

CAPITAL Market

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Principles of corporate governance become a more frequent topic for discussion



Experts of the Organization for Economic Cooperation and Development (OECD) recommend the joint stock companies of Moldova to implement the principles of corporate governance so as to avoid the multiple problems resulting from defective management. The private companies are ready to use these principles, being also constrained by investors' demands. But the state companies hesitate doing it.

THE ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD)

The OECD is an international organization that provides a cooperation framework at intergovernmental level that enables to assess public policies and to compare the progress made and to identify common problems in order to deal with the economic and other types of challenges as well as good practices with a view to improving the policies pursued at internal and international levels.

For over 50 years, by its global role in promoting sustainable development, the OECD collects data, monitors trends, studies the economic influences and forecasts economic development models. The OECD ensures the activity of over 250 working groups and committees and makes effort to help governments to use the opportunities of globalization so as to foster prosperity by effective governance, economic growth, trade and investment, economic stability, technology and cooperation aimed at ensuring development. The expertise recognized at world level and its inclusion in the world economy's functioning system certifies the validity and value of the organization's work.

EURASIA WORKING GROUP ON CORPORATE GOVERNANCE

"Even if the Republic of Moldova is not a member of the OECD, this organization offers other states the possibility of cooperating within different working groups set up within the OECD's bodies. The cooperation of the National Financial Market Commission (CNPF) within the Eurasia working group is a first experience and will contribute to the development of policies aimed at implementing the principles of corporate governance. The CNPF is interested in taking part in exchange of ideas in areas of major interest such as the development of the capital market and in permanently assessing the results of the implementation of these policies in the Republic of Moldova. The implementation of the recommendations as a result of assessments and communication on good practices will contribute to an increase in the professional ability of the CNPF specialists to work out and implement policies in the field," said Aurica Doina, a member of the CNPF Administration Board.

In continuation, Aurica Doina said that "the organization, in concert with representatives of the OECD, and holding in Chisinau

of a meeting of the Eurasia working group helped to bring together experienced specialists from international capital markets, representatives of the national public authorities and professional participants in the area of securities and to create an active platform for discussion on the principles of corporate governance and their implementation. Within the discussions, there were identified a number of problems, including the need to restore confidence in the capital market by improving the mechanisms that enable it to work. The promotion of solutions for improving and strengthening the national fiscal policies so as to develop the capital market remains a priority".

MINORITY SHAREHOLDERS ARE MANY IN NUMBER

The necessity and method of implementing the principles of corporate governance and their impact on the capital market were discussed in an international conference that was held in Chisinau at the start of June. The foreign experts said the situation on the capital market of Moldova is not unique. It is rather characteristic for the Eurasian countries. That's why the OECD concentrated its attention on them.

OECD policy expert Daniel Blume said: "In the process of cor-

porate governance, emphasis should be laid on the transparency of companies. Equal conditions should be created for the majority shareholders and the minority ones. This will help improve performance and will foster economic growth. For the Republic of Moldova, we make recommendations that include the improvement of transparency of the conditions in which decisions are taken in the board of directors and of the market strategy so that the investors are sure that the companies achieve good results".

Attending the event, the head of the parliamentary commission on economy, budget and finance Veaceslav Ionita explained that the capital market of Moldova faces a serious challenge: how to protect the minority shareholders and the majority shareholders of joint stock companies. "As a result of the privatization process, there appeared joint stock companies where 90% of the shares are owned by one person or an affiliated group of persons, while the rest 10% are distributed among a large number of shareholders. Thus, there are about 170,000 minority shareholders. It is hard to take decisions at political level. Thus, there should be adopted and implemented measures and principles of corporate governance," said Ionita. He also said that only 10% of the companies that report to CNPF pay dividends to shareholders. At the same time, it is hard to determine the real value of a share so that any mechanism used to determine the price of these shares is an equitable one. The prices are regulated with the aim of offering the minority shareholders the possibility of receiving the equivalent value of shares when they withdraw from the company.

On the other hand, the president of the Stock Exchange Cornel Dodu said the state's role in the process of corporate governance is rather great, but the state must take into account the needs of businesses. According to Dodu, though the Law on Joint Stock Companies obliges the majority shareholders to purchase the shares of the minority ones, if the majority shareholder does not want to do this, he will find a possibility of avoiding it. "The state should intervene here and oblige the companies to ensure greater transparency, using the principles of corporate governance. The dividends are not paid owing to the unwillingness to pay taxes. In order to avoid taxation and the payment of dividends, the joint stock companies channel the capital to raw material and production, obtaining thus greater amortization. Thus, they show that they do not have resources to pay dividends," explained the president of the Stock Exchange. Cornel Dodu stressed that conditions should be created for the joint stock companies to be in listing and to be quoted on the Stock Exchange.

Currently, under the Tax Code, the joint stock companies that pay dividends to their shareholders are obliged to retain and pay a tax of 6% of the dividends into the budget, including in the form of stocks and shares, except for those afferent to the undistributed profit made in the fiscal period between 2008 and 2011 inclusive. If dividends are paid, including in the form of stocks and shares afferent to the undistributed profit made in the fiscal period between 2008 and 2011 inclusive, the joint stock companies are obliged to retain and pay a tax of 15% of the dividends. The

given provisions also apply in the case of dividends paid preliminarily during the fiscal period.

The stimulation of direct investment flows to the country's economy can be generated by efficient fiscal mechanisms and leverage. A balanced fiscal policy enables the economic entities to develop the businesses, to increase the number of workplaces, contributing indirectly to the supplementation of the consolidated budget. In order to solve the problems concerning the implementation of the fiscal policies on the securities market, including those afferent to the dividends, the CNPF drafted a bill and submitted it to the Ministry of Finance. In order to ensure greater attractiveness of investment in securities and their circulation on a regulated market, the bill suggests that the dividends paid to joint stock companies should be included in nontaxable sources of income. Also, in order to ensure new alternative sources for financing economic entities and developing the capital market by diversifying the financial instruments, provisions are proposed to the Tax Code, which define the interest on bonds issued by joint stock companies and local and central public authorities as nontaxable sources of income. It is suggested that the joint stock companies whose shares are included in the listing should be exempted from paying the tax.

According to the provisions of Article 18 of the Tax Code, the taxable sources of income include the rise in capital (following the sale/purchase, including on the stock exchange market, of shares issued by joint stock companies). In order to implement the provisions of Article 90 of the Tax Code, the professional participants in the securities market retain preliminarily, as a part of the tax, 7% of the value of the transaction performed with securities in favor of the private individual, without knowing whether a rise in the capital was recorded or not at the moment of the transaction. As it is known, most of the people in Moldova became shareholders of joint stock companies as a result of investing patrimonial bonds in the privatization process. The analysis of the statistics of the stock exchange and the over-the-counter market shows that the shares are sold by the holders in most of the cases at lower prices than the nominal value or the purchase price. Thus, a rise in capital is not witnessed in such cases. At the same time, the professional participants in the securities market are obliged to retain preliminarily, as a part of the tax, 7% of the transaction's value. It is suggested examining the opportunity of including provisions concerning tax concessions for investments into the Tax Code. Thus, provisions are suggested to exempt from the preliminary retention of payments made in favor of the private individual on incomes obtained in the form of capital rise.

Corporate governance expert Bistra Boeva said that Bulgaria also faced such problems and they were quickly solved when the taxation of dividends was abandoned. Moreover, the Bulgarian capital market opened immediately and became much more transparent as the income tax rate for private individuals and legal entities was equaled at 10%.

In the same connection, Konstantin Saroyan, a representative of the Armenian Stock Exchange NASDAQ OMX, said the joint stock

companies of Armenia are obliged to announce the dividends once in three years and are not taxed.

SPECIFIC FEATURE OF MARKET PLAYS AN IMPORTANT ROLE

According to OECD experts, the capital markets in the Eurasian countries are stagnant in development owing to the insufficient capitalization. Though they reported a 10% growth last year, they need access to finances, capital raises and improvement of company management.

Bistra Boeva said that the most important detail in the implementation of the principles of corporate governance is the specific feature of the development of the national markets. The relations between shareholders and the regulations laid down, including by the corporate governance act, is important on one condition – the specific feature of the development of the national markets should not be infringed. The Eurasian area especially concentrates joint stock companies that need certain mandatory regulations, “said Boeva.

OECD officer for corporate governance operations Merima Zupcevic Buzadzic said that in Bosnia for example, the capital market develops slowly, mainly because 90% of the joint stock companies include a state holding. The minority shareholders in this country are constrained in decisions because there is no legal base for protecting their rights.

The most important recommendations of the OECD concerning the implementation and application of the principles of corporate governance concern the strengthening of the role of the regulatory institutions, observance of the rights of all the shareholders, creation of favorable conditions for the companies to be included in the listing on the stock exchange, attraction of capital and formation of liquidities for a better development of the joint stock companies, development of corporate bonds and training of participants.

It should be noted that in Moldova there are registered about 3,000 joint stock companies, less than half of them being viable. Respectively, almost 700 of them represent possible adherents to the corporate governance act, as provided by Article 2 of the Law on Joint Stock Companies. The given article regulates the activity of companies that have a minimum capital of 500,000 lei and are managed by 50 and more shareholders as well as those of public interest.

The Corporate Governance Code approved by the National Financial Market Commission (CNPF) in 2007 is now the only document of the kind and is based on the OECD principles. The most important provisions defined by this organization refer to shareholders' rights as regards corporate governance, namely the right to take part and vote in the general assembly of shareholders, the right to obtain relevant and sufficient information about the company in time and regularly, the right to choose and dismiss members of the Administration Board, and the approval of extraordinary transactions. The successful implementation of the principles of corporate governance depends mainly on the interest of the minority shareholders. They should be the first to be interested in knowing, promoting and ensuring them.

Lilia PLATON

Iurie Filip: “Effective annual interest will enable the clients to know exactly how much they will have to pay in the end”

The specifying of the annual effective interest rate in the lending or loan contracts is an important provision of the draft Law on Lending Contracts for Consumers. This change will have an impact both on the debtor and the creditor. The National Financial Market Commission (CNPF) was one of the institutions that took part in the formulation of this bill. Iurie Filip, a member of the CNPF Administration Board, provided details concerning the implementation of this law.

– Mister Iurie Filip, what is the importance of such a law for the financial institutions that provide lending services and, implicitly, for their clients?

– There are a number of problems in the area of bank and nonbank loans and the way of providing this type of financial services by commercial banks and the nonbanking sector owing to the legal shortcomings because Moldova until now didn't have a law that would regulate especially the consumption loans. The problems refer mainly to the different and non-unified methods of informing the consumer about the contract conditions and the lack of transparent and comparable regulations as regards the method of determining the interest rate.

If the law is adopted by Parliament, it will oblige the banking and nonbanking financial institutions to ensure greater transparency in their lending activity and will make the clients to seek greater protection. In other words, it will fill the gap, laying down clear, univocal and equitable requirements that would reflect and ensure the consumer's protection when taking out loans, including consumption ones.

The drafting of such a bill was based on two factors. On the one hand, it is the realities on the market of financial services, both banking and non banking. On the other hand, there are certain needs deriving from the general policy of integrating into the communitarian area as regards the legislation and the quality of the financial services. In fact, the bill was inspired by European practices and adjusted to the European directives in this field.

– Why do problems as regards loans for consumers appear? Is it because the people are poorly informed or for other reasons?

– The people now started to use the loans as financial resources for solving current consumption or investment problems. This sign of financial activism is positive. But, with the rise in the volume of loans, some of the problems also increase in number. First of all, they appear because the people have rather poor financial experience and knowledge. In such conditions, the providers of financial services are tempted to use the situation for their own benefit so as to obtain additional profit or can have a not quite loyal behavior towards the clients. A relevant example is the difficult text of the contracts and lending offers. A person without knowledge in the field encounters difficulties in determining the total costs of the financial product that they need. Thus, there is a risk that they will become overindebted without realizing this. Furthermore, they cannot compare institutions' offers.

The comparison is very important, especially because we already



got used to analyzing and comparing offers when we want to purchase a particular service or thing. In the case of financial services, the situation is much more difficult. In most of the cases, the client takes a decision based on the interest rate on the loan. But, this is not the final cost as there are other commissions and related payments and penalties. The client often signs the contract without perceiving its essence and is to pay twice more than they imagined. Thus, the client is deprived of the possibility of comparing offers so as to establish if it is more convenient to take out a loan from a bank or from a microfinance organization for example.

– You mentioned the real cost of the loan or credit. I know that that draft law envisions including the effective interest in the consumption loan contracts. How can this thing affect the providers of financial services?

– Indeed, the effective annual interest will enable the clients to know exactly how much they will have to pay in the end or what is the total cost of the loan and if they are able to repay the loan. I want to warn about an important detail. The law does not aim to set a cap on the interest rate on the loan. This is against the spirit of market economy. Nobody sets a price limit on a merchandise or service. The goal is only to enable the potential clients to compare the offers. That's why it is proposed a common algorithm for calculating the effective interest rate on loans so that there is an accessible pre-contract procedure. I think that this measure will make the activity of financial institutions much more transparent and will establish loyal competition. Those financial marketing instruments that will be in sight will be viable. After their implementation, there will appear a competition of interest rates, not yet of the practices to camouflage commissions and afferent payments and costs.

We do not think that this bill will have a complicated impact or will require additional financial efforts from the participants in the market. They will only be put in the situation to change the way of organizing work with the clients, especially.

– If the law is adopted, what is the probability that the problematic aspects of the users of loans or credits will be fully excluded?

– The principles of market economy say that one cannot invent regulations that would guarantee that somebody would not try to

resort to cheating. We now speak about certain trends on the lending market and the goal of this law is to create a framework that will enable to homogenize the situation with increased probability. We want the irregularities to be only exceptions.

– For the law to work efficiently there should be institutions that would supervise its implementation. Which institutions will have such duties?

– It's clear that the National Bank of Moldova will monitor and ensure the observance of the law the banking sector. The situation in the nonbanking financial sector is more difficult for the simple reason that the activity of this sector is not supervised at least by the CNPF, though it forms part of the nonbanking financial market, as stipulated by the Law No. 35 of March 2011, by which the strategy for developing the nonbanking financial market was approved. Thus, the CNPF has only the power to monitor the nonbanking lending system, but not of the whole sector. We should not forget that the sector includes microfinance organizations and leasing companies that are not regulated or monitored by a state institution. The bill on lending loans for consumers makes reference to the services provided by leasing companies.

If the CNPF is not named responsible for the observance of this law by the institutions of the nonbanking financial sector, it will be natural for it to have certain instruments of influence that it does not have at the moment. This thing was to be done if the Law on Nonbanking Financial Organizations, which was put forward a year and a half ago, was adopted. This law solved also the problem of leasing companies because this type of activity was also introduced. On the other hand, it would create those instruments by which the CNPF could influence the situation on the market. The law was submitted to Parliament for examination last February.

– What happens if the Law on Lending Contracts for Consumers takes effect before the Law on Nonbanking Financial Organizations?

– It's simple. The CNPF will not have the necessary efficiency, while its organizational capacity will be minimal as regards the implementation and supervision of the application of this law. The institutional effort of the state or the bodies that will be empowered with control powers, in this case is very great. Furthermore, if the CNPF is empowered to

ensure the observance of this law by the nonbanking financial sector, major involvement will be necessary. This means logistic effort, examination of contracts, etc. Currently, the CNPF does not envision such costs as it is a self-managing institution, while the economic entities of this sector do not contribute to the formation of the commission's budget, i. e. they do not pay regulation taxes because they are only monitored.

A regulation tax was to be included in the Law on the CNPF if the Law on Nonbanking Financial Organizations was passed as this law would establish a regime of supervision as a form of authorizing the activity. Currently, the activity of these organizations is not licensed or authorized. Any Ltd that includes this kind of activity in its statutes can treat the provisions concerning loans and the obligation to inform the CNPF and to present the statistic report annually to its own advantage. The new law instituted a preliminary authorization form and imposes requirements towards the own capital of these organizations.

A danger is that this bill can be passed as it is. In the current form, it stipulates that the responsibility for the implementation of the law in the nonbanking financial sector is borne by the CNPF. But, if the other two laws are not adopted, the CNPF will be unable to influence and we will reach unwanted and dangerous deadlock as a very important and necessary law will be implemented in the banking sector and not implemented in the nonbanking sector.

I think that simultaneously with the voting of the Law on Lending Contracts for Consumers, relevant powers should be given to the body that would be responsible for the observance of this law, in this case the CNPF. If eventually the state changes its policy and gives such powers for example to the National Consumer Protection Agency, all the related laws will have to be amended so as not to happen that everyone is risible for this, but nobody actually does it. Currently, the law says that the CNPF monitors this sector. The petitions come to us, but we do not have instruments to influence the situation. Nothing will change if only certain facts are established. The National Bank of Moldova for example has leverage to influence the banking sector and can withdraw the license when irregularities are identified. If such cases are determined, the CNPF can only inform the investigation bodies.

Lilia PLATON