



POLICY BRIEF

THE IMPACT ON THE CAPITAL MARKET AS A RESULT OF SIGNING THE ASSOCIATION AGREEMENT BETWEEN THE EUROPEAN UNION AND THE REPUBLIC OF MOLDOVA

Authors: Natan Garstea, Alexandru Coica, Artur Gherman, Anatol Cobzari, Alina Cazachevici, Valeriu Covalenco, Viorel Chivriga

About the Study

At the initiative of Soros – Foundation Moldova, “EVM Consulting” Company developed a study on the impact of signing the Association Agreement between the European Union and Moldova, on the capital market of Moldova.

The purpose of the study was to perform an analysis of the current status of the capital market of Moldova and its evolution, both in time and through benchmarking with the capital markets of the European Union member states. The study aimed also at establishing the main changes that will take place on the market as a result of signing the Association Agreement and its impact on capital market as a whole, and on key market participants.

Based on the findings of the impact of signing the Association Agreement, several recommendations could be made, with regard to both the negotiation of the agreement and further aspects of its implementation.

The current situation on the capital market

Stock Market in Moldova was created in the process of mass privatization, and some of its features had been inherited from this particular process. Thus, initially the majority of citizens became shareholders in various joint-stock companies directly or through investment funds or trust companies. This led to an enormous number of shareholders, who, however, did not know their rights and were not involved in the management of companies where they were co-owners. As a result, in the absence of effective owners the situation quickly deteriorated at many joint-stock companies.

Later, the processes of ownership consolidation in joint-stock companies started. It led to appearance of a shareholder or a group of shareholders who took control over the company. This process was very beneficial to ensure efficient operation of the joint stock company and its development, but also it poured into permanent reduction of the number of shares in free circulation on the secondary market.

Placement of securities could be made both through public and closed issues. Public issue of securities had a very limited spread and only one public placement of shares was organized so far. Just a few placements of bonds were made until now, currently shares being the only securities circulating on the market.

The secondary market consists of the Stock Exchange and OTC, transactions being directed primarily to the stock market. Thus, OTC sale transactions may be conducted only with the securities obtained through the privatization. Margin transactions and short sales are not allowed.

The capital market infrastructure was formed during the development of the privatization. It consists of the Stock Exchange with the Central Depository, independent registrars, brokers and dealers (bank and non-bank), securities depositories and estimators. Initially, immediately after the formation of the market, the number of professional participants had been much higher, but it decreased with time due to both the size of capital requirements, which had increased over time, and to the significant competition within the relatively small size of capital market.

Non-banking financial market regulation and control is carried out by the National Commission on financial markets.

The measures to be taken in the negotiation of the Association Agreement

It is expected to undertake a range of measures in the preparation and execution of conditions of the Association Agreement that are related to the capital market. The most important of them (which results in a series of subordinated actions) is approving the Law on the capital market, which will radically change the legal basis and capital market infrastructure.

Among the effects of approval of the new law the following is to be noted:

Positive effects:

- Introducing the possibility of withdrawal of securities required by holders of more than 90% of securities, will allow completion of the consolidation of ownership shares in many companies, increasing the attractiveness of significant investments through joint stock companies, compared with investment in other type of companies. At the same time, implementation of these provisions of the law will have a significant social impact.
- Simplifying the authorization system for operating on capital market (three types of authorizations instead of 10 types of activity) will facilitate the proceedings to obtain the license and will bring more transparency of professional activities to the general public and clients.
- Creating the compensation fund for investors will increase the attractiveness of securities as investment instruments. At the same time, it will increase the costs of trading on the market.
- Irrevocability of transactions within the settlement systems from the moment an order is introduced, will increase the attractiveness of that kind of systems for investors.
- Expanding the types and rules of regulation in accordance with the European Legislation of the organizations for collective investment in securities will revive such type of institutions in Moldova.
- Introducing quarterly reporting will increase significantly the degree of market transparency and will provide investors with more information on securities, which will lead to a better market efficiency.

- Clarifying the definition of insider and prohibition of transactions using inside information will ensure a better protection of investors and at the same time, will liberalize the transactions for people who previously fell under the category of insiders.

Negative effects:

- The new requirements to the size of owners' capital of the participants can significantly affect certain types of professional activity. Thus, the law will require increase of owners' capital for many professional participants on the market. Although these provisions will enter into force within 7 years, the Stock Exchange and the National Depository is not able to supplement the equity from internal resources (profit).
- Automatically allowing European professional players on the market will obviously ease the European professional participant's access to the capital market of Moldova, but will marginalize or eliminate domestic market participants. Participants from foreign markets have a number of advantages over local companies (access to foreign financial markets, diversity of financial instruments, services with more added value, using modern technology and economy of scale effect), which will provide a clear competitive advantage against companies from Moldova.
- After the Law is approved, some types of professional activity will get into a legal vacuum, as the current law that is governing them will be substituted by the new one and they won't find themselves under the regulations of the new law. In particular it is important to refer to independent registrars that form the most important component of market infrastructure, responsible for records of property rights over the securities.

Recommendations

Based on this analysis, a series of recommendations can be formulated, both in the negotiation process related to the Association Agreement and on other actions to be taken in connection with signing the agreement.

- Finding a solution to the Stock Exchange and Central Depository. This can be either the reduction of the equity requirements or extension of the dead line. Another possibility would be to increase the size of contributions of the Stock members into its capital, or attracting additional investors (eventually, market operators in the EU or other states). However, currently there is no guarantee of finding such a solution, which makes it an important risk factor for capital market infrastructure.
- Gradual admission of foreign participants to the domestic capital markets, provided the market is mature enough and domestic investment companies have an increased competitive capacity. Acceptance of professional participants from another state can be made only after signing the bilateral agreement between the National Financial Market Commission and the competent authorities. We recommend that in determining priorities for signing such agreements, the National Commission should take into account the degree of capital market development of Moldova and of the state intending to sign the agreement.

- Avoiding the situation where some activities, essential for the functioning of the market, would remain without legislative coverage. In particular, it relates to the business of keeping the register of securities holders. Therefore, it is necessary to develop a set of laws and regulations regarding this activity for this transition period, before the implementation of changes in legislation.
- Given that many shareholding companies on the market will leave the market after the liberalization (due to the final consolidation of capitals and reduction of the amount of securities for circulation), next step would be to undertake a series of measures to encourage the open market. This means both the promotion of the basic ideas of capital market (especially on public offerings, bonds, bills, derivatives) and the insurance of qualitative growth of capital market services (through the development of underwriting and market making, creation of UCITS). These measures, although not directly related to the negotiation process, are vital for reviving the capital market after signing of the Association with EU.

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