
A REVIEW OF THE CORPORATE GOVERNANCE FRAMEWORK APPLIED TO ROMANIAN INVESTMENT FIRMS

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Abstract: Romanian investment firms have the status of public interest entities authorized, regulated and supervised by a public authority (FSA) and the scope of their commercial business relates to financial investment services offered for investors. Consequently, we believe that the general principles of corporate governance as defined by the OECD (2004) is the essential foundation to identify and implement effective corporate governance model by investment firms in Romania. This paper focuses on best practices of corporate governance recommended for European investment firms, as adapted from "The EU Corporate Governance Framework - Green Paper" issued by the European Commission in 2011. However, our attention is directed to the views and recommendations of the European Securities and Markets (ESMA) on best practices, with respect to some controversy or limitations arising from the implementation of the EU Corporate Governance Framework. The main objective of our research is to process and adapt these results to the Romanian financial intermediation industry, where investment firms are subject to our empirical investigations.

Keywords: investment firms, corporate governance, financial investment services, best practice, compliance.

1 Introduction

The OECD Principles of Corporate Governance have become “an international benchmark for policy makers, investors, corporations and other stakeholders worldwide” and “have provided specific guidance for legislative and regulatory initiatives [...] as one of the 12 key standards for sound financial systems”. “Policy makers are now aware of the contribution good corporate governance makes to financial market stability, investment and economic growth. Companies better understand how good corporate governance contributes to their competitiveness. Investors, especially collective investment institutions and pension funds acting in a fiduciary capacity, realize they have a role to play in ensuring good corporate governance practices, thereby underpinning the value of their investments. The Principles are a living instrument offering non-binding standards and good practices as well as guidance on implementation, which can be adapted to the specific circumstances of individual countries and regions.¹” Based on these assumptions we focused our research on assessing the general corporate governance framework applied for Romanian investment

¹ OECD Principles of Corporate Governance, OECD Publications Services, Paris, France, 2004, pp. 3 - 4.

firms, in connection with: (i) the rules and practices announced by OECD Principles, and (ii) the EU Corporate Governance Framework.

2 Research methodology

The main objective of this paper is to obtain sufficient and adequate knowledge regarding the Romanian legislative and regulatory framework applied to investment firms, in order to assess the compliance level with international corporate governance standards and practices. Relevant research activities consisted in: (i) reviewing international literature on the matter of corporate governance; (ii) analyzing OECD Corporate Governance Principles; (iii) examining relevant deficiencies and barriers in implementing EU Corporate Governance Framework; (iv) reviewing national laws and regulations that govern the activities of investment firms; (v) assessing the national framework's level of harmonization with international corporate governance principles and European best practices.

3 A critical review of the EU Corporate Governance Framework

As explained in the EU Corporate Governance Framework² *“major developments in capital markets in recent decades, including innovative products and technical change, mostly focused on the trading function of the capital markets and facilitated faster and more efficient trading. [...] At the same time, intermediation of investments has increased, amplifying the importance of the agency relationship between long-term investors and their asset managers”*. We expect therefore a major interest in developing and enforcing regulations and internal procedures to enhance efficiency of corporate governance structures within investment firms, as regard sensitive areas, such are: safekeeping of client assets, segregation of funds, IT compliance, financial reporting integrity, remuneration practices and board of directors' responsibilities.

Surveys conducted³ among listed companies and investors put in value the “Comply or Explain⁴” statement as an effective instrument to assess compliance with corporate governance principles and best practices, widely supported by regulators, companies and investors. This statement is designed to make entities more responsible by encouraging them to consider whether their corporate governance practices are appropriate and by offering them a target to meet. However, the study we referred above showed that in over 60% of cases where companies chose not to apply recommendations, they did not provide sufficient explanations. The entities subject to empirical investigations simply stated that they had departed from a recommendation, without any detailed explanation, or provided only a general or limited explanation. Therefore, we agree that further improvement could be achieved by introducing more detailed requirements for the information to be published by companies departing from the recommendations. These requirements should be clear and

² Green Paper - The EU Corporate Governance Framework, European Commission, Brussels, 2011, pp. 12 - 19.

³ *Study on Monitoring and Enforcement practices in Corporate Governance in the Member States*, available at http://ec.europa.eu/internal_market/company/ecgforum/studies_en.htm

⁴ Under this “Comply or Explain” statement, an entity which chooses to depart from a corporate governance code recommendation must provide detailed, specific and concrete reasons for such a departure.

precise, since many of the present difficulties are due to misunderstanding of the nature of the explanations required.

The Green Paper refers also to a better monitoring of corporate governance, admitting that in most Member States, the responsibility for enforcing the obligation to publish corporate governance statements is left to investors who, depending on the culture and traditions in their Member State, often take little actions. In most cases, financial market authorities have only a formal role of verifying whether the corporate governance statements have been published, or the completeness of information provided (in particular, the explanations). The “Comply or Explain” statement could be more effective provided that securities regulators, stock exchanges or other authorities were authorized to check whether available information is sufficiently comprehensive and adequate, without interfering with the content of the information disclosed or making business judgments on the solutions chosen by the entity. The authorities could make the monitoring results publicly available in order to highlight best practices and to push companies towards more complete transparency. The use of formal sanctions in the most serious cases of non-compliance could also be envisaged.

The European Securities and Markets Authority (ESMA)⁵ has considered the EU Corporate Governance Framework (the Green Paper) and concluded that many of the questions raised are within the remit of corporate law, rather than securities law. Consequently, it was established that ESMA and national securities regulators have little or no jurisdiction on matters regarding corporate governance. However, in pursuing its objectives, ESMA has enrolled to contribute its views on the corporate governance issues raised in the Green Paper, based on its and European competent authorities’ knowledge and experience as securities regulators. ESMA agreed that the corporate governance framework in Europe varies significantly between Member States depending upon the interaction between company law, listing rules and codes. Consequently, codes on their own cannot work without regulation and the challenge is to obtain the right mix of the various options available. European securities regulators recognize that there could be value in developing a common set of minimum corporate governance principles for listed companies across the EU. Member States would be at liberty to implement more stringent requirements, where appropriate⁶.

A summary description of ESMA’s responses to the questions emerging from the EU Green Paper on corporate governance framework is further presented:

- Promote uniform application of corporate governance standards for listed entities;
- Promote the voluntary application of corporate governance codes by non-listed entities;

⁵ESMA is an independent EU Authority that contributes to safeguarding the stability of the European Union’s financial system by ensuring the integrity, transparency, efficiency and orderly functioning of securities markets, as well as by enhancing investor protection. ESMA has been invested in accordance with (EU) Regulation no. 1095/2010 (Article 1, paragraph 3) to carry out activities relating to corporate governance, auditing and financial reporting, to the extent that such activities are necessary to ensure the consistent and effective enforcement of applicable regulations.

⁶ Official letter *RE: Green Paper – The EU Corporate Governance Framework*, signed by Mr. Steven Maijor, Chair of ESMA, on 20 July 2011, available at http://www.esma.europa.eu/system/files/2011_219.pdf

- Enforce a clear separation of functions and responsibilities between the Chairman of the Board and the Chief Executive Officer;
- Submit internal policies to recruit members of the Board of Directors;
- Enforce periodic external evaluation of the members of the Board of Directors;
- Require disclosure of the remuneration policy for executive and non-executive members of the Board of Directors, including the option for shareholders to vote on remuneration policy;
- Define corporate profile and "appetite for risk" strategies, as well as procedures to effectively monitor risk exposures;
- Define the role of institutional investors in strengthening corporate governance processes, including for financial incentives allocated to fund managers;
- Facilitate cooperation / consultation between shareholders, subject to regulations against market abuse generated by concerted actions;
- Avoid conflict of interest in the provision of investment advisory services;
- Protect minority shareholders' rights, particularly against related party transactions;
- Provide detailed explanations of each situation where there is a lack of compliance with corporate governance principles.

4 Insight Analysis of Romanian Corporate Governance Framework

The major areas of corporate governance are subject of enforcement by two fundamental Romanian laws, respectively The Company Law no. 31/1990 and The Capital Market Law no. 297/2004. These fundamental laws are subject to application for Romanian investment firms, as well. Furthermore, the secondary legislative tier applicable for investment firms consist of rules and regulations issued by the Financial Supervision Authority (FSA). However, a distinctive enforcement of corporate governance principles was firstly prescribed in 2008 by the Bucharest Stock Exchange (BSE) Corporate Governance Code, referring to Romanian companies listed on the BSE regulated market. These principles have been structured into the following areas of interest for corporate governance:

- Protect the rights of shareholders and ensure a fair treatment, especially for minority shareholders;
- Effective communication with shareholders;
- Decision-making process and the responsibilities of the members in the Board of Directors;
- The balance between executive and non-executive members or independent members in the Board of Directors;
- Appointment of Board members and the role of the Nomination Committee;
- Remuneration policy of directors and senior executives and the role of the Remuneration Committee;
- Financial and non-financial reporting and the role of the Audit Committee;
- Internal control and risk management;
- Avoidance of conflicts of interest among the members of the Board of Directors;
- Procedures for the identification and reporting of transactions with related parties;
- Corporate information treatment, between confidentiality and disclosure obligations;
- Corporate Social Responsibility;

- Corporate governance models and structures.

The BSE Institute of Corporate Governance issued in March 2010 the Corporate Governance Code Implementation Guide, containing some recommendations subject to the preparation of "Comply or Explain" Statement by securities issuers. This guide identifies significant areas of interest in evaluating the effectiveness of the corporate governance process and structures.

5 Empirical results

Our approach was based on a pyramidal analysis of the level of harmonization regarding the legislative and regulatory framework applied to Romanian investment firms (RIF CG Framework), starting with international corporate governance standards (OECD Principles), continuing with European framework (EU CG Framework) and finishing with the Bucharest Stock Exchange Corporate Governance Code (BSE CG Code) applied to Romanian listed entities. We focused on determining whether the Romanian legislative and regulatory framework applied to investment firms is consistent with the relevant corporate governance requirements, as identified in the top of the pyramid. The empirical results are detailed as it follows:

- (a) Ensuring the Basis for an Effective Corporate Governance Framework: *“The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities”*. The correspondent requirements are detailed in Table 1.

Table 1 Ensuring the Basis for an Effective Corporate Governance Framework

Code	OECD Principles	EU CG Framework	BSE CG Code	RIF CG Framework
	Market integrity	n/a	n/a	Law 297/2004 NSC Regulation 32/2006
	Rule of law	n/a	n/a	Law 297/2004 NSC Regulation 32/2006
	Division of responsibilities	n/a	n/a	n/a
	Supervisory authorities	n/a	n/a	n/a

Source: authors' projection

Relevant findings: An effective Corporate Governance Framework is assured for Romanian Investment Firms, as they are supervised entities and subject to FSA regulations. Subsequent principles (3) and (4), related to the supervisory authority (FSA) are not relevant to the corporate governance framework applied to investment firms.

- (b) The Rights of Shareholders and Key Ownership Functions: *“The corporate governance framework should protect and facilitate the exercise of shareholders' rights”*. The correspondent requirements are detailed in Table 2.

Table 2 The Rights of Shareholders and Key Ownership Functions

Code	OECD Principles	EU CG Framework	BSE CG Code	RIF CG Framework	CG
	Basic shareholder rights	Minority shareholder protection	√	Law 31/1990 NSC Regulation 2/2009	
	Sufficiently informed	Proxy advisors	√	NSC Regulation 4/2011	
	General Shareholder Meetings	Cross-border voting	√	Law 31/1990 NSC Regulation 6/2009	
	Corporate Control	Additional rights for minority shareholders	n/a	Law 297/2004 NSC Regulation 2/2009	
	Exercise of ownership rights	Proxy advisors	√	Law 31/1990 NSC Regulation 2/2009	
	Shareholders' cooperation	Shareholder identification	√	n/a	

Source: authors' projection

Relevant findings: Except for subsequent principle (6), we obtained a reasonable assurance regarding the compliance level of the corporate governance framework applied to investment firms with international OECD Principles. However, subsequent principles (2) and (3) as described in EU CG Framework are not covered by the RIF CG Framework.

- (c) The Equitable Treatment of Shareholders: “*The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights*”. The correspondent requirements are detailed in Table 3.

Table 3 The Equitable Treatment of Shareholders

Code	OECD Principles	EU CG Framework	BSE CG Code	RIF CG Framework	CG
1	Equal treatment	The agency relations Transparency in voting policies	√	Law 297/2004 NSC Regulation 1/2006 NSC Regulation 6/2009	
2	Abusive self-dealing	Protection against potential abuse	√	Law 297/2004 NSC Regulation 1/2006	
3	Conflict of Asset managers vs.			Law 297/2004	

interests	Institutional Investors	√	NSC Regulation 32/2006
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Source: authors' projection

Relevant findings: We obtained a reasonable assurance regarding the compliance level of the corporate governance framework applied to investment firms with international OECD Principles. However, subsequent principles (1) and (3) as described in EU CG Framework are not covered by the RIF CG Framework.

- (d) The Role of Stakeholders in Corporate Governance “*The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprise*”. The correspondent requirements are detailed in Table 4.

Table 4 The Role of Stakeholders in Corporate Governance

Cod	OECD Principles	EU CG Framework	BSE Code	RIF CG Framework
1	Rights of stakeholders	of Better corporate governance	monitoring of n/a	Law 297/2004 NSC Regulation 32/2006
2	Effective Redress	n/a	n/a	Law 297/2004 NSC Regulation 3/2006
3	Performance	– Shareholder	√	n/a
4	Access to information	to Improving quality of relations	n/a	Law 297/2004 NSC Regulation 1/2006 NSC Regulation 4/2011
5	Freely communication	Shareholder relation	√	n/a
6	Efficient agency framework	n/a	n/a	Law 297/2004 NSC Regulation 11/2010

Source: authors' projection

Relevant findings: We obtained a reasonable assurance regarding the compliance level of the corporate governance framework applied to investment firms with international OECD Principles. However, subsequent principles (3) and (5) as described in EU CG Framework are not covered by the RIF CG Framework. Furthermore, we observed a poor compliance of the BSE CG Code with the general OECD Principle regarding the role of stakeholders, since only shareholders are subject to application. Another relevant finding refers to a poor compliance of RIF CG Framework to subsequent principles (2) and (6), provided that different legislative framework is applicable.

- (e) Disclosure and Transparency: “*The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company*”. The correspondent requirements are detailed in Table 5.

Table 5 Disclosure and Transparency

Code	OECD Principles	EU CG Framework	BSE CG Code	RIF Framework	CG
1	Disclosures	Related parties Remuneration policy Relevant societal risks	√	NSC 4/2011 FSA no. 4/2014	Regulation Regulation
2	High quality reporting standards	IFRS reporting (Regulation (EC) 2002)	√	NSC no. 6/2011	Instruction
3	External audit	Directive on Statutory (2006/43/EC)	a	n/ 4/2011	NSC Regulation
4	Auditor due professional care	Role of the auditor	a	n/ 4/2011	NSC Regulation
5	Dissemination of facts	Comply or Explain each	√	NSC 3/2006	Regulation
6	Analysts, brokers and rating agencies	Proxy advisors	√	n/a	

Source: authors' projection

Relevant findings: We obtained a reasonable assurance regarding the compliance level of the corporate governance framework applied to investment firms with international OECD Principles. However, subsequent principle (6) as described in EU CG Framework is not covered by the RIF CG Framework. Furthermore, we observed a poor compliance of the BSE CG Code with external audit matters.

- (f) The Responsibilities of the Board “*The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board and the board’s accountability to the company and the shareholders*”. The correspondent requirements are detailed in Table 6.

Table 6 The Responsibilities of the Board

Cod	OECD Principles	EU CG Framework	BSE CG	RIF CG Framework
1	Due diligence and care	Availability and commitment	√	Law 31/1990 NSC Regulation 32/2006
2	Fairly treatment	Conflict of interest	√	Law 31/1990 NSC Regulation 32/2006
3	High ethical standards	Directors’ remuneration	√	Law 31/1990 FSA Regulation no. 4/2014

4	Key functions	Risk management	√	NSC Regulation 32/2006
5	Independent judgment	Board evaluation	√	Law 31/1990
6	Accurate, relevant and information	Board evaluation	√	NSC Regulation 32/2006

Source: authors' projection

Relevant findings: We obtained a reasonable assurance regarding the compliance level of the corporate governance framework applied to investment firms with all relevant international OECD subsequent principles, as described above.

6 Conclusions

The research we conducted allowed us to reach the conclusion according to which there is an overall satisfactory compliance of the corporate governance framework applied to Romanian investment firms in comparison with OECD Principles and European best practices, in all relevant aspects. This conclusion should provide a reasonable assurance that stakeholders' interests in a Romanian sound financial intermediation system are satisfied, offering credibility and protection against abusive market practices. Future research will provide a basis for conclusion regarding the effective compliance level of the Romanian investment firms with relevant corporate governance practices and the regulations that support them.

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