



COMISIA DE SUPRAVEGHERE A ASIGURĂRILOR



CNVM Regulation no. 14/2006 modifying CNVM Regulation no. 2/2006 on regulated markets and alternative trading systems

Policy Recommendations

Stakeholders consulted

Market operator

Market operator shareholder

Team Composition

Participants	Authority
Mr. Albert Schreiber	National Securities Commission
Ms. Camelia Oprea	National Securities Commission
Ms. Antoaneta Alexe	National Bank of Romania
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Bucharest, October 2007

This document is a report summarizing feedback provided by consulted stakeholders and policy recommendations for the regulator, arising from a comparison of options and an analysis of their impacts. The report was drawn up by a joint working group (RIA WG) consisting of representatives of authorities involved in this exercise. Though RIA WG members have worked in good faith and best efforts were made to analyze selected potential stakeholders opinions, this document shall not be construed as a real IA report, and its authors have no liabilities whatsoever deriving from it.

EXECUTIVE SUMMARY

The World Bank administered *Convergence Program* has organized in 2007 in Romania a knowledge transfer and capacity building program, designed to help participants from various regulation and supervision authorities to get acquainted with the basics of Regulatory Impact Assessment (RIA).

After an introductory session, where presentations were made by experienced speakers from EU authorities and their consultants, participants joined in Working Groups (WG) and they took part in a training exercise, designed to develop basic skills in undertaking a RIA.

One of the WGs, consisting of representatives from Prime Minister's Office, Ministry of Economy and Finance, National Bank of Romania, National Securities Commission, Insurance Supervision Commission, Commission for Supervision of Private Pensions System and National Authority for Consumer Protection has chosen to set up an *ex-post* RIA on an existing piece of legislation, namely **CNVM Regulation no. 14/2006 modifying CNVM Regulation no. 2/2006 on regulated markets and alternative trading systems**. Some categories of key stakeholders were identified as being affected by this regulation, then they were contacted and a consultation was organized (written questionnaire and face-to face interviews.)

Under the guidance of experts from the World Bank Convergence Programme and facilitators, the WG performed the main steps recommended by the *Impact Assessment Guidelines for EU Level 3 Committees* jointly issued by CESR, CEBS and CEIOPS in May 2007, drafting the suitable documents related to each step.

These documents included:

- a consultation document;
- a summary of consultation feedback; and finally
- a policy recommendations document.

The present document is a summary of all the activities described, and it ends with a comparison of the proposed options and policy recommendations resulting from an analysis of qualitative and quantitative impact of each of them.

SECTION I – PROCEDURAL ISSUES AND CONSULTATION OF INTERESTED PARTIES

This document is the outcome of an Impact Assessment (IA) knowledge transfer and capacity building program organized by the World Bank administered *Convergence Program*. The participants of the Working Group are representatives of some Romanian authorities involved in regulation of financial markets issues (Prime Minister's Office, Ministry of Economy and Finance, National Bank of Romania, National Securities Commission, Insurance Supervision Commission, Commission for Supervision of Private Pensions System and National Authority for Consumer Protection).

The IA training exercise was undertaking a retrospective IA – *ex-post RIA* - on an existing piece of legislation, namely **CNVM Regulation no. 14/2006 modifying CNVM Regulation no. 2/2006 on regulated markets and alternative trading systems**. After discussions some categories of key stakeholders were identified as being affected by this piece of legislation.

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 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 of it, thus recognizing the fact that in a "live" IA exercise different policy responses could be considered to address the same policy problem.

Stakeholders were also asked 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.

After reception of answers from stakeholders, a summary of questionnaire results was drafted, then these were processed into a consultation document. The consultation document, including more in-depth issues that were raised

during the meeting with stakeholders, became the basis for drafting a summary of consultation feedback, which was used in its turn as the underlying evidence for this report, summarizing all findings gathered during the process.

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 internet consultations, public disclosure and summary of comments, feedback statements, national and/or European focused consultation, the WG was forced 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.

The report was drafted with a view to follow the format as prescribed by the *Guidelines* and their relevant recommendations; however, given the limited resources available to the WG, it is but an outline of what should be such a real report. The WG acknowledges the valuable support and guidance received during the whole process from SPI-Convergence, through experts and facilitator who were always available for help and advice.

SECTION II – PROBLEM IDENTIFICATION

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, capital market operators (as defined by MiFID) 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 believed that this was 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, the previous regulation, Regulation No. 14/2006, had a significantly positive impact on the **factors** listed below, which are key to address the **objectives** set by the capital market 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 could secure the specific objectives set by the regulator, as listed above.

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*.

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.

Feedback from consulted stakeholders on this specific issue:

This reasoning was generally supported by respondents, however one of the respondents remarked that the stated rationale on the baseline of Regulation No. 14/2006 was 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).

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 (BVB), 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, while intermediaries are those entitled to make the best decisions regarding the governance of the market operator. He also noted that Regulation no 14/2006 had effects only on BMFMS because BVB already complied with the capital requirements of the Regulation no 2/2006.

Our response was that the respondent's 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 BMFMS, while the other market operator, BVB 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. When the new regulation was issued, the transition period was over and both entities were authorized as Market Operators.

SECTION III – OBJECTIVES

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

- **General objectives of the regulating authority** (as stated by law)
 - 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.

Feedback from consulted stakeholders on that specific issue

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

Our response was that in our opinion, the new regulation, 14/2006 had a significantly positive impact on the factors listed under *Problem identification*, 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.

SECTION IV – POLICY OPTIONS

Three policy options were taken into consideration, one of them being the option actually chosen by the regulator in 2006 (option no. 1), while option no. 2 was the "do-nothing" option and the option no. 3 was a version of option no. 1, whereby the final capital threshold was lower, yet it had to be reached in two years. Both active options allowed a possible change in the majority voting

rights, if shareholders decided so and included such a provision in the articles of incorporation of the company.

The options are summarized in the table below:

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)

SECTION V – ANALYSIS OF QUALITATIVE AND QUANTITATIVE IMPACTS

A summary of the impact of the three options considered, as assessed by stakeholders and accepted by the WG after discussions and analysis is given below. Costs were divided into subcategories, as this was an easier task for the WG, and they are supported mostly by the regulated firms. We could collect no

evidence from consumers as to their prospective costs derived from policy options considered, and this is a significant deficiency of our work that could be mitigated by more extensive consultation. Even though some figures were provided by stakeholders, we chose to keep them only in our draft papers, since they are quite dispersed and we found it difficult to check and match them. Possible side effects and unintended consequences of the policy options should have been considered, too, but we couldn't go into more depth and such issues were left for a more advanced exercise.

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 our 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.

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.

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, a majority of questioned stakeholders answered 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 a different matter – there are very demanding capital requirements for post trading entities, too, and these 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.

Feedback from consulted stakeholders on impact over competition

While assessing competition impact of option no. 1, a stakeholder said that, in his opinion, one of the former *Exchange Companies*, the Romanian Commodities Exchange (BRM) stopped the procedures to turn from an *exchange company* into a market operator, due to the setting of the capital level for a market operator at 5 mil EUR, by Regulation no. 2/2006.

Actually, Regulation no. 14/2006 set new capital increase terms only for BMFMS, because BVB had already exceeded this capital level.

Our response

In our view, BRM temporarily gave up getting authorized as a market operator not because of the mandatory capital level, but since it saw better business opportunities in a different area, namely commodity auctions and subsequently getting in line with other legal provisions. The second remark seems reasonable, however the regulation was not targeted to a certain entity and compliance was required from all operators.

SECTION VI – COMPARISON OF THE OPTIONS

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

As additional input that would need to be scrutinized with more attention in terms of cost-benefit-analysis it is worth noticing that, had Regulation 14/2006 not been issued, BMFMS would have not complied with the capital requirements of Regulation 2/2006 and would have lost its market operator authorization, and as a consequence it should have changed its line of business, thus resulting in a temporary closing of an important financial instruments regulated national market – the derivatives market.

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.

We deemed as unfeasible a quantitative evaluation of the options considered, mainly because of the lack of data regarding possible costs. Though a certain comparison of costs was done, options were mainly compared in a qualitative manner, in terms of benefits, and as stated above, the benefit of keeping afloat a valuable market operator was paramount.

SECTION VII – POLICY RECOMMENDATIONS (OUTCOME OF COMPARISONS; CONCLUSIONS/RECOMMENDATIONS)

Having in mind the policy options listed under Section IV, the relevant impact analysis described under Section V, and the subsequent comparison of the options included in Section VI, the WG supports the decision of issuing a new regulation according to **option no. 1** – actually, it happened in fact, this being an ex-post impact assessment.

In this particular case, we may consider that the policy proposal (option no. 1) was properly implemented and achieved its objectives. Its effects were not obvious at the outset, and it should have been kept under review. The review resulting in the present RIA confirms that the option adopted was adequate.

However, this exercise is at least resulting in a warning signal, 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 applied whenever possible.