

Romania RIA Knowledge Transfer and Capacity Building Program



SUMMARY OF CONSULTATION FEEDBACK

Consultation Period	Start: end June 2007	End: early October 2007
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Name of regulation	CNVM Regulation no. 14/2006 modifying CNVM Regulation no. 2/2006 on regulated markets and alternative trading systems
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Stakeholders participating in the consultation process	
Market operator	
Market operator shareholder	

This document summarizes feedback provided by stakeholders answering to a written consultation questionnaire and was drawn up following the consultation meeting between the RIA WG and the involved stakeholders. The aim of the consultation meeting was to learn more about the stakeholders' views so as to incorporate them into the proposed policy recommendation.

1. REASONS FOR CONSULTING STAKEHOLDERS

Representatives of Romanian regulators are participating in an Impact Assessment (IA) training initiative organized by World Bank administered *Convergence Program*¹.

Since consultation with stakeholders is a key part of the IA process, because it promotes public accountability and provides stakeholders with the opportunity to contribute to the evidence base that should underpin the policy making process, an explanatory cover letter and an attached questionnaire were designed, and they were sent to a set of selected stakeholders.

The cover letter started by explaining that the IA training exercise was undertaking a retrospective IA – *ex-post* - on an existing piece of legislation. In this case we are looking at **CNVM Regulation no. 14/2006 modifying CNVM Regulation no. 2/2006 on regulated markets and alternative trading systems**. Key stakeholders were identified as being affected by this piece of legislation.

The questionnaire was designed to provide evidence relating to:

- a) the nature of the problem that the regulation was seeking to address, and
- b) the costs and benefits of the regulation and of two alternative policy options that in theory could have been chosen instead (this recognises the fact that in a "live" IA exercise we would be expected to consider different policy responses to the same policy problem).

Stakeholders were also ask to help after the questionnaire-answering phase was completed by attending a face-to-face meeting to quality check all stakeholder responses and enhance the WG's understanding of their answers.

2. METHODS USED

From a variety of possible methods available, as recommended by the *Impact Assessment Guidelines for EU level 3 Committees* jointly issued by CESR, CEBS and CEIOPS in May 2007, such as concept releases, calls for evidence, publication of consultation papers, public hearings and roundtables, written and

¹ Participants in this knowledge transfer and capacity building program are the following: Prime Minister's office, Ministry of Economy and Finance, National Bank of Romania, National Securities Commission, Insurance Supervision Commission, and Commission for Supervision of Private Pensions System and National Authority for Consumer Protection.

internet consultations, public disclosure and summary of comments, feedback statements, national and/or European focused consultation, the WG decided to use a very limited set of methods. These methods were chosen as being the most appropriate for the scope of the exercise, the limited resources of the WG in terms of time, human resources and expenses. The questionnaire was circulated using internet and other means of communication, while telephone calls and personal calls were used as additional methods.

3. MAIN ISSUES INVOLVED

In our Working Group (WG) view, the problem being addressed by this new regulation, **CNVM Regulation no. 14/2006**, is that in the absence of regulatory intervention, market operators would not have been able to ensure the adequate maintenance and development of the trading infrastructure, to cover for potential operational risks, as well as to provide comprehensive market information and secure market participants' confidence. In other words, there was a market failure due to insufficient supply of a public good (i.e. the supply of capital required to allow the market to function efficiently.)

In addition, we believe that this is also a case of regulatory failure as too restrictive ownership rules imposed by the previous regulation exacerbated the problem by preventing fresh capital from entering the market.

In our opinion, Regulation 14/2006 had a significantly positive impact on the **factors** listed below, which are key to address the **objectives** set by the regulator (to ensure the adequate maintenance and development of the trading infrastructure, to cover for potential operational risks, to provide comprehensive market information and to secure market participants' confidence):

- a) Market operators' capitalization;
- b) Trading and other types of commissions earned by market operators;
- c) Increase of diversity of services offered by market operators
- d) Affiliation to international professional bodies;
- e) Mergers with other market operators.

We also assumed that the market operator is the sole entity which can secure the specific objectives set by the regulator, as listed above.

In the WG's opinion, the **main objectives addressed by the new regulation** are the following:

➤ **General objectives of the regulator**

- to set and maintain the framework required for the development of regulated markets;
- to **promote confidence** in regulated markets and investments in financial instruments;
- to provide operator and investor protection against unfair, abusive and illegal practices;
- to **promote the adequate and transparent functioning** of regulated markets;
- to prevent fraud and market manipulation and ensure the integrity of regulated markets;
- to establish standards for financial strength and fair practices on regulated markets;
- to take adequate measures to prevent systemic risk on regulated markets;
- to prevent situations of asymmetric information and unfair treatment of investors and their interests.

➤ **Specific objectives**

- to set **capital standards for market operators in line with similar standards** set by supervision authorities in other Member States, that could reasonably be achieved, given the financial strength of eligible investors;
- to enable market operators to have **resources** to cope with more **demanding disclosure requirements** arising from EU regulations becoming mandatory for domestic firms after accession.

➤ **Operational objectives**

- to reach a **first prescribed capital level** by market operators before end-2006 (€750 000), **easier to attain** if the firms are permitted to decide to implement statutory changes allowing a wider range of investors;
- to ensure **compliance with European transparency requirements** in force for Romania as early as January 1st, 2007.

4. RESTATEMENT OF QUESTIONS

The questionnaire that was submitted to selected stakeholders was preceded by a brief presentation of the reasons for issuing *CNVM Regulation no. 14/2006 modifying CNVM Regulation no. 2/2006 on regulated markets and alternative trading systems*:

In our view, the problem being addressed by this regulation is that in the absence of regulatory intervention, market operators would not have been able to ensure the adequate maintenance and development of the trading

infrastructure, to cover for potential operational risks, as well as to provide comprehensive market information and secure market participants' confidence. In other words, there was a market failure due to insufficient supply of a public good (i.e. the supply of capital required to allow the market to function efficiently).

In addition, we believe that this is also a case of regulatory failure as restrictive ownership rules imposed by the old regulation exacerbated the problem by preventing fresh capital from entering the market.

Stakeholders were asked to provide answers as detailed and as reasoned as possible to the following questions:

Question 1: do you agree with us that the problem is as described above? Please explain your answer, including evidence (or suggesting the type of evidence that would be relevant) where at all possible. For example, what evidence do you think would demonstrate or in fact does demonstrate that there was a shortage of capital, and what sort of evidence suggests that capital was prevented from entering the market?

Question 2: In your opinion, what are the factors that can contribute to ensuring the adequate maintenance and development of the trading infrastructure, covering for potential operational risks, providing comprehensive market information and securing market participants' confidence?

Respondents were asked to assess the importance of some factors, as suggested below, or to pinpoint other factors:

- Market operators capitalization;
- Trading and other types of commissions earned by market operators;
- Increase of diversity of services offered by market operators;
- Affiliation to international professional bodies (e.g. World Federation of Exchanges WFE, Federation of European Securities Exchanges FESE);
- Mergers with other market operators (e.g. NYSE Euronext).

Question 3: Please estimate the importance of the above mentioned factors for securing the adequate maintenance and development of the trading infrastructure, covering for potential operational risks, providing comprehensive market information and securing market participants' confidence.

Respondents were required to rank the factors' importance as high, medium or low.

Question 4: We assume that the market operator is the only entity which can secure the adequate maintenance and development of the trading infrastructure, cover for potential operational risks, provide comprehensive market information and secure market participants' confidence. Do you think that third party

providers (e.g. professional associations, etc.) could ensure some of the above mentioned objectives? Please explain your answer, including evidence (or suggesting the type of evidence that would be relevant) where at all possible.

Question 5: The enactment of Regulation no. 14/2006 has had the following effects: narrower spreads, increased liquidity, increase in new investors, increase in trading volumes, introduction of new instruments, etc. Do you think that this is wholly due to the increase in capital held by the exchange or can other factors explain these evolutions? Please explain your answer, including evidence (or suggesting the type of evidence that would be relevant) where at all possible.

Under this question, respondents were asked:

- a) to provide details on how their firm was affected by the effects of the enactment of the new regulation before and after it was issued; and
- b) if they think that this is wholly due to the increase in capital held by the exchange or can other factors explain these evolutions. They were also asked to explain their answer, including evidence (or suggesting the type of evidence that would be relevant) where at all possible.

Question 6: Please estimate the influence of the market operators' capital increase over the mentioned capital market indicators.

Respondents were required to rank the influences of the prescribed capital increase over the listed effects as high, medium or low.

5. SUMMARY OF RESPONSES (MAIN COMMENTS)

One of the respondents remarked that the stated rationale on the baseline of Regulation No. 14/2006 is not complete. In his opinion, another reason of the issue of Regulation no. 14/2006 was to repair the lack of provisions regarding the transition procedures in the Regulation no. 2/2006 with respect to the means to transform the organization of an "exchange company" to a market operator (provisions regarding the type of shareholders with voting rights, and the minimum capital level of the market operator).

This remark is reasonable, yet that was not one of the rationales of the new regulation. Indeed, according to previous legislation, commodity exchanges could establish and manage derivatives markets, too. Entities that were authorized to establish and operate commodity exchanges (regulated by CNVM under Government Emergency Ordinance 27/2002) were the so-called *exchange companies* ("societăți de bursă") and had to comply with specific rules. Under

the new regulations in force, they had to become market operators, in order to be authorized to establish derivatives (as financial instruments) regulated markets. This was the case for BMFM Sibiu S.A. - the other market operator, Bucharest Stock Exchange (BVB S.A.) had followed a different path, having never been an exchange company, but a public institution, later on being corporatised by law as a joint stock company owned by investment firms. However, when the new regulation was issued, the transition period was over and both entities were authorized as Market Operators.

The respondent further remarked that Regulation no. 2/2006 was prepared taking into account the organization of the market operator, on the model of the Bucharest Stock Exchange, without considering that the Sibiu Monetary-Financial and Commodities Exchange (BMFMS) was organized as an "exchange company". The restrictions regarding the status and structure of the shareholders of a market operator are necessary, taking into consideration the fact that it is the General Assembly of the Shareholders that decides on the operations of the entity. He also admitted that Regulation no 14/2006 had effects only on the Sibiu Monetary-Financial and Commodities Exchange because the Bucharest Stock Exchange already complied with the capital requirements of the Regulation no 2/2006.

In our opinion, Regulation 14/2006 had a significantly positive impact on the factors listed under Question 2, which are key to address the objectives set by the regulator (to ensure the adequate maintenance and development of the trading infrastructure, to cover for potential operational risks, to provide comprehensive market information and to secure market participants' confidence).

Stakeholders estimate that market operators' capitalization is not very important to achieve the objectives above indicated. Moreover, also market operators' affiliation to international professional bodies is not rated high.

When asked if the market operator is the only entity which can secure the adequate maintenance and development of the trading infrastructure, cover for potential operational risks, provide comprehensive market information and secure market participants' confidence, Stakeholders agreed that the market operator cannot be the only entity but rather that other players should have a role (e.g. post-trading operators, such as CRC - Romanian Clearing House Sibiu.)

This is true, yet it leads to another story – there are very demanding capital requirements for post trading entities, too, and they are the object of other regulations.

Stakeholders asked to assess the impact of the regulation on narrower spreads, increased liquidity, increase in number of new investors, increase in trading

volumes, and introduction of new financial instruments, answered it had a low influence with regard to all the above factors, except the number of new intermediaries.

Given the three options considered, as summarized in the table below, stakeholders were asked to help with their own estimate of costs for each of the options.

Options	Main policy drivers for market operators		
	Shareholder composition	Majority voting rights	Equity level
Option 1	No single shareholder (whether an intermediary or not) may hold more than 5% (as provided by Law)	With intermediaries, or with any investors, if so allowed by Articles of Incorporation (that could be modified to include such a provision)	Gradual and mandatory equity increase (Eur 750,000 by 2006, Eur 2Mln by 2007, Eur 5 Mln by 2008)
Option 2 (do nothing)	No single shareholder (whether an intermediary or not) may hold more than 5% (as provided by Law)	With intermediaries	EUR 5 mln by the end of 2007 mandatory
Option 3	No single shareholder (whether an intermediary or not) may hold more than 5% (as provided by Law)	With intermediaries, or with any investors, if so allowed by Articles of Incorporation (that could be modified to include such a provision)	Gradual and mandatory approach based on 2 yearly steps (Eur 750,000 by 2006, Eur 2 Mln by 2007)

We summarize hereafter their cost assessments for the options:

A) Quantitative costs

Stakeholders have identified, also providing quantitative assessment, one-off and ongoing compliance costs stemming from option 1. Costs for meeting equity compliance are also foreseen for this option.

Stakeholders' feedback for the do-nothing option (no. 2) says that some one-off compliance costs may be incurred whilst neither ongoing compliance costs nor other kinds of costs are expected on a significant basis.

When assessing option 3, stakeholders interviewed draw the attention on their belief of incurring compliance costs (both one-off and ongoing) as well as costs for meeting equity compliance. Quantification of such costs was also provided.

B) Qualitative costs

For all three options, significant qualitative costs are not foreseen.

C) Market impact

C.1. Trading volumes

Market participants agree that options no. 1 and no. 3 would have an impact on trading volumes at medium to low level, while option no. 2 would generate high impact on trading volumes.

C.2. Quality/quantity/variety of goods and services

Market participants agree that options no. 1 and no. 3 would have such an impact at medium-to-low level, while option no. 2 would generate high impact on quality/quantity/variety of goods and services.

C.3. Product innovation

Stakeholders assess that option no. 1 would generate a medium-to-low impact on product innovation, while option no. 2 would generate high impact, and option no. 3 would generate a low impact on product innovation.

Competition

According to stakeholders, option no. 1 affects the competition by discouraging the set up of a new market operator. Apparently one of the former *Exchange Companies*, the Romanian Commodities Exchange (BRM) stopped the procedures to turn from an exchange company in a market operator, due to the setting of the capital level for a market operator at 5 mil EUR, by Regulation no. 2/2006. Regulation no. 14/2006 set new capital increase terms only for the Sibiu Monetary-Financial and Commodities Exchange, because the Bucharest Stock Exchange had already exceeded this capital level.

For options no. 2 and no. 3 stakeholders interviewed do not envisage competition-related issues.

D) Benefits section

While assessing option no. 1, respondents say that some benefit might arise for the market operator rather than for intermediaries. Moreover, this option allows the capital increase of the market operator to be produced (in 2008) after the capital increase of the intermediaries.

Stakeholders interviewed do not think option no. 2 can bring benefits.

In our respondents' view, option no. 3 allows the outline of an intermediary step in the capital increase of the market operator.

As additional input that would need to be discussed with more attention in terms of cost-benefit-analysis it is worth mentioning that if CNVM had not issued Regulation 14/2006, Sibiu Commodity Exchange BMFMS would have not complied with the capital requirements and would have lost its market operator authorization, and as a consequence should have changed its line of business, thus resulting in a temporary closing of an important financial instruments regulated national market – the derivatives market.

6. CONCLUSIONS

Under this heading we are trying point out some of the main conclusions shared by questioned stakeholders and by WG members.

It is generally agreed that **Option 2** would be detrimental, since it would mean the loss of one of the two Market Operators and subsequently a temporary closing of the domestic derivatives market, which already has a tradition and an infrastructure. This infrastructure (post-trading institution, CRC) would have been adversely affected, too.

Option 1 is still seen as better than **Options 2 and 3**, although it involves some costs, and its market impact is perceived as rather low in terms of trading volumes, quality, quantity and variety of goods and services, product innovation, and high only as regards competition. Anyway, the aim of ensuring the survival of a Market Operator was of essence to the regulator.

Finally, given these, the WG supports the decision of issuing a new regulation according to option no. 1 – actually, this happened in fact.

However, this exercise is giving us food for thought, since we found out that stakeholders do not always share regulators' views and surprising conclusions may arise from a consultation, possibly leading to a change of policies, with the aim of getting an optimized result. Had regulators not been pressed by time, an

impact assessment could have helped in many instances and we believe it should be used whenever possible.