactions with securities and under the Law on the stock market offers the possibility of investment firms will hold category C license;
- issue of licenses for an undetermined maturity, today their validity is for 5 years;
- financial capacity building of local professional participants in the securities market, so that they can develop new products and activity programs, hire adequate staff, develop information infrastructure and new technologies, which also positions them more comfortable in a competitive environment loyal foreign;
- diversification of financial securities subject list being expressly determined and placement procedures for issuing Moldovan depository receipts, fund units issued by collective investment undertakings;
- introducing the possibility of withdrawing securities by the holder of more than 90% of the total voting securities, allowing completion of the consolidation of ownership in many joint stock companies increasing investment attractiveness, these procedures are in accordance with Directive 2004/25 on takeover bids;
- regulation of the multilateral trading system, offers the possibility of creating new platforms for trading of financial instruments;
- irrevocability of transactions since placing the order clearing and settlement systems;
- create prerequisites for the emergence of institutional investors, which can take both legal personality as well as without. Efficient operation of collective investment schemes in securities will allow attracting surplus liquidity from the public capital market, which will help increase the flow of investment that will benefit domestic companies;
- introducing quarterly reporting by public interest entities (currently - 14 commercial banks, 18 insurance companies, 6 joint stock companies other than banks whose securities are listed on a stock exchange listing, and, in the future, companies will securities public place or will conduct business as collective investment in transferable securities or state pension fund), thus ensuring the provision of more information to investors and that a better functioning of the market. These issuers will disclose information in electronic form on their website;
- simplification of trading procedures and making public offers in relation to professional customers (investment firms, commercial banks, insurance companies, organizations of collective placing of securities, pension funds, public authorities, etc.) and qualified investors, categories of persons who possess a high level of knowledge of capital market institutions that are able to decide individually on investments in financial instruments that do not require state protection afforded to small investors.

To provide services to regular customers (depending on knowledge and experience in investing in financial instruments) investment companies will establish, implement and maintain appropriate internal policies and procedures to detect any risk of failure by the company of their obligations to identify situations that generate or may generate conflicts of interest in relation to their customers.

Requirements of compliance, risk management, internal audit, rules of conduct and restrictions on personal transactions are established in order to provide services to investment companies honestly, fairly and professionally to meet the client's interests first. Therefore, there is a shift from

prescriptive model of behavior of professional participants in a model based on the management and supervision.

➤Increasing the attractiveness of securities and the level of investor protection by creating and managing the Investor Compensation Fund, and by improving the transparency requirements to capital market participants.

The law provides the National Commission of Financial Market to issue decisions on the approval status of person accepted for legal persons of the EU Member States authorized to perform investment services and activities and supervised by the competent authorities of the Member States of the European Union, under agreements concluded between authorities and NCFM.

Currently, the legislation does not contain such regulations. Given the comparative maturity of the domestic market and markets of other EU countries, investment firms will be able to take the experience and provide access to foreign financial markets.

Analysis of legal framework in regulating the activity of institutional investors: problems and solutions for the development of the capital market

In Republic of Moldova, the securities market was created not to accomplish its main function – of accumulating capital for realization of investments and its distribution towards investment projects, but with another scope: insurance of privatization program realization of state ownership. Due to the fact that the Regulator's activity and regulation of securities market was not a priority for state authorities, the selective approach led to the fact that ***in Republic of Moldova was created a securities market with a contradictory legal framework for the development opportunities of the capital market.***

The infrastructure of the securities market is very complicated, although is limited in terms of volumes and functionality, and there are created different ***types of participants the activity of which is doubled.*** Normally, market participants could have cumulate actions or types of performed activities. Irrespective the legal framework of other countries, national legal framework provides 13 types of activities [4].

Another fact is characterized by the competence of regulation of some market segments by public bodies. This fact is manifested through ***the tendency of central public body on the securities market to massively imply within processes that occur on the capital market,*** which is the practice that is not applied in developed countries and namely consisting in delegating some empowerments to self-regulating bodies, including the ones with normative regulation character.

The consequences of such a continuous implication of the central authorization body in the activity of market participants on the capital market are not favorable, being created ***a too regulated market, in terms of normative framework, with multiple requirements and procedural barriers.***

Another subjective factor consists in undertaking, sometimes totally, of some rules and practices from more advanced countries. This approach is sometimes not correct, as it does not take into considerations country developments' distinctions.

As a comparative example can be taken Romania, where starting from 2002, the capital market was subjected to important new regulations that brought changes in mechanisms and functioning of capital market. These legislative changes were necessary to be implemented within the binding conditions of implementing EU directives and recommendations before adhering to EU. In this order of ideas, the National Commission of Capital Market of Romania implemented, on the one hand, a whole set of European directives, but, on the other hand, took over the European legal model – the global capital market regulation. The new legal framework led to a favorable evolution of the Romanian capital market, and namely:

- New banks entries on the segment of rendering financial services;
- Implementing requirements of capital adequacy;
- Organization of investors' compensation fund;
- Realizing changes in the activity of mutual funds, which are obliged to insure a more efficient management of resources and to simplify procedures on attraction of investors;

➤Simplifying financing procedures on the capital market.

Considering the decrease of the number of professional participants on the capital market (legal changes led to the possibility of investment funds to reorganize into common joint stock companies), there can be stated another unfavorable phenomenon on the domestic capital market, and namely – ***trend of disappearance of the most active investors, of investment funds and trust management companies***, that resulted in real and irretrievable disappearance of ownership by thousands of minor shareholders.

The capital market of Moldova needs to be subjected to an institutional reform to be unified and consolidated (bank-and non-bank sector) within a unique state authority, with one Regulator - that is the National Commission of Financial Market that would regulate and control the consolidated financial domain (bank, real estate, insurance, microfinance, savings, pensions, investment funds sectors).

The regulation framework, which is costly, inefficient and confuse for the market participants will led to establishment of a unique market regulator with clear objectives and a whole set of coherent competences and efficient functions. Good practices of other countries with one regulator are beneficial to be taken and applied in Republic of Moldova.

It is important to elaborate a complex strategy of capital market development in Moldova, which would in fact be a complex normative reform that would trace distinct efficient development methods, including – basing capital market development concept on norms of populations informing, as well as reestablishing of investors' trust in institutional structures. For a positive development of capital market, population needs to be informed on the possibilities of active and efficient trading on the secondary capital market. In this case for the capital market development, an advantage would be organization and development of OTC market, and not its exclusion off the capital market. Also, the normative regulation of the objective of fusing the state securities market with corporate securities market would lead towards unification, stabilization and increase of securities market liquidity in Moldova.

The process of securities market should be based on public offerings, principles of offers' competitiveness, bid/ask liabilities that would be clearly fixed. That is why it is important to legally regulate the tangency of interests of managers, on the one side, and shareholders and institutional investors, on the other side.

Normative defining of infrastructure and launching the financial instruments (municipal bonds, futures, options contracts, deposit receipts and other derivatives) for capital market maximization and development, including also trading state securities through National Bank of Moldova should be offered to institutional investors through state programs offered by Regulator and proposed to investors, that would also be guaranteed by international well recognized structures, like EBRD, IMF, WB etc.

This aspect is extremely important, as the insurance of consumers rights of financial services lacks on the domestic capital market, namely in the domain of protection of control package of shareholders in cases of their illicit ownership deprivation (*raiders attacks* - in Republic of Moldova the concept "raider attack" lacks in legal interpretation. A simple definition of this notion would consist in: the process of establishing a full control over a company, both in the physical sense and in the legal sense, against the will of the directors and / or its owners), lack of personal responsibility of members of company's administration council (in case of performing large transactions) and so on.

It is important to reform taxation policy of capital market participants. Taxation policy of financial market should not consist in a simple method of money collection in order to increase state budget. ***The Regulator's normative policy on the financial market should base on the logistics of market taxation starting from economic reality and country objectives with stimulatory factors for institutional investors.*** A good example would be: institutional investors having the same activity degree as previous years will pay lower taxes.

Projects of normative acts of the Regulator on taxation policy and the process of taxes' collection should be publicly consulted and approved based on the opinion of market participants: both investors and issuers.

It is necessary to change in Moldova (example, Romanian practice) some provisions in legislation relating to taxation of profits obtained on capital market and introduction of tax grills of revenues on capital market, based on period of securities holding and acquisition/sale prices. This taxation grill should not stimulate speculative transactions. But when considering this higher fee on speculative transactions, it is important to match investors' interests who are searching investment profits and issuing companies who are willing to finance with low costs, as limitation of speculative transactions by a higher fee would result in limitation of issuers' access towards financing resources.

An efficient capital market is a good foundation of accelerated economic growth of once country through a correct regulation framework, including tax regime of attraction mechanisms of capital resources and their distribution towards country financing and development.

The potential of state regulation of capital market should be directed towards:

- Reduction of trading costs for most active institutional investors;
- A financial and investment activity that would ensure efficient revenues;
- Increase of participants' confidence;
- Generation of positive externalities;
- Efficiency of authorization procedures;
- Increase of requirements of information disclosure.

In Moldova a dogmatic concept of regulation in applied on the capital market, due to the following reasons:

- An asymmetric regulation of the domestic capital market is carried out, where some of the segments are excessively supervised and regulated, while other ones not;
- There are applied interdictions and conditionings through which are applied price controls on securities market;
- A distorted role is given to the Moldova Stock Exchange (MSE), where are traded such operations as "Repurchase Agreements (REPOs)", which in fact are not stock exchange transactions;
- Lack of advanced trading technologies.

The foundation of capital market should be based on three pylons – transparency, liberal regulation policies and ensuring investors' trust in financial services and tools offered by capital market operators.

Conclusions

Legal and institutional framework is a key element for the development of the securities market that is why it is important for the regulation body to implement the best practices in order to ease the activity of market participants, but, at the same time, not to affect the secure functioning of the economy.

Recent crisis that have hit the whole global economic system gave lessons for all regulation authorities, that is why it is important not to repeat mistakes undertaken by foreign countries, but create a legal infrastructure that would favor attraction of foreign capital and capital market development.

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