

Notes on Important Changes Introduced by the New Capital Market Law

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The Capital Market Law adopted on May 5, 2011 (Official Gazette 31/2011) is replacing Law on Securities and Other Financial Instruments (Official Gazette 47/06). The Capital Market Law (hereinafter: Law) will be implemented starting from November 2011.

Important Note: While these notes are intended to capture the most significant changes, they are for information purposes only and should not be relied upon in any way as legal advice, legal interpretation, or reflecting every change brought about by the law.

Time Line from Date of Adoption:

- Securities Commission (Commission) needs to prepare bylaws in 6 months,
- Central Register needs to adjust in 9 months,
- Belgrade Stock Exchange needs to adjust in 9 months,
- Broker-dealers need to adjust in 1 year,
- Deposit Insurance Agency has 9 months to organize and submit to the Commission the request to establish the Investor Protection Fund, and
- There is a one-year deadline for certain specific articles to be fully implemented (see Article 302).

The major changes are made regarding: the OTC market, public offer, Investor Protection Fund, market abuse, capital requirements for investment firms, possibility for broker-dealer to manage clients' money on its money account, reporting, auditing and Register of Required Information.

Changes in General Provisions and Instrument Characteristics

- Definitions are given in much more details (firm control, direct and indirect control of company, etc.) more aligned with EU Directives; new definitions and instruments are included (regulated market, multilateral trading platform, OTC, reopening, investment services, commodity derivatives with no commercial purposes, weather derivatives, etc.).
- Regarding currency, the main difference is that the Law specifies that issuer needs to be consistent – an issuer shall be obliged to pay liabilities arising from securities in the currency in which securities are stated; as before, stocks can be issued and traded only in RSD and bonds both in RSD and FX (with approval of the NBS in case of FX).

Changes on the Primary Market

- In a Chapter 3 - "Public Offering, Admission to Trading, Exemptions" - the major change is made regarding the role of the SC – the SC now only approve Prospectus, but not the public offer itself;
In the Law on Securities and Other Financial Instruments, the SC approves offerings (even in case it is not public), but by the Law it approves Prospectus in case of public offering, and admission to trading (including cases where Prospectus is not needed but Law defines that the SC needs to approve it).
- Public offering and admission to trading, excluding OTC, must include a Prospectus;

- In case of public offering, the Law identifies varieties of exemptions. Some of the exemptions are: if offer is made to not more than 100 investors, both qualified and unqualified; if minimal nominal value of an offer is EUR 50,000 per security; if total offering is lower than EUR 100,000 during 12 months period; in case stocks are issued as a non-cash dividends, etc.);
- The requirement of the Prospectus in case of admission to trading also has exemptions in case when securities are offered, allotted or to be allotted in connection with a merger;
- The Law on Securities and Other Financial Instruments does not specify this difference between public offering Prospectus and admission to trading Prospectus;
- Qualified investor is defined in a way that the SC can only deal with a procedure and the Register of Qualified Investors, but the Law prescribes who can be considered as qualified investor which was not the case before (previously the SC was defining criteria);
- The Law in details specifies summary as a part of Prospectus (“short prospectus” in Serbian), as well as exemption - in case the Prospectus relates to the admission to trading of debt securities, having a denomination of at least EUR 50,000 in RSD equivalent, there is no requirement to provide a summary;
- By the Law, issuer can choose between making Prospectus as single document (“joint prospectus”) or as separate documents (“divided prospectus”);
- The more people/institutions are now clearly responsible for the content of the Prospectus.

Changes Regarding Transparency and Information

- The Law includes new obligations, terms and definitions regarding transparency, such as obligatory quarterly reports, advertisement recommendations, obligations of the journalists regarding information misused, etc.
- Annual, semi-annual reports and auditing are more precisely defined, which will help the implementation.
- The Law adds new article regarding auditing, mainly following Sarbanes-Oxley Act; auditor can have the same client for maximum 5 continues years, cannot perform both consulting and auditing services for the company, and must be independent, where the Law defines independency. The SC is obligatory to prepare a list of auditors that can perform auditing of the public companies.
- The Commission shall establish the Official Information Registry, that includes following types of public registers: the register of issuers to whom the SC has approved the publishing of the prospectus for public offer of securities; the register of issuers whose financial instruments are included into trading on the regulated market or MTF in the Republic of Serbia; the register of public enterprises, including sub registers.

Changes regarding Market Abuse

- The Law on Securities and Other Financial Instruments does not treat market abuse precisely enough to allow proper implementation; The Law considers market abuse as a whole chapter (Chapter VI) defining it according to EU Directives; the market abuse chapter defines in detail manner inside information and market manipulation, including supervisory measures;
- Market manipulations and insider trading are now treated as a **criminal offence**.

Changes Regarding Secondary Market

- The Law on Securities and Other Financial Instruments defines secondary trading as trading on the exchange (*berzansko*) and non-exchange (*vanberzansko*), both under the SC regulation, but the Law makes changes in secondary trading according to the concept that was introduced within the Markets in Financial Instruments Directive (MiFID) – secondary trading now can be performed only on a Regulated Market (RM), a Multilateral Trading Facility (MTF) (in Serbian version called multilateral trading platform - MTP) and a Systematic Internaliser (SI) (in Serbian version called OTC);
- The OTC is not directly regulated by the SC and can be established without organizer/operator; the SC shall supervise this market through implementation of supervision over investment firms performing transactions in financial instruments on the OTC market.
- The RM and MTF are under the SC regulation, but not the OTC;
- An operator must establish the RM, nevertheless both the investment company and the operator can establish the MTF, and OTC has no operator at all; operator cannot trade financial instruments, but Law adds exceptions in case of government debt, municipal bonds, the NBS securities and specific foreign institutions bonds.
- Short selling is introduced and can be done only if a client signs the permission; broker-dealer can also use their securities for short selling, but in a case when client's securities are used profit goes to the client and broker-dealer receives only a fee.
- Every stock exchange must have listing, plus one more segment of the RM.

Changes Regarding Investment Firms and Institutional Framework

- Investor Protection Fund is a new institution defined by the Law. The Investor Protection Fund has its organizer (the Law stipulates that it will be the Deposit Insurance Agency), but is not a legal entity. The purpose of the Fund is to protect investors in case that broker, dealer or other institution goes bankrupt or cannot meet its obligations to the clients. Highest guaranteed sum is EUR 20,000 per client. Membership is obligatory for all institutions managing clients' portfolios, funds, collaterals, etc. Membership fee is fixed, or it is percentage of revenues, or it is combination of previous two, and it is set by the SC. The initial membership contribution is EUR 5,000. The Fund can invest its assets in government and the NBS securities, securities guaranteed by the government, or some others in case of the SC's approval. The Law prescribes the list of entities that cannot be treated as a "client" , like investment funds, insurance companies, credit institution, etc.
- Client can have cash account at the bank or broker-dealer, subsequent not being the case before.
- The Law specifies that state must have 51% of ownership in the Central Register and its minimal capital increased from EUR 50,000 to 750,000; The Central Register can be a public company in addition to being private/closed company.
Capital requirements for investment firms have being changed; minimum capital is increased and now is between EUR 125.000 – EUR 730.000 in RSD depending on the services they provide;
The own funds of any broker-dealer company shall not at any time fall below the minimum capital requirements; assets of the broker-dealer company shall always correspond to assets required to cover its liabilities and potential losses due to risks to which the broker-dealer company is exposed to in its business operations exposures;
The broker-dealer company shall calculate the assets amount, risks and exposure as prescribed by the SC; by the Law risk includes credit risk, market risk, operational risk, liquidity risk and exposure risk – the Law on Securities and Other Financial Instruments is focused only on liquidity and exposure risk; regarding risk management strategies and

policies brokers-dealers need to establish and apply appropriate administrative and accounting procedures for calculation and control of capital requirements for those risks, and in order to identify and monitor large exposures.

Changes Regarding Supervision

- The SC licenses organizer of Investor Protection Fund and approves fund's statute, rules, etc.
- Specific supervisory, investigatory, enforcement and remedial competencies are defined in much more details.