FUNCTIONING OF BOARDS OF DIRECTORS

IN ROMANIA

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The information contained in this report is publicly available information.

The reader should consider, along the report, that the surveys conducted were not done on a large scale, due to time constraints. Therefore, the findings of the report should be treated accordingly.

Any comments or suggestions on the report are highly appreciated. They could be sent to ionita@efm.ro.

I. Introduction

The **macroeconomic situation** in Romania has improved in the last 3 years. GDP increased, reaching a value of USD 39.7 billion in 2001, inflation decreased significantly for the first eight months of 2002, to 10.7% and the unemployment rate decreased to 9% at end July 2002. The Central Bank's hard currency reserves have increased steadily since their record low at the end of 1996, to a level 5,545 million, at end August 2002. In parallel, the Government continued the privatization process and demonstrated its political commitment by privatizing in 2001 some large state owned companies. Romania has been accepted in NATO, at the November Prague Summit, this year. Romania is proposed to enter the European Union in 2007, based on future developments (see more details in the Appendix no. 1).

The **Romanian capital market** registered some progress in the last two years, compared to the period 1999-2000 that could be considered a "recession" period. In 2001 and 2002 local interest in the stock market started to increase and "pushed up" the BET Index which grew by more than 100%, in USD, for the first ten months of 2002 year (the BET Index is the official Index of the Bucharest Stock Exchange). The BET Index might be the best performing Index in the world, for the year 2002.

The Rasdaq market also registered progress recently. The "Rules no. 2/ 2002 regarding the transparency and the integrity of the Rasdaq market", were approved by the National Securities Commission, in October 2002. The rules established three "tiers" of the Rasdaq market, the listing requirements for the three tiers and the rules regarding the trading activities (settlement of the price, variation of price etc.).

The main players of the Romanian capital markets are:

(i) Foreign Investment funds: they invested in listed companies, based on some general estimates, more than USD 250 million, over the last 5-6 years.

(ii) Financial Investment Funds (SIFs): the five SIFs are self-managed local funds, 100% private. The main activities of the SIFs are the management of the portfolio of shares for the companies where they invested and investments, in order to maximize the value of their shares. In October 2002, the five SIFs had a total market capitalization of approx. USD 275 million while they had total Net Asset Values, of approx. USD 610 million. The total number of companies in the portfolio of the five SIFs was of 2106 (See Appendix no. 5).

(iii) Mutual funds, insurance companies etc.: they are very small players in the market.

(iv) Private individuals, who started to play a bigger role in the market, in the last few months.

There are no private pension funds established in Romania.

In Romania, the Romanian Shareholders' Association (RAS) was founded in October 2001. The Association is a non-profit and non-governmental organization of Romanian Companies' shareholders. The mission of the RAS is to serve and protect the interests of the Romanian Companies' shareholders. Its aim is to introduce and enforce the principles of the corporate governance issued by the OECD within the Romanian economic environment. It was created by the five SIFs (mentioned above) and one individual.

In Romania, currently, "Financial Market Reform" is a USAID project administered by Deloitte Touche Tohmatsu Emerging Markets, . The project is implemented on behalf of USAID under a two-year technical assistance contract. A core team of capital markets experts began work in November 2001. The beneficiary institutions include, but are not limited to, the main capital market institutions such us, the Senate Sub-Commissions of Capital Markets, National Securities Commission, BSE, Rasdaq, UNOPC, ARA (Romanian Shareholders Association), APAPS (Authority for Privatization and Management of State Ownership), and others.

For more details regarding the Romanian capital market, see Appendix no. 2, Appendix no. 4 and Appendix no. 5.

As regarding **corporate governance**, the concept in Romania is relatively new and in the last two years started to be more actively promoted by the stock market and by the listed companies.

The "Companies Law no 31/1990" was the first pillar of the corporate governance system in Romania. Then, in 1994, the Romanian Parliament approved the "Law no. 52 regarding securities and stock exchanges" which unlike the "Companies Law" which was inspired by the continental model and the Romanian Commercial Code, was absolutely a new piece of legislation. For the listed/publicly owned companies, the securities legislation and the related rules issued by the National Securities Commission (NSC), completed the corporate governance legal framework.

Due to the necessity of harmonization of the Romanian securities law with the legislation of the European Community, the National Securities Commission issued in April 2002 the "Emergency Government Ordinance no. 28 regarding securities, financial services and regulated markets". Then, in the summer, the ordinance was approved through the Law no. 525/ 2002 (hereinafter the Ordinance 28/2002 and the Law 525/2002 will be referred as to the "Romanian Securities Law").

The new "Romanian Securities Law" stipulates what exact procedure should be followed by the majority shareholders, when making a capital increase in cash or "in kind", how the price shall be established, when the Board and the management have to provide written reports on the activity of the company etc.. The new law also introduced the cumulative voting method.

The capital market participants expected the new law to reduce the controversy between the minority and the majority / strategic shareholders. However, it seems that, in practice, there is a heavy dispute between the two groups of interests, especially regarding the price for which a public offer should be made by the majority shareholder, when reaching 90% of shares, for "closing" the company (the mandatory withdrawal from the market).

As regarding the "awareness" of the corporate governance principles, we have to mention that, in the last two years, the professional associations started to issue opinions, "codes", debates on corporate governance and for the first time, due also to the coverage of the media, a larger impact was made in the business community.

Also in this respect, a very important milestone was the "South-Eastern Europe Corporate Governance Conference", which was organized in 2001, in September, by the OECD, and was hosted by the Bucharest Stock Exchange and the National Securities Commission. Although the predominant theme of the Conference was "Shareholders rights and equitable treatment", extensive discussions were held also on all the corporate governance principles.

In the year 2001, the Bucharest Stock Exchange (BSE) initiated the "Transparency tier", or the so-called "Plus tier", where companies could apply for listing. In order to be listed to the "Transparency tier", the companies have to adopt a Code of Corporate Governance. By the end of October 2002, one company joined the "Plus tier".

In Romania, currently, there is a commitment towards the implementation of the corporate governance principles, from the side of the National Securities Commission, Bucharest Stock Exchange and recently from the side of the Rasdaq market. The principles promoted by these organizations are:

(i) the corporate governance framework should protect shareholder' rights
(ii) the equitable treatment of shareholders
(iii) the role of stakeholders in corporate governance
(iv) disclosure and transparency
(v) the responsibilities of the Board of Directors

However, unless this commitment is made by the shareholders, Board of Directors and executive managers of the publicly held companies, the "one – side" effort of the capital market institutions might have only a limited impact.

Among the three main "corporate governance agents" (shareholders, Boards of Directors, Managers), the Board of Directors plays the most important role in the promotion and in the implementation of "healthy" corporate governance principles, inside a company. The unique position of the Board, between the shareholders/stakeholders and the managers, makes its role extremely important. Therefore, the duties and the powers of the Board

are extremely important: first of all to be known very well by the Board members and secondly to be followed / implemented by the Board.

The duties and the powers of the Board of Directors of publicly traded companies (called also "open companies"), could be found mainly in the "Companies Law", the "Romanian Securities Law" and the By-laws/Constitutive Act/Statute of any joint stock company. In addition, the Board members must observe the Board of Directors Rules adopted by each company, the rules and procedures applied to the publicly traded companies issued by the National Securities Commission, the rules and procedures of Bucharest Stock Exchange or Rasdaq, the Code of Corporate Governance issued by the BSE etc..

All in all, in the above mentioned legislation, the main rules, internal procedures, duties and responsibilities of the Board are identified.

However, the newly adopted "Romanian Securities Law" provides some specific requirements, through its articles, on how the Board / management / auditors should act, in some specific cases, such as: (i) takeovers, (ii) providing quarterly reports, (iii) providing reports when the GSM delegates some of its attributions to the Boards of Directors, (iv) payment of dividends, (v) concluding of contracts to buy, sell, exchange or set up guarantees for assets, (vi) "in kind" contributions, (vii) capital increases and price establishment for the capital increases, (viii) reporting obligations for an investor reaching one of the following thresholds: 5%, 10%, 33%, 50%, 75% or 90%.

The "Companies Law" stipulates in Chapter VIII – "The infringements", that the directors along with the founders, executive managers etc., are punishable to imprisonment, in many cases, if they do not comply with the requirements of the law. The law also stipulates the cases that could be classified as a contravention. The "Romanian Securities Law" also indicates some contravention and infringements. However, the conclusions of the professional people working in the market is that, although the legal framework has many sanctions to be applied to the directors, in practice, there have been only a small numbers of cases where the members of the Board have been sanctioned, although directors do not comply with the law.

As regards the banking system and the state owned companies, we can mention the following: (i) in the banking system, the two tier Board system is applied and all the duties and responsibilities of the Board members are well defined; (ii) in the companies owned by the State / Apaps (Authority for Privatization and Management of State Ownership), it seems that one of the main problems to be addressed is the monitoring of the activity of the representatives in the Board of the "Apaps", in order to limit the potential damages that might be provoked to the company. A very important improvement was made through the "Law no.137/ 2002 regarding measures to be taken for acceleration of the privatization process". Based on this law, Apaps is implementing the "special administration procedure" in the period of privatization. The "special administration" is defined as "the administration of the company between the date when the decision of the Ministry/Local Administration is made and the date of the transfer of

the ownership / the date established by the State". This is a very important progress which was made and which should "preserve" the value of the company over the period when the ownership transfer takes place.

Taking into account the duties and responsibilities of the Board, above mentioned, we can say that the Board acts as a "corporate governance agent" and as a "training agent", in any company. The Board has the power and the tools to "enforce" the corporate governance principles and the capital market legislation, in each company, by putting pressure on the management and shareholders, in this respect.

Regarding the **independence** of the Board members, we can say that neither the "Companies Law" nor the "Romanian Securities Law" mentions anything about independent directors. The BSE, in the Code of Corporate Governance which has to be adopted by the companies listed on the "Transparency Tier", has defined the "independent directors".

On the **composition of the Board**, the law is quite general. However, based on a limited survey conducted and based on the public information available, we can conclude the following:

(i) Size of boards : generally between 3 to 9;
(ii) Executives/non-executives: on average, the executives are not members of the Board with the exception of the Banks and Management and Employees Buy-Outs (MEBO) companies;
(iii) Chairman of the Board / CEO of the company: in general, the Chairman is the general manager, especially in the case of the State Owned Companies and in the case of MEBO companies. However, in the majority of companies where the foreign investment funds have the control / the majority position, the Chairman is different from the CEO;
(iv) Independent directors: there are quite rare cases when independent directors are members of the Board.

For the SIFs, with the exception of Muntenia Investment Fund, the Board of Directors is composed of seven members and the Chairman is also the CEO.

The Board of Directors, regardless of their composition and their independence, has to observe the provisions of the Chapter VI of the "Companies Law" which provide concrete steps and conditions to be followed by the directors and the management, in cases of mergers, splits etc.. Chapter VII of the "Companies Law" provides specific provisions regarding liquidation.

In addition to the provisions stipulated above, the directors have to submit to the NSC, based on the art.123 of the "Romanian Securities Law", current reports which shall be published in the NSC Bulletin. These reports should declare any juridical acts concluded between the company and its directors, employees, majority shareholder, affiliated or **related parties,** which have a value of more than EUR 50,000. The Code of Corporate

Governance issued by the BSE provides that the issuers have to present, on a monthly basis, related party transactions and a situation with cross ownership.

Based on the Romanian Law, the Board of Directors may delegate a part of their attributions to a Directors Committee that shall report back to the Board. In practice, in Romania, this delegation does not take place or it takes place very rarely. Going further to the notion of Committees, in Romania the Audit, Nomination and Compensation Committees are not regulated and implemented. In addition, in some companies, the censors *) /financial auditors (in many cases the former censors became the financial auditors) are not recognized as independent parties and they are rather recognized as being subordinated directly or indirectly to the management / majority shareholders. In the companies where the censors were replaced by the financial auditors, some functions of the censors were not covered by the financial auditors (ex. mandatory participation to the Board meetings; appointing a temporary director until the GSM is called etc.)

Note: *) Censors are individuals performing activities as external auditors. For simplicity, all over the text they will be called censors.

In the banking system, the Central bank may decide that a bank will be under "special supervision" through a **special commission** established for this purpose and which is independent of the management and directors of the bank. If the special supervision program is not providing results, the Central Bank can impose a **"special administration"** program. The "special administrator" program is designated by the central bank to takeover the functions of the directors of the bank.

As regarding the very large state owned companies, there are cases when the Board of Directors delegates part of its duties to a "Directors Committee" which assumes, along with the management, important managerial decisions validated subsequently by the board of directors.

The "Companies Law" and the "Securities Law" are not specific with any concrete details regarding the **qualifications of the Board of Directors.**

However, in the case of the five SIFs, the NSC issued some rules regarding the qualifications of the Board members.

From the public available data, we could say that, on average, the qualifications of the Board members at the five SIFs are as follows:

(i) The Chairman is the CEO (with the exception of SIF Muntenia); in isolated cases (SIF Moldova) some executives are members of the Board.

(ii) Some of the five CEOs worked in the Government in the past, then in the National Agency for Privatization, and or in the State Ownership Fund. All the CEOs have at least 5 years working experience with the SIFs.

(iii) Board members have extensive experience in finance/accounting, the legal field or worked with the Government in the past.
(iv) In each SIF one or more members of the Board were or are currently members of the Romanian Parliament (they are either deputies or senators).

For the banking sector, the central bank will require the directors of each commercial bank, for authorization, to fulfill some qualifications. The commercial banks have to have professional directors and executive managers. The Central bank specifically requires the directors and the executive managers to be honest. The bank might reject some directors or executive managers, as considered appropriate.

Since 1999, the Apaps rules, for the state owned companies, have clearly stipulated that its representatives in the Boards could not be employees of the Apaps, due to the conflicts of interests.

Regarding **board compensation**, the main conclusions are:

(i) For the state owned companies, the fees for directors are expressed as percentage of the gross salary/ salary/ base salary of the general manager (in the majority of cases is 20%); we can assume a board monthly fee range between USD 100 to USD 500 (from small to very large companies).

(ii) For the rest of commercial companies the net fixed monthly fee of a board member, excepting the banks, is on average between USD 200 – 300.

(iii) For the banks, the net monthly fees of the members of the Board are between 600 – 800 USD net.

(iv) There are cases where the chairman is better remunerated than the rest of Board members, including the banks.

(v) Directors are not remunerated based on the performance of the company.

(vi) Very rare, other directors, with the exception of the Chairman, are better remunerated; when this happens it is due to having a foreign expert in the board etc..

We can conclude that, in general, if the Board members are paid only based on a net fixed fee and the payment is quite poor (10% to approx. 15% of the general manager salary). In practice, however, some strategic investors and investment funds will pay additional salaries and compensations, for the members appointed by them in the Board, from non-company funds.

As regarding the SIFs, from some informal discussions, it seems that the range of the Board remuneration is between USD 300 – 500 net. From the data available, in SIF Oltenia and SIF Banat, at least, the directors along with the employees will get a bonus

based on the performances obtained at the end of the year. The global bonus is expressed as a percentage of the net profit and it is approved by the GSM.

The overall **evaluation** of the activity of the Board is made in many cases, at the annual GSM, where the budget is compared to the results. However, even at the annual GSM, the evaluation is done in a superficial way, in many companies. It seems that there is no systematic evaluation of the Boards.

For the conclusions and recommendations on Romanian boards of directors, see Chapter VII.

II. Duties and powers of the Boards of Directors

Based on the OECD Principles, Chapter V: "The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of the management by the board, and the board's accountability to the company and the shareholders".

The board of directors is of crucial importance in promoting and implementing corporate governance standards and practices.

In Romania there are two-tier boards (with the exception of the banks), that separate the supervision function and the management function into different bodies. Therefore, in Romania, the supervision board is composed of non-executive board members. The only executive allowed to be a Board member is the general manager / CEO which shall also be the Chairman of the Board.

The duties and the powers of the Board of Directors of publicly traded companies (called also "open companies") are found mainly in the "Companies Law no 31/1990", new "Romanian Securities Law", the By-laws/Constitutive Act/Statute of any joint stock company. In addition, the Board members must observe the Board of Directors' Rules adopted by each company, the rules and procedures applied to publicly traded companies and issued by the National Securities Commission, the rules and procedures of Bucharest Stock Exchange or Rasdaq, the Code of Corporate Governance issued by the BSE etc..

2.1 The duties of the Board members based on the provisions of the "Companies Law no. 31/1990"

In Romania, based on the **"Companies Law",** the appointment and replacement of the board of directors is exclusively made by the General Shareholders Meeting (GSM), in the ordinary session, following a secret ballot procedure. Based on the recently adopted "Romanian Securities Law", **cumulative voting** was introduced for the election of Board members. As such, at the request of a significant shareholder (owning at least 10% of shares), the cumulative method of voting is mandatory to be implemented in the GSM.

The Companies Law does not clearly stipulate the general attributes of a desirable member of the Board, such as: strength of character, independent mind, practical wisdom, mature judgement and, of course, independence.

The law is clearly stipulating that the directors may not have a criminal record.

In addition, the "Companies Law no. 31/1990" stipulates in the article 136 (1) that "a legal person might be nominated or elected as director". However, the legal person is obliged to nominate a natural person/ an individual as a permanent representative. Such a

natural person has to observe the law. When the juridical person will revoke its representative in Board it has to name a new person.

In practice, in the overwhelming majority of cases, at the moment of appointment of a director, there is not a contract signed between the company and the directors or between the directors and shareholders. Therefore, it is implied that, all the laws and rules mentioned above must be observed by the directors.

The most important duty of a director is to act on behalf of the company and therefore to protect the interests of the company. It could be inferred that the duty of a director is to act in the best interest of shareholders, the reference to shareholders should be always translated as a reference to all the shareholders**,** regardless of their equity participation in the company.

In Romania, each director is required to deposit, in cash, either double their remuneration or the nominal value of 10 shares as a guarantee. If the guarantee is not made before taking over the director's role, the director is considered resigned.

The Romanian Companies Law also stipulates how the directors can vote in a General Shareholders Meeting (GSM).

The directors are obliged to register their signature specimen at the Trade Registry. In practice, after the director has resigned, if the company will not perform the diligence to erase his signature specimen from the Trade Registry, he remains liable until such an erasure takes place.

The respective director can recover the guarantee deposited only after the approval by the GSM of the balance sheet and related financial statements, of the year when the director exercised his duties. The GSM has also to approve specifically a discharge of its duties.

For the validity of the decisions of the Board of Directors, at least half of the directors have to be present at the Board of Directors meeting, if the Constitutive Act does not provide for a bigger number. The decisions of the Board of Directors are made with the absolute majority of its members.

The directors should not fail to disclose to auditors, known irregularities committed by themselves or their predecessors. They also should not fail to disclose any direct or indirect interest in a transaction that a director (or his relatives or associates) may have, which could be contrary to the interests of the company.

Based on the Companies Law, the directors are allowed to be on a maximum of three Boards at the same time. However, the law stipulates that the interdiction mentioned previously does not apply where the respective director is owner of at least one fourth of the total shares of the company where he/she is elected (or he/she is the director of a company which owns the above shown quota).

The person who does not comply with the above mentioned provision (three boards maximum) will lose accordingly, in the chronological order, the position of director obtained by exceeding the legal number of consequent appointments, and he/she will be required to make the payment of the remuneration and the other benefits and to return all amounts received, to the state. The action against the administrator can be exercised by any shareholder or by the Ministry of Finance. In practice, however, the legal experts are interpreting this provision more strictly and the exception is accepted to apply only to persons/ individuals owning of at least one fourth of the total shares of the company where he/she is elected.

The directors and the management of a joint stock company can not be, without the authorization of the Board of Directors, members of the Director's Committee, censors or associates with unlimited liability, of other competing companies or with the same object of activity. They can not exercise the same trade activities or a competing trade activity, on their own account or in any other person's account. The violation of this provision will entail revocation and liability for damages.

The board of directors shall not, without the approval of the Extraordinary GSM, conclude contracts on behalf of the company to purchase, sale, rent, change or set up guarantees of assets of the company, for a value exceeding half of the accounting value of the assets of the company, at the date of the conclusion of the contract. However, each company, in its Constitutive Act / Statute could stipulate a lower amount.

The board of directors is liable to the company for the acts of the executive managers and employees, when the damage would have not occurred if they had exercised the supervision required by the duties of their appointment.

The boards of directors are jointly liable with its predecessors if, having knowledge of the irregularities committed by these predecessors, they do not disclose the respective irregularities to the censors.

In the companies with several directors (which together represent the Board of Directors), the liability for acts or omissions does not extend to the directors who registered their opposition in the Book of Decisions of the Board of Directors. The directors who registered their opposition have to also notify the censors, in writing.

If a director will not register his/her opposition to decisions made by the Board, at a meeting where the respective director did not attend, he/she remains liable for the respective decisions along with the rest of the members of the board of directors.

The director, who, in a certain transaction, has direct or indirect interests contrary to the interests of the company, must inform the other directors and the censors and he/she can not take part in the proceedings concerning this transaction. The director has the same obligation if he/she knows that his/her spouse, relatives or associates are interested in a certain transaction. The director who does not comply with this provision shall be liable for the damage incurred by the company.

At the Board meetings, the executive management will prepare written reports concerning the activities of the company and the Directors' Committee will present the registry with its decisions.

At the meetings of the Board of Directors it is mandatory for the censors to be invited. However, under the new legislation regarding the financial auditors, the financial auditors who are replacing the censors are not obliged to participate at the meeting of the Board.

The "Companies Law" mentions that the executive managers can not be members of the Board, with the exception of the general manager who could be the Chairman of the Board.

The "Companies Law" is also providing that, if the social capital is reduced by half, the directors are obliged to call a GSM to decide an increase of the capital, a limitation of the capital at the amount which exists or the cessation of activity of the company.

Based on art. 150 of the "Companies Law", legal action against the founders, directors, censors and the managers of the company can be initiated by the general meeting of shareholders, which shall decide upon it. The decision can be made even if the matter of their liability is not included on the agenda. The GSM will decide with its majority of votes the person empowered to pursue with the legal action for the situation mentioned before. If the GSM decides to start legal action against directors, their mandate ceases immediately and the GSM will act to replace them. If the legal action is started against the management, the law suspends them until the decision of the Court becomes final.

Unless the Constitutive Act does not otherwise stipulates, if the seat of one or more directors becomes vacant, the other directors together with the censors, with a quorum of two thirds and with absolute majority, proceed to the appointment of temporary director until the next GSM will be called for the final approval of the director. In practice, the timing is not clearly stipulated and for a few months (sometimes for more than six months), some positions remain vacant in the Boards. In addition to that, the law does not clearly stipulate what will happen when financial auditors replace the censors.

A relatively new paragraph of the Companies Law is article 152 which stipulates that: "in the case where the directors or the managers conclude legal documents which are damaging the activity of the company, and the company, due to the position the directors and managers have in the company, does not act to recover the damage from the respective representatives, any of the minority shareholders have the right to start legal action, in the name of the company, to recover the damage".

2.2 The duties of the Board members based on the provisions of the "Constitutive Act" and of the "Romanian Securities Law".

Based on the Constitutive Act, in addition to the duties/responsibilities mentioned in the "Companies Law", the board of directors of listed companies have to:

(i) Review the corporate strategy/business plan, major plans for action, and risk policies of the company;

(ii) Make proposals to shareholders for the approval of the Annual Report which contains, at least: the report of board of directors, the annual financial statements, the report of the financial auditors/censors, the budget for the next year, including the capex, the press release to be issued to the BSE, NSC, to shareholders/ investors etc.;

(iii) Appoint, monitor and compensate the key executives of the company; compensation should be related to the objectives of the company which need to be set;

(iv) Ensure the integrity of the company's accounting and financial reporting system, including an independent audit; the Board has to make sure that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law;

(v) Make recommendation to shareholders for the selection of censors/ financial auditors;

(vi) Make sure it organizes the "Internal Audit" Department;

(vii) Monitor and manage potential conflicts of interests of management, directors, shareholders, including misuse of company assets and abuse of related party transactions;

(viii) Monitor implementation and corporate performance, the effectiveness of governance practices under which it operates;

(ix) Oversee capital expenditures, acquisitions and divestitures, the process of disclosure and communication;

(x) Call the annual GSMs for ordinary or extraordinary sessions;

(xi) Provide continuos and periodic information disclosure of information to current shareholders and to potential investors.

Based on the Constitutive Acts, the Boards have to:

(xii) Approve of the organizational chart of the company;

(xiii) Make sure all the rules and procedures are in place and are implemented;

(xiv) Negotiate or delegate to the management the right to negotiate the Collective Bargaining Contract with the union;

(xv) Supervise and oversee the management in elaborating all the procedures of the company;

(xvi) Decide regarding loans, acquisitions, divestitures, renting, leasing etc., in some limits, as established in the Constitutive Act or by law;

(xvii) Approve the insurance policy of the company;

(xviii) Is responsible for protection of patents, for confidentiality of operations;

(xix) Propose to the GSM the setting up of joint stock companies;

(xx) Oversee the overall internal and external communication of the company;

(xxi) Ensure timely payments to the shareholders, for dividends;

(xxii) Maintain the legal registries;

(xxiii) Execute the decisions made by the GSMs;

(xxiv) Comply with the laws and by-laws of the company.

The Boards act as a ”corporate governance agent”.

The Board is acting and should further act as a “training agent”, in particular in the area of capital market legislation, for the executive management, since capital market is a relatively new field.

What is interesting is the fact that very rarely, in the Constitutive Act of the Romanian companies, someone could find a main attribution of the Board and management to increase shareholders value.

Additional duties of the board members, based on the new “Romanian Securities Law”:

(i) In the case of a **takeover**, the Board of Directors has to submit to the NSC, to the bidder and to the securities market where the shares are traded, its view regarding the

opportunity of the takeover, within a period of maximum 5 days from the date when the preliminary announcement is made to the public, by the bidder.

In this case, the Board of directors may call the GSM to present his view on the opportunity of the takeover and on the strategy to be followed. If the takeover is launched by a significant shareholder (a shareholder owning at least 10% of shares), the Board is obliged to call the GSM. In this particular case, by derogation from the provisions of the "Companies Law 31/1990", the GSM will take place in 5 days from the publication of the convocation of the GSM in a national newspaper (in a normal procedure, the convocation has to be published in a national newspaper in 15 days from the date of the GSM).

From the moment the Board has received the preliminary announcement for the takeover, it can not conclude any contract and can not make any decision that will materially impact the company's assets or the objectives of the takeover. Therefore, the Board can only make decisions on current issues.

(ii) In the Chapter "Investors Protection", the law mentions in a special paragraph the following: "the members of the Board and the employees of the company can not abuse their position in the company, they should be **loyal** to the company".

(iii) Shareholders owning more than 5% in the shares of one company may request **quarterly reports** to the censors or financial auditors regarding the operations of the company. Based on this request, the directors together with the censors / financial auditors must submit, in 15 days, a report which shall be published in the NSC Bulletin. However, the report should not contain confidential information filed as such at the NSC. If the directors and censors/financial auditors do not finalize such a report or the report does not contain the relevant information, the shareholders that requested such report could ask the Court to name an expert. This expert should analyze the respective operations and his/her conclusions will be published in the NSC Bulletin. Until the expert report is published in the NSC Bulletin, the directors and censors/financial auditors will be obliged, together with the company, to pay for damages for each day of delay of the report.

(iv) If the GSM delegates to the Board some of its attributions, the directors are obliged to publish their **decisions on the delegated subjects, in** the Trade Registry**, i**n the Official Gazette and in two national newspapers, for three consecutive days. These decisions will also be sent to the NSC and to the BSE / Rasdaq market.

(v) The directors and managers are obliged by the law to pay **dividends** within maximum of 6 months from the date the GSM established the dividend. If the GSM does not establish the date of payment of dividends, the dividends should be paid within maximum of 60 days from the decision of the GSM regarding dividends, which is published in the Official Gazette. If the directors do not comply with this decision, the shareholders could start an enforced execution in this matter, against the company.

(vi) Any contracts to buy, sell, exchange or set up guarantees of "non current assets" (defined as tangible, intangible and investments in securities), which individually or cumulatively, represent more than 20% of the "non current assets" minus receivables, over one year period, will be concluded by the managers and directors only after the GSM will make a preliminary approval. The law stipulates a similar provision for renting the assets. In the case the directors and managers do not comply with these provisions, any shareholder can ask the Court to cancel the contract that was not approved by the GSM and to sue the directors for the damages provoked to the company.

(vii) **In kind** contributions are forbidden, with few exceptions specifically stipulated by the law.

(viii) Publicly held companies can not make capital increases before an **asset reevaluation** is being made. The article 116 (4) stipulates also how the price should be calculated.

(ix) An investor should announce the market, when reaching one of the following thresholds: 5%, 10%, 33%, 50%, 75% or 90%.

The newly adopted "Romanian Securities Law" enforces the following provisions:

(i) If 10% of shareholders are calling a GSM, then, the directors should call the GSM immediately, as requested and with the agenda requested.

(ii) The access to the room where the GSM takes place should be allowed based on the identity card of the physical persons and based on the Powers of Attorneys for the juridical persons.

(iii) It is allowed the shareholders to be able to be represented in the GSM not only by other shareholders but also by any person presenting a valid Power of Attorney.

2.3 Sanctions for directors

The "**Companies Law"** stipulates in **Chapter VIII – "The infringements"**, that the directors along with the founders, executive managers etc., are punishable to imprisonment, in many cases, if they do not comply with the requirements of the law. The law is also stipulating the cases that could be classified as a contravention.

The sanctions against directors are quite serious. However, in practice, there are rare cases when the directors were sanctioned and punished by the law.

The Board members are criminally liable for the prejudice provoked to the company. They are liable for the bankruptcy situations caused by fraud or offenses provoked by directors, like use of the company's assets, spreading false information, or payment of dividend out of fictive benefits.

The members of the Board are liable as above, with the exception when they can prove that they did not approve a certain decision.

In practice, there are some companies where the company has sued the directors. However, it seems that the cases solved in the favor of shareholders are quite rare.

The **Romanian Securities Law** is also stipulating some contravention and infringements, specific to its requirements.

All in all, the conclusions of the professional people working in the market is that, although the legal framework stipulates many sanctions to be applied to the directors, in practice, there are still only a small numbers of cases where the members of the Board were really sanctioned although they did not comply with the law.

Some of the abuses done by directors and clearly mentioned by the Romanian Association of Shareholders and minority shareholders are: (i) no analysis provided for the capex plan; (ii) refusal to call a GSM (which is a criminal offence); (iii) concluding contracts against the interests of the whole company; (iv) trading on insider information; (vi) un-equal treatment of the shareholders; (vi) lack of supervision for transfer pricing; (vii) in-kind contributions and disposal of assets at non fair values; (viii) dividends paid with discrimination; (ix) dividends declared and not paid; (x) transactions performed with related parties; (xi) lack of disclosure and transparency; (xii) refusal of some Boards of Directors to provide to shareholders the documents before the GSM; (xiii) omission by some directors to notify the shareholders about major extraordinary events (ex. starting of a bankruptcy procedure etc.); (xiv) in same cases - false reporting.

As re-enforced by the art. 133 of the "Romanian Securities Law", the Board has to keep confidential all the matters involving the company until there has been a general disclosure to the public. They also have to make sure that the directors and the management do not trade in the company's shares when significant matters affecting the price of the shares have not yet been disclosed to the general public.

The Board has to insure that the business and other opportunities available to the company are not taken by a director or other members of the management (or by relatives, friends, outside business associates), for personal gain. The directors have to avoid conflicts of interest and apparent conflicts of interest.

The law provides that the directors have full access to information, in the company. However, the information should be accurate, relevant and timely.

2.4 Duties and powers of the Board of Directors in the banks*)

The duties of the members of the Boards of Directors in a bank are provided by the Companies Law, by the Banking Law no. 58/1998 and by some specific norms, such as: (i) Norms no. 8 / 1999 regarding the credit risk; (ii) Norms no. 1/ 2001 regarding the liquidity of the commercial banks; (iii) Norms no 3 /2002 regarding "know your client" standards etc..

The Banking Law 58/1998 stipulates that at lest two persons should be appointed by the GSM of a bank to mange the day by day activity of the bank, respectively the President and the Vice-president of the bank (one or more vice-presidents could be appointed by a bank)

Based on article 29 of the Law 58/1998, the directors:

- have to declare immediately any conflicting situation; the conflicting situation is defined.

- at least once a year the director has to sign a declaration to state if he/she has any material interests with the bank.

- if a director is in a conflict of interest he/she has to refrain from voting.

The law also provides references to the professional secret and to the notion of "involved parties".

Law 58 stipulates also what persons can not be directors in a bank (a person can not be a director of a bank if the person is an employee of the bank with the exception of the President and Vice president(s)), if it works with another bank, if in the last 5 years the Central Bank withdrew the authorization of an individual which is proposed to be a director in a bank.

**) The purpose of all the sections in the paper referring to the banks, is to provide a short review of situation in the banking sector. The author is not considering the sections on banks as comprehensive sections.*

2.5 Duties and powers of the Board of Directors in the State owned companies **)

Apaps, which is the Romanian authority for the privatization of the state owned companies, would provide to their representatives in GSMs general or special mandates, based on which its representatives could make decisions.

Some "special mandates" would be provided for special cases such as: restructuring, divestiture of significant assets etc.. The representatives of the Apaps in the boards of directors would have to sign a "Director's Contract", immediately after being elected in

the Board by the GSM. The contract would be signed by the respective representative on one side and by one person representing the company, on the other side.

The mandate is usually provided for four years.

From discussions held with specialists who are close to the Apaps/State owned companies, one problem encountered with the board of directors representing the State is monitoring the activity of the director who is representing Apaps. The Apaps has to limit the potential damages that might be provoked to the company.

In the "Law no 99 / 1999 regarding measures to be taken to accelerate the process of privatization", Title III provides "Changes and amendments of the Companies Law 31/1990":

"Between the meetings of the shareholders, twice a year maximum, the shareholders have the right to be informed about the administration of the company. They may request, on their own expense, copies of some documents regarding the administration, the control, the management and functioning of the company. The directors have to answer in writing in maximum 15 days from the request of the shareholders. If the Board does not answer, the shareholders can go to the Court and can ask for the payment of some penalties, for each day of delay. One or more shareholders, owning at least 10% of shares, may request individually or together, to the Court, to name an expert to analyze the activity of the company. The report should be provided to the censors of the company in order to make the necessary proposals. "

Based on the "Decision no. 678/2001 regarding the approval of the functioning rules of the Apaps", art 13: "Apaps will empower its representatives, in the GSMs, to effectively exercise the quality of director, for improving the performances of the company and increase of competition".

A very important decision was made by Apaps, through the "Law no.137/ 2002 regarding measures to be taken for acceleration of the privatization process": Apaps started implementing the "**special administration procedure**" in the period of privatization.

The "special administration" is defined as "the administration of the company between the date when the decision of the Ministry/Local Administration is made and the date of the transfer of the ownership / the date established by the State".

The special administration is done based on a special mandate.

Apaps also adopted some measures to speed up the privatization process. By derogation from the Companies Law, the GSM could be called in 7 days instead of 15 days, in same cases.

Based on the Governmental Decision no. 577/2002, which approves the methodological norms for the special administration period, an administrator shall be designated by the

State authority. The administrator could be juridical or physical person, Romanian or foreign entity.

The "special administrator" shall participate at the GSMs and at the meetings of the Board of Directors, in order to supervise if the company fulfills the decisions taken by "the special administrator" over the period of special administration. If the GSM or Board makes a decision against the mandate of the special administrator, the "special administrator" can cancel the respective decision, with the approval of the State authority.

The main attributions of this "special administrator" are defined.

***) The purpose of all the sections in the paper referring to the Apaps companies, is to provide a short review of the situation in the State owned companies. The author is not considering the sections on Apaps as comprehensive sections.*

III. Composition of boards and their independence

3.1 Composition of boards

The main provisions of the "**Companies Law"**, regarding the composition of the board, is as follows:

(i) One or more directors administer the joint stock companies. If there are more directors they will form a Board of Directors.

(ii) The chairman of the Board could be the CEO/ General Manager of a company. The CEO is the only executive allowed by the Companies Law to be a member of the Board.

(iii) The first directors might be nominated through the Constitutive Act but their first mandate can not exceed 4 years. If the duration of the mandate was not established in the Constitutive Act, it is assumed to be of two years. The administrators might be re-elected, if the Constitutive Act does not mention any restrictions.

(iv) If the by-laws do not stipulate otherwise, at least half of the directors shall be Romanian citizens.

In order to find more regarding the composition of the Romanian boards of directors, in listed companies, two questionnaires were developed:

(i) A very simple Questionnaire, Questionnaire 1, of four questions. This questionnaire, with the great help of the Bucharest Stock Exchange, was distributed: (i) to the 14 companies listed and traded on the first tier (the market capitalization of the 14 companies listed and traded on the first tier represents 85% of the total capitalization of the BSE) and (ii) to the five SIFs.

11 companies and 2 SIFs answered the Questionnaire.

(ii) The second questionnaire, Questionnaire 2, with 24 questions. This questionnaire was distributed to professionals working (i) with the representatives of foreign investment funds holding minority shareholdings (ii) with the Association of the Romanian Shareholders; (iii) with the SIFs etc.. For this questionnaire, the companies were split in seven groups:

Group 1 – State-owned companies
Group 2 – Companies owned by strategic investors
Group 3 – Companies owned by foreign investment funds

Group 4 – Companies privatized through MEBO (Management & Employees buy-outs)
Group 5 – Banks
Group 6 – Insurance companies
Group 7 – SIFs

From the answers received on both questionnaires, here we can summarize some conclusions:

Size of boards

Of all the 14 companies listed on the first tier of the BSE, 13 companies have the size between 4 to 7 members; only one bank has a board composed of 11 members, (which is the maximum number of directors allowed by the law).

From the Questionnaire 2, the results show that the typical size of boards is between 3 to 9 members.

Executives / non executives

At the BSE, in the majority of cases, the only executive represented in the Board was the general manager/CEO. However, in the banks, due to the fact that the law allows it, more executives are allowed to be directors.

Based on the data provided on the Questionnaire 2, rare or very rarely the executives, others than the CEOs, are members of the Board; however, in the companies privatized by MEBO, it is common to see executives sitting in the Boards, although the "Companies Law" interdicts this situation.

So, we can conclude that executives are members of the Boards, with the exception of the CEO, in most of MEBO companies and in the banks.

Chairman of the Board / CEO of the company

At the BSE, in approximately half the companies listed on the first tier, the GM is also the Chairman, in the state owned companies. Foreign investment funds decided for the separation of the Chairman from the CEO.

Based on the Questionnaire 2, it seems that it is quite rare when the Chairman is different from the general manager. In particular, in the state owned companies and in the companies privatized by MEBO, the chairman is also the general manager.

3.2 Independent directors

Neither the "Companies Law" nor the "Romanian Securities Law" stipulates any provisions about the independent directors.

There are quite very rare cases when the independent members are elected to the Board. If so, they are experts in the field of activity of the company.

The notion of the "independent director" was introduced by the Bucharest Stock Exchange, in the Code of Corporate Governance. **Independent directors** are defined as the persons who: (i) are not relatives with the members of the management and with the significant shareholders (>10%); (ii) are not employees or directors of the majority shareholder; (iii) are not receiving any compensation from the issuer or its affiliates, with the exception of the monthly fee; (iv) did not sign any contract with the issuer.

However, the BSE did not define the two concepts of independence: (i) independence from shareholders and (ii) independence from management, as the OECD did. The two concepts of independence are very important considering the fact that it is extremely rare to find directors being independent both from shareholders and management.

3.3 Other cases

SIFs

Regarding the SIFs, with the exception of Muntenia Investment Fund, in all the rest of SIFs the Board of Directors is composed of seven members. Muntenia Investment Fund has a Board of Directors composed of 11 members. However, the management of the fund was delegated to "Muntenia Invest", based on a "management contract". Muntenia Invest has five directors.

With the exception of SIF Muntenia, in all the SIFs the Chairman is also the general manager.

From the general overview of the directors of the SIFs, it seems that all the five SIFs are meeting the requirement of having a few independent directors. However, we can say that these directors are independent from shareholders but they are not independent from the management (general manager is also the CEO). The shareholder structure is very dispersed and the power of the general manager / CEO is extremely high in the SIFs.

Foreign investment and venture capital funds

In many companies where foreign investment or venture capital funds have control or majority positions, the Chairman is not the same with CEO/ general manager.

Banks

Law 58/1998 provides that the operations committee of the bank should be also part of the Board of Directors. So, we can say that banks have one-tier boards, with executives also being directors.

IV. Role of boards in case of exceptional corporate actions

Chapter VI of the "Companies Law" mentions concrete steps and conditions to be followed by the directors and the management, in the cases of mergers, splits etc..

Chapter VII of the "Companies Law" provides also specific provisions regarding liquidation.

The "Romanian Securities Law" provides in art. 123 that the directors have to submit to the NSC current reports which shall be published in the NSC Bulletin. In these reports the directors should declared any juridical act concluded between the company and its directors, employees, majority shareholder, affiliated or **related parties** with the parties mentioned previously, which have a value of more than EUR 50,000.

The Code of Corporate Governance issued by the BSE provides that the issuers have to present monthly:

(i) The trading activity of the directors and managers;

(ii) Cross ownership:

a) any participation above 5% of the issuer in the ownership structure of any company,

b) any participation of any company where the issuer is a shareholder, if the participation is above 5%;

(iii) Commercial transactions concluded between the issuer and directors, the employees, the shareholders or any "related party";

(iv) Details about how preemptive rights were exercised.

V. Committee practice, audit committees, censors & financial auditors

5. 1 Committee practice

Based on art. 140 of the "Companies Law", the board of directors can delegate part of its power to a Directors' Committee, composed of members selected from the board of directors. The Chairman of the Board may be the CEO (general manager of the company) who may be also the chairman of the Directors' Committee. The decisions of the Directors' Committee are taken with absolute majority of the votes of its members. The Director's Committee is obliged by the law to present, at each meeting of the Board of Directors, its decisions. In the Director's Committee, the vote can not be mandated through a power of attorney. The Board of Directors may revoke at any moment the persons named in the Directors' Committee. The Directors' Committee must inform the Board of Directors immediately of any violations observed in the process of exercising its duties. The Directors' Committee has to meet at least once a week, in the company.

In practice, in Romania, such delegation does not take place. There are extremely rare cases where the Board delegates parts its responsibilities to a Directors Committee.

However, informally, in some Boards, this delegation takes place: at the meeting of the Board, a director(s) empowered to present their opinion(s) on some specific issues, would do so and would make his/her recommendations to the whole board which shall make a final decision.

5.2 Audit, Nomination and Compensation Committees

In Romania, the concept of the Audit, Nomination and Compensation Committees, composed of members of the Board of directors, is not in place. There is not law to define these committees.

Worldwide, it is well known that, the three Committees should be composed of independent directors and should have a very important role in the corporate governance of the company.

The **Audit Committee** should act based on written procedures on its responsibilities and obligations. The Audit Committee should provide an annual letter to shareholders regarding its activity and also should make an interim revision of the quarterly financial reports. The Audit Committee should revise the press releases regarding the financial situation, should evaluate the accounting policies selected by the management, should review significant or un-common transactions, and should discuss the financial statements with the management and the external auditor.

All in all, the Audit Committee has three fundamental responsibilities: (i) evaluate the internal and external audit process; (ii) oversee financial reporting and (iii) assess the processes related to the company's risks and control environment.

The Audit committee should assess the risks of fraud at all levels of management.

It is also well known that the board, the CEO/general manager, the executive managers, the other employees, and the independent auditors should enforce open communication.

While the internal auditor is responsible for monitoring the performance of company's internal controls, the independent external auditor is responsible for auditing and attesting the company's financial statements. An independent communication and information flow between the audit committee and the internal auditors are recommended, in order to improve the effectiveness of both. However, today, in many companies in Romania, this communication needs to be strongly improved.

The Nomination and Compensation Committees have to be considered also in Romania, bearing in mind their role in the selection of the directors and in providing a "fair" compensation for directors and managers.

Voluntary, Romanian companies can set up the three committees, until they are regulated by laws/rules etc., in order to improve the corporate governance.

5.3 Censors & financial auditors

The censors may not have a criminal record for fraudulent administration, breach of fiduciary duty, forgery, embezzlement, perjury, bribery or certain other crimes.

The "Companies Law" provides that a joint stock company has to have 3 censors and 3 deputies. It also indicates that an external independent censor should be appointed (the external auditor is imposed by securities regulations). The law provides that the number of censors have to be odd.

Based on the "Companies Law", the censors: (i) are appointed by the GSM; (ii) at least one censor must be an authorized accountant or an expert accountant; (iii) if the State holds more than 20% of shares in a company, the Finance Minister nominates one censor; (iv) in public companies there are also external censors; (v) participate in Board meetings and eventually express their opinion; (vi) they have obligations to inform shareholders and administrators in case of irregularities; (vii) they check compliance with legislation and Constitutive Act; (viii) they perform monthly check of cash and securities; (viii) they participate at the GSM; (ix) their report is presented at the GSM; (x) they call for a GSM on the request of 25% of shareholders.

The "Accounting Law no. 82/1991" was the pillar of the Romanian accounting system, for all companies, up to the year 2001 when the Ministry of Finance issued the Order no. 94/2001 (the so called OMF 94/2001).

Based on the OMF 94/2001 and the subsequent regulations regarding the audit activity, for the companies which will apply the audit requirements harmonized with the European Community Directive IV and International Accounting standards (IAS/IFRS), the provisions mentioned above (censors and the external independent censors), shall stop being applied. As a consequence, starting with the year 2001, the companies embarked for the application of the international accounting standards were obliged to have a so called "financial auditor" and were also obliged to organize an internal audit activity which includes some of the former activities performed by the censors. Therefore, the companies were obliged to have their financial statements audited by an auditor (physical or juridical person) and they had to organize a Department of Internal Audit that should have had at least one "qualified" person to perform such activity.

However, when the change of legislation took place, some attributions of the censors were not covered completely by the financial auditor: (i) censors issued a certificate to demonstrate that the directors deposited their guarantees; (ii) censors participated at the Board of Directors meetings; (iii) if 25% shareholders requested a GSM, censors were obliged to call the GSM; (iv) in the case of a vacancy of one director, the censors together with the other directors, appoint a temporary director until the GSM is called.

Currently, by having the financial auditors, the Board of Directors may invite the auditor, at any of its meetings, for clarifications, BUT it is not mandatory for the Board to invite the financial auditors.

Based on the provisions of the new "Romanian Securities Law":

a) The censors should supervise and control, not only the activity of the company but also the correctness and the opportunity of transactions or contracts concluded by the company with its directors, employees, shareholders or related or affiliated parties (article 113).

b) The half-annual report should include the censor/ financial auditor report, including his/her comments (article 125).

In same companies, the censors/financial auditors are not recognized as independent parties and they are rather recognized as being subordinated directly or indirectly to the management / majority shareholders.

5.4 Who is applying IAS standards in Romania?

Based on the OMF 94/2001, each group of companies selected to apply the new rules will have to prepare two sets of financial statements, in the first year, respectively one set according to the Accounting Law no. 82/1991 and another set according to the OMF 94/2001. In order to start the application of the OMF 94/2001, a very small group of

companies (around 10 companies) were selected to form a "pilot" group to first apply the new rules, for the year 2000, which was the first fiscal year for which both financial statements were needed to be prepared. For the first year of implementation of the OMF 94/2001, the auditors issued two audit opinions.

In the year 2001, approx. 700-800 companies started to apply the OMF 94/2001 and therefore they prepared two sets of financial statements.

At the end of the year 2002, all the companies that will comply with two of the three conditions mentioned below should start applying the provisions of the OMF 94/2001. The conditions are: (i) sales for the 2002 of more than EUR 8 million; (ii) total assets of more than EURO 4 million; (iii) number of employees above 200.

Romania is a hyperinflationary economy (cumulative inflation rate for three consecutive years is at least 100%). Regarding the hyperinflation, the OMF 94/2001 stipulates that companies have to prepare a set of financial statements without the Standards IAS 29, IAS 21 and SIC 19, which must be reported to the Ministry of Finance. Companies have the option to apply the standards IAS 29, IAS 21 and SIC 19 but the financial reports including these standards will be submitted only to the Trade Registry, for information of shareholders, stakeholders, other third parties etc..

Therefore, we can conclude that, at this moment, the Romanian companies do not apply "full" IAS standards, under the provisions of the OMF 94/2001.

Also, it has to be clearly stipulated that, for the first year of application of the OMF 94/2001, from the fiscal point of view, the companies had to keep two sets of registries: one set based on the Law 82/1991, based on which the income tax was paid and one set based on OMF 94/2001.

For small and micro enterprises, Ministry of Finance issued the Order no. 306/2002, to approve the simplified accounting rules, harmonized with the European Directives. Therefore, as of January 1st 2003, all small and micro enterprises should comply with the provisions of this Order.

Based on the OMF 94/2001, companies MUST report the following information:

a) Details regarding the salaries and retirement benefits of the managers and members of the Board of Directors;
b) Details regarding the loans provided to the members of the Board of Directors, the interest and the guarantees offered;
c) The payments made to auditors.

In practice only very few companies complied with the three requirements. Some companies preferred to mention the details specified on point a) as a percentage of their sales or as an aggregate amount.

Going back to the situation of the **banks**, the conclusion is that the main functions of the independent auditor are: (i) to assist the bank with accounting advice; (ii) to perform an yearly report to present its opinion about the financial statements and activity of the bank; (iii) to analyze how the bank performed its internal control and to make specific recommendations; iv) to inform the Central Bank regarding any act which might cause a prejudice to the bank.

The Central bank may decide that a bank has to be under “special supervision” through a special commission established for this purpose, which is independent of the management and directors of the bank. If the special supervision program does not provide results, the Central Bank can impose a “special administration” program. The “special administrator” program is designated by the central bank to takeover the functions of the directors of the bank.

VI. Board members qualifications, compensation and evaluation

6.1 Board members qualifications

In the Romanian joint stock companies, based on the survey organized through the Questionnaire 2, it seems that, in general, the qualifications of most directors are: technical/ engineering, financial, banking, and academic. Some directors are also involved in politics.

In November 2002 the Government publicly recognized that a significant number of its advisors, which are civil servants, are members of the boards of private companies. Some measures will be taken to reduce/stop this situation.

On the other hand, in some state companies where some civil servants are directors, some conflict of interests situation occur since some of these servants might act in the interest of the companies where they are directors, in situations where they should be independent (ex. speeding up authorizations etc.).

SIFs

The National Securities Commission issued the Order no. 7/ 1997, to approve the Instructions no. 4 regarding the qualifications needed by the Board members of the SIFs:

(i) They shall be Romanian citizens

(ii) The number of members shall be of at least five and shall be odd

(iii) The person: (i) has to have university degree studies; (ii) has to have at least five year experience in the legal, financial sector or in business; (ii) shall not have a criminal record and should not have been involved in public scandals; (iii) should not have been sanctioned by the NSC or by the Central Bank; (iv) should not have been a Board member in any of the companies where the SIF owned any shares; (v) should not have been a member of any Board or executive management of a depositary company or of a securities company; (vi) should not own, alone or together with third degree relatives, more than 5% of the social capital of a depository company or of a securities company; (vii) should not own, alone or together with his wife, relatives up to the third degree etc., more than 5% of the outstanding shares of the SIF where he is a member of the Board.

From the publicly available data, we have a summary of the qualifications of the members of the Boards, in the five SIFs:

SIF Oltenia

The Board of Directors is composed of seven members.

The Chairman of the Board of Directors is also the General Manager.

The Chairman graduated from the Technical Institute had different job positions in different companies (ex. engineer, chief of production, general manager). The Chairman worked in the Ministry of the National Economy, in the National Agency for Privatization, in the State Ownership Fund. He is the general manager and Chairman of SIF Oltenia since 1994.

Three members of the Board graduated and have extensive experience in the financial accounting area; one of the members was the deputy general manager of SIF Oltenia between 1996 – 2001; another member was an independent external censor & expert accountant in the period 2000-2001 (he worked at SIF Oltenia as chief in one of the departments of the SIF); the third member has a Phd in economics, worked as an inspector in the Ministry of Finance and worked in the Internal Affairs Ministry.

One member of the Board graduated from the Agronomic Institute, the Technical Institute and he has a Phd in technical sciences. He is also a deputy of the governing/ruling party.

One member graduated the law faculty and also international relations; he was a deputy of the governing/ruling party.

One member graduated the law faculty, has a Phd in economics and is also a qualified securities agent.

SIF Transilvania

The Board of Directors is composed of seven members.

The Chairman is also the General Manager / CEO of the SIF Transilvania.

Of the seven members, six members graduated from financial/ accounting/ economic faculties. One of the six members is a university professor, another member is a deputy, the third member is a director in a bank, the forth one is the Chairman of a County.

The seventh member graduated from law school and is also the Chairman of the Board of Directors in a joint-stock company.

SIF Moldova

The Board of Directors is composed of seven members.

The Chairman is also the general manager of SIF Moldova.

The Chairman graduated the Technical Institute/ industrial chemistry department, and worked on different job positions in different companies. The Chairman worked in the National Agency for Privatization, and in the State Ownership Fund. He was the Vice-president of the SIF Moldova in the period 1994-1997. Since 1997 he has been the Chairman and the general manager of SIF Moldova.

Two members graduated economic studies; one of the members was a chief of the shareholders department and is an expert accountant; the other member was a senator between 1992 – 1994, Vice President of the Senate in the period 1994 – 1996 and also in the year 2000.

Two members graduated the Technical Institute; one of the members has a Phd in engineering and for several years was the deputy general manager and respectively the general manager of the local municipality. In the period 1996-2000 he was a university professor and currently is a director in a joint stock company and university professor. The second member is the Vice President of SIF Moldova.

Two members graduated the law faculties: one of the members is also a Phd in economics and after 1990 he was either deputy or senator; the other member is an associate at a law cabinet and he is also a senator.

SIF Muntenia

"Muntenia SA" manages SIF Muntenia.

The Board of Directors of SIF Muntenia is composed of eleven members.

Eleven members of the Board have extensive experience in the economic /financial/ accounting fields; two members work in the banking sector, four members are deputies or senators; one member is an academic professor, one member resigned. One member graduated the Technical Institute and worked in public administration.

The Board of Directors of Muntenia SA is composed of five members.

SIF Banat – Crisana

The Board of Directors is composed of seven members.

The Chairman is also the General Manager / CEO of the SIF Banat - Crisana.

The Chairman has a Phd in economics, worked for 2 years with the Municipality of Arad, worked as a university professor for 4 years and starting in the year 1996 and is Chairman / CEO of SIF Banat Crisana.
The second member of the Board has a Phd in economics, it was and it is currently a university professor.

The third member is a lawyer and was a senator in the past.

The forth member is retired currently but acts also as an advisor to Arad Municipality.

The fifth member graduated a technical university and started to work for the SIF Banat Crisana in 1992.

The sixth member is a university professor, specialized in chemistry, and food technology, in economics.

The seventh member graduated from a technical university, and is currently a deputy in the Parliament.

As regards the banking sector, the central bank requires each **commercial bank**, for its directors, to fulfill some qualifications. One of them is to have professional directors and executive managers. The Central bank specifically requires the directors and the executive managers to be honest. The bank might reject some directors or executive managers, as considered appropriate.

The directors and executive managers of the banks should reside in Romania, must have 5 years experience in financial-banking activity and should not have been involved in the bankruptcy of any commercial company. They have to be approved by the Central Bank, before they start their activity. The Central Banks establishes ethical and professional rules for the banking sector.

Since 1999, the **Apaps** rules have clearly stipulated that its representatives in the Boards could not be employees of the Apaps, in order to avoid the conflicts of interests.

6. 2 Board compensation

The monthly fees received by the directors and members of the Directors' Committee have to be approved by the GSM. The Companies Law stipulates that the fixed salaries / remuneration and any benefits which will be provided to directors and to censors, have to be provided in the Constitutive Act or approved as a decision of the GSMs.

Based on article 178 (4) of the Companies Law: "the directors can be compensated from the net profit of the company, if this is provided in the Constitutive Act or it is approved in the extraordinary general shareholders meeting".

Based on the answers provided by the listed companies on the Bucharest Stock Exchange, here we have some conclusions:

(i) For the state owned companies the monthly fees for directors are expressed as a percentage, respectively 20% of the gross salary/ salary/ base salary of the general manager; the salary of the general manager is confidential. However, we can estimate a range of the net monthly fee for a director between USD 100 in small companies to USD 500 in large companies.

(ii) For the rest of companies the net monthly fixed fee, excepting the banks, is between USD 200 – 300.

(iii) For the banks, the net monthly fees of the members of the Board are between 600 – 800 USD net;

(iv) There are 4-5 cases where the chairman is better remunerated than the rest of Board members, including the situation of the banks;

(v) Directors are not remunerated based on the performance of the company.

Based on the information received also from the general Questionnaire, the Questionnaire no. 2, the following conclusions could be made:

(i) Net fixed remuneration of the directors is between US 100 – 500, from small to very large companies;

(ii) The directors in larger companies are better remunerated that the directors from small companies;

(iii) The Chairman, on average, is better remunerated than the rest of Board members;

(iv) Very rarely, other directors, with the exception of the Chairman, are better remunerated; however, this situation might happen in the case of foreign advisors etc.

(v) Directors are not remunerated based on the performance of the company;

(vi) Among “other advantages” received by the members of the Board are: mobile phones, cars etc..

Based on the answers received for the Questionnaire 2, there are some controversies regarding the remuneration of directors: some people who answered considered that the board members are quite inactive (and better remuneration is not needed), while some people believe that they really have to be remunerated based on performance and therefore, in the cases of good performance, they should be remunerated better.

Bearing in mind the average salaries of the CEOs/ general managers, we can conclude that on average, the payment of the directors is quite poor, respectively between 10% to 15% of the general manager salary.

In practice, strategic investors and investment funds, for the members appointed by them in the Board, would pay additional salaries or compensations, from non-company funds.

In some companies, some experts were invited to join the Board and to share their expertise with the directors and the executive managers. There are cases when in the GSM some higher fees were approved for such experts.

SIFs

In the case of the **SIFs**, it was quite difficult to get some data about their remuneration.

Among all the five SIFs, SIF Oltenia made public Board remuneration, on their Web site, and the Board remuneration is of USD 325 net.

In SIF Moldova, the remuneration of the Board members is 25% of the salary of the general manager.

From some informal discussions, it seems that the range of the Board remuneration, in SIFs is between 300 – 500 net USD.

However, what is very interesting is the fact that, for SIF Oltenia and SIF Banat at least, the directors along with the employees will get a bonus based on the performances obtained. The global bonus is expressed as a percentage of the net profit and it is approved by the GSM.

6.3 Board evaluation

The overall evaluation of the activity of the Board is very often made at the annual GSM, where the budget is compared to the results. However, even at the annual GSM, the evaluation is done in a superficial way, in many companies.

There is no systematic “comprehensive” evaluation of the Boards.

The Companies Law stipulates in the article 111 that the GSM has to decide upon the Report of the directors, which is presented annually.

The accountability of the board and board’s members to the company and the shareholders is in practice poorly defined, understood and enforced. There are extremely few cases when boards and board members have been found responsible for the damages suffered by the companies and by shareholders.

VII. Conclusions and recommendations

1. A contract between the company and its directors might increase the awareness of the responsibilities and duties of the respective directors.

The Board members who are nominated and appointed by the control / majority shareholders might be "tempted", in same cases, to act in the interest of the control/majority shareholders. As such, they might not ensure "an equal treatment of shareholders".

A contract might be useful to be signed, by each director, with the company, at the moment of his/her appointment. The contract shall stipulate all the major duties and responsibilities of each director, based on the legal framework in place, Constitutive Act/ By-law of the company, NSC/BSE rules etc.. The contract should stipulate also to the sanctions from different laws/regulations etc.. In addition, the contract shall enumerate in its body all the laws, regulations, codes that shall be known by each director.

Due to the fact that in the majority of cases the directors are not signing any document/contract with the company, at the moment of their appointment, they are not fully aware of their responsibilities / duties.

This recommendation is not providing a solution to make directors responsible but I believe will increase the awareness of the directors and, in time, might determine directors to become more responsible in front of the company and all shareholders.

2. The "Directors guideline" should be published.

Like in other countries from the region, it will be very useful a "Directors' guideline" to be published.

This guideline shall contain all the necessary laws, regulations, codes etc. needed to be known by a director.

3. The "Board fee" shall be paid entirely by the company. The "Board fee" shall be paid based on the work, involvement and results of directors. Performance bonuses shall be established for directors.

In all companies the directors receive a "board monthly fee" from the company. However, in some cases the directors are paid, for the "director" position, also by shareholders, from non-company resources, based on some confidential arrangements.

In these cases the directors might lose their independence towards the company and all shareholders.

I would recommend that the Board fee, for any Board member, to be paid entirely by the company. This recommendation will determine an increase of the "director fee" / company cost. However, the company / all shareholders will have to bear equally the cost in order to ensure more transparency and independence of these directors.

Different directors allocate different time and know-how resources, from company to company, in exercising their duties. As mentioned above, some directors are paid also from non-company funds, for their duties, when they allocate more time/resources in exercising their duties. As such, in many cases, their "board fee" is in fact much higher than the "official Board fee" which was approved in the General Shareholders Meeting.

When establishing the "official board fee" I would recommend the following: (i) the strategy of the company to be analyzed in order to make an estimate of the amount of time / resources needed to be allocated by directors; (ii) a directors contract to be signed to stipulate the average number of days to be allocated, per month, by each director; (iii) performance criteria to be established for ensuring a bonus scheme for directors (each year, the activity of directors shall be analyzed/ evaluated).

If board members would be paid according to their contribution towards the success of the company, more professionals will be attracted in the "directors" industry and the number of professional independent directors will increase.

4. Implementation is needed of the IAS/IFRS standards regarding directors compensation.

Under the IAS/IFRS regulations that started to be applied in Romania in 2001, directors and managers should disclose their remuneration in the Annual Report, when the financials are approved. In practice, there are extremely rare cases when this provision is applied.

Due to the fact that the "board fee" is approved in a GSM, I recommend directors to start applying this provision. Shareholders should also make sure this information is disclosed in each annual report.

The BSE and Rasdaq market should also exercise some pressure over the "first tier listed companies", in disclosing this information.

For the compensation of the management, I would recommend that at least the total cost of the company to be included in the Annual Report, for a specified number of top executives (Ex.: for "x" top managers the total cost of the company is "y").

5. Sanctions for directors shall be enforced.

Although the legislation is stipulating the sanctions for abuses etc., in reality, there are still small number of cases where the directors have been sanctioned.

A better enforcement of the sanctions would determine the directors to watch more carefully upon the legislative framework/requirements and to perform better their duties.

6. Executives should be eliminated from the Board of Directors

In general, the number of cases where the executives are also directors decreased over the last years. However, in companies privatized by "MEBO" we can say that having executives in the Board is rather a rule that exception, although it is prohibited by the law.

By not having executives in the boards (other than the Chairman who could be also the CEO/general manager), the influence of the executives over directors is reduced. Conflicts of interest are very much reduced and in many cases the performance of the company is better.

7. Companies should start appointing independent directors.

As mentioned by the OECD, an independent director shall be independent from shareholders and from management. I believe this is a very important clarification to be made from the beginning.

In the case of the SIFs, in general, the directors are independent from shareholders. However, it is difficult to say if they are also independent from management. I would rather believe that they are not independent from management.

The Romanian Securities Law, very recently issued, defined the cumulative voting. This is a very important step forward. Due to this provision the number of independent directors in listed companies will increase over the next 1-2 years.

In general, in Romania, there are quite rare cases when directors are independent both from management and from shareholders.

8. The position of Chairman should be separated from the CEO/general manager.

In companies where the Chairman is also the general manager/ CEO, the power of the management over the Board is bigger. In some cases this situation might determine the Board to be less transparent or to be "manipulated".

Some experts believe that the Board is weaker if there are no executives there. They believe that the Board is missing the technical abilities to make the best decisions.

In practice, in many cases, if the CEO is excluded from the Board, directors with extensive industry expertise are appointed in order to fill the potential gap. In many cases, the company performed better when this solution was adopted.

Therefore, separation of the chairman from the CEO is further encouraged, in parallel with making sure that the Board has all the technical/industry abilities to be able to make the best decisions for the company.

The SIFs and MEBO companies shall very carefully consider this recommendation.

9. A "Directors Institute" should be established. Training for directors should be initiated.

In order to improve the quality of the work of the Boards, a Director's Institute was recommended by the OECD, back in September 2001, to be set up, for training, sharing experience, setting up and checking qualification requirements, building-up a database of suitable Board members etc..

In Romania, setting up of a Directors Institute is a must. The main market players should consider solutions for setting up this Institute.

However, if the Institute is not organized soon, I would recommend that the BSE, Rasdaq, Apaps,etc. to organize seminars/ training sessions for directors. By inviting professional directors to lead these seminars, the level of education will increase and in time the quality of directors will improve.

10. A new profession on the "horizon" ?

The OECD is emphasizing how important is for directors to devote sufficient time to fulfill their responsibilities.

In a developing country such Romania, companies are confronted with many complex problems. In addition, the management is quite rarely able to "cope" with all these problems. The involvement of directors, in some cases, is needed more than 2-3 days a month. There are directors working on average of 1-2 weeks per month, for one company.

In some cases, an experienced director might work for 2-3 boards in the same time and might be "full time" director.

11. Nomination of directors should be based on professionalism.

Nomination of directors for the Board has to be made upon experience and professionalism. The nomination process of board members has to be more transparent.

Some basic procedures for the nomination of directors should be included in the legislation or should start being promoted by companies on their own initiative.

The companies listed on the first tier of the BSE might be the best examples for the market. It might be helpful the BSE to draft a procedure regarding nomination of directors.

12. Start voluntary the implementation of Directors Committees: Audit, Nomination and Compensation Committees.

The current laws dos not define the Audit, Nomination and Compensation Committees. Some progress should be made in this aspect and the appointment of independent directors in these committees should be encouraged.

It might take too much time until these committees will be legally defined/regulated.

Companies are encouraged to voluntary appoint these committees.

13. Revision of the attributions of the auditors/censors vs. financial auditors. Strengthening of the censorship/financial auditors' activity. Strengthening internal control activities.

Some attributions of the auditors/censors were not transferred to the financial auditors, when companies started to apply the IAS/ IFRS standards.

The activity of censors/auditors and of some financial auditors (especially when financial auditors are private individuals instead of companies) is poor.

The internal audit department, in many cases is under developed.

Internal and external audit activities shall be strengthening.

14. Continue to lobby companies to list on the Transparency Tier of the Bucharest Stock Exchange.

The BSE and the securities companies should continue to persuade banks, large companies like Petrom, to get promoted to the "Transparency tier". These are the most

important targets for the Bucharest Stock Exchange, due to the weight they have in the BSE market capitalization and also due to their total turnover. In this way the process of appointing independent directors is further developed. It is very important "big players" to provide good examples for the market.

BSE and Rasdaq should impose to the companies listed on the first tier and to SIFs to provide on their internet site the CVs of the top managers and Board members.

15. The Rasdaq should follow the BSE in implementing a Code of Corporate Governance.

Rasdaq very recently established the first tier where the most transparent companies were listed.

Rasdaq market shall start implementing a Code of Corporate Governance, like the BSE.

16. The SIFs and the foreign investment funds should become "corporate governance agents"

The SIFs and some foreign investment funds are in the same time minority, control and majority shareholders, due to their very diversified portfolio. As such, they could be considered major "agents for change" and "corporate governance agents".

I would recommend these funds to be leaders in implementing the corporate governance principles.

17. Separation between the "political involvement" and the "director" function

Especially in the case of SIFs, the shareholders and also the NSC shall consider the degree of involvement of the directors who are deputies and senators.

The Boards of SIFs are composed of many directors who are deputies and senators in the Parliament.

18. Excluding civil servants from the Boards

In long run, step by step, the civil servants have to be excluded from serving as directors. This subject has to be considered especially for the state owned companies.

In some companies, these civil servants are in clear cases of conflict of interest.

19. The Company Law should be amended.

Some lawyers believe that a special chapter on the corporate governance of the listed companies should be included in the Companies Law.

I believe this is a good recommendation.

20. Corporate Governance principles shall be applied by foreign investors, as in their country of origin.

Some foreign investors, although coming from western markets, hesitate to apply the corporate governance principles in Romania like they do in their country of origin.

It is well known that the foreign investors are “corporate governance agents”. Therefore, more transparency and disclosure is recommended also from their side.

21. The correlation between the “premia” to be paid and better corporate governance shall be observed.

In other countries some surveys demonstrated that the "premia" that investors are willing to pay for better corporate governance are inversely proportionate to a market’s liquidity and depth. As the market conditions worsen and equity risks rise, the importance of the corporate governance will rise as well.

Abbreviations/definitions

Apaps - Authority for Privatization and Management of State Ownership

Board - Board of Directors

BSE - Bucharest Stock Exchange

Censors - are individuals performing activities as external auditors; for simplicity, all over the text they will be called censors

CEO - Chief Executive Officer

Directors – members of the Board of Directors

GSM - General Shareholders Meeting

MEBO - Management and employees buy-outs

NSC - National Securities Commission

Open company – publicly owned company

"Ordinance 28/ 2002 regarding securities, financial services and regulated markets" amended by the "Law 525 / 2002 for the approval of the Ordinance 28/2002" - "The Romanian Securities Law"

OTC / Rasdaq - Over the Counter/ Romanian Association Dealers Automated Quotation

RAS - Romanian Association of Shareholders

SIFs - Financial Investment Funds

Appendix 1

Romania - a macroeconomic review

Romania suffered an economic recession in 1991 and 1992, when GDP contracted by a cumulative 30%. In 1993, an increase in GDP was observed. Another increase followed in 1994, and in 1995 Romania noted the second highest GDP growth rate in the region after Poland. The GDP growth rate slowed in 1996 to 4.5% and in 1997 GDP growth was negative (-6.9%), below expectations. 1998 and 1999 continued the downward trend, with 5.4% and 3.2 % decreases, respectively. Starting in 2000, the National Statistics Institute changed the calculation methodology for GDP, introducing the new European System of Accounts (SEC 95). Thus, the previous 1.6% increase in 2000 was restated to a 1.8% increase while 2001 provisional data show a 5.3% real growth. The first semester 2002 figures (provisional) report a 4.5% year-on-year increase in real GDP.

During the last ten years, the GDP structure suffered important changes; the most important of all is related to Services: their weight increased from 26.5% in 1999 to 46.4% in 2001. Agriculture and Forestry decreased to half of their 1990 value (10.7% in 2000, down from 21.8% in 1990) but recouped in 2001 to 13.4% due to a very good agricultural year. The construction sector has not suffered major changes, while the industrial sector decreased from 40.5% to 30.4%.

In value terms, in 2001 GDP reached ~ USD 39.7 million.

Romania experienced high inflation over the last 10 years. The inflation figure for 1998 reached 40.6%, in 1999 it went up to 54.8%, but decreased to 40.7% in 2000. The 2001 initial target of 29% was only marginally surpassed, to 30.3%; 2002 target is 22%, as it was included in the IMF agreement. The cumulative inflation for the first eight months of 2002 was 10.7% while recently Government officials announced that the whole year inflation will be lower than the initial target, possible even below 19%. One of the main goals of the Government National Medium term Development Strategy is to achieve one-digit inflation by 2004-2005.

Unemployment rate reached a peak of 11% in 1995. As of end July 2002 the unemployment rate was 9%. However, compared to other countries in the region, Romania has a lower unemployment rate. The average net salary is the equivalent of USD 118.

The Central Bank's hard currency reserves have increased steadily since their record low at the end of 1996 of USD 600 million, or less than one month's imports. The Central Bank ended 2001 with a reserve of USD 3,926 million while at the end of August 2002 they stood at USD 5,545 million. The Central Bank has already directed one third of the

hard currency reserve to EURO. A gradual increase of the EURO share in total hard currency reserve is expected.

By end 2002, Romania has to face debt repayments of USD 524 million.

The private sector accounts for over 67% of GDP compared to 49% in 1994. Private enterprises have rapidly developed in trade, services and, to a lesser extent, industry.

The trade gap reached its maximum of the last 10 years in 2001: with imports computed in FOB prices, it amounted to USD 2,969, 76.4% wider than the USD 1,683 gap recorded in 2000. Textiles, machines and equipment, metallurgic products, footwear and mineral products accounted for 69.8% of cumulated exports. Machines and equipment, textiles, minerals, chemicals and metallurgical products took a combined 68.3% of imports. The seven-month 2002 trade deficit, with imports computed in FOB prices, amounted to USD 1.44 billion, 11.6% lower than the USD 1.62 billion gap recorded in the similar period of 2001.

Privatization in Romania began in June 1990 with Law 15/1990 which regrouped state enterprises into "Regies Autonomous" (self-autonomous state owned entities, which were usually in sectors of strategic importance and were supposed to stay under the state control) and joint-stock companies. Law 58/1991 created the State Ownership Fund (SOF) and 70% of the shares in most state-owned companies were assigned to it. Additionally, five Private Ownership Funds (POF) were established into which the balances of shares in these state-owned companies were contributed.

In order to accelerate the pace of privatization under the above framework, a complementary law, Mass Privatization Law no 55/1995 was passed. Under the resulting Mass Privatization Program, privatization vouchers were distributed to about 16 million eligible Romanian citizens, exchangeable for shares in approximately 6,000 state-owned companies. 1995 successfully completed the voucher distribution process and citizens/shareholders can now trade on the Rasdaq (OTC) and Bucharest Stock Exchange markets.

Shares not distributed to the population have remained under the SOF's administration (currently named – Apaps, the Authority for Privatization and Management of State Ownership) and have been sold by various methods including auctions, initial public offerings and trade sales. Majority shareholdings (at least 51%) in a number of state-owned companies are currently being sold to strategic investors through direct negotiations.

According to the legal framework in force before 1998, state-owned companies were transferred into private hands by one of the two methods:

- Free transfer (the Mass Privatization Program – "MPP")
- For cash (public sale, direct negotiations, trade sale, management –employee buy-outs – "MEBO").

Under the MPP, typically between 40% to 60% of approximately 4,000 state-owned companies, including the five POFs, were freely distributed to the population. The freely transferable percentages comprised up to the POFs' entire shareholding, with the balance being covered by the SOFs. The citizens therefore have the option to place privatization vouchers either with a commercial company, or with one of the five POFs.

In 2001, the government demonstrated its political commitment through the sale of Sidex, Eastern Europe 's largest steel plant, and Banca Agricola, a once-troubled farmer's bank.

Romania was nominated by the US Congress among the countries recommended to be accepted in NATO, at the November Prague Summit, this year.

Romania is proposed to enter the European Union in 2007, based on the future developments.

Appendix 2

The Romanian capital market

There are two organized securities markets in Romania: the Bucharest Stock Exchange (BSE), and the Over the Counter (OTC) market, which uses the RASDAQ (Romanian Association Dealers Automated Quotation) system.

The ***National Securities Commission*** (NSC) regulates the institutional network and the infrastructure of the capital market. NSC is an autonomous administrative authority, subordinated to the Romanian Parliament.

The first securities law adopted by the Parliament was the "Law no. 52/1994 regarding securities and stock exchanges". Based on the Law 52/1994, the institutions of the securities market were established and started to function.

Bucharest Stock Exchange

The Bucharest Stock Exchange resumed operations in 1995, after 47 years of inactivity. The BSE benefited from the assistance of the Canadian Government. The BSE is covers 3 trading categories: (i) securities issued by domestic entities; (ii) bonds and other securities issued by the Romanian state, counties, cities, and central or local public administration authorities; (iii) and the international section.

On October 31st, 2002, the market capitalization of the Bucharest Stock Exchange was of 2.9 billion USD. Of the USD 2.9 billion, 14 companies listed and traded on the first tier (see Appendix 4), and accounted for USD 2.4 billion market cap.

The average weekly turnover of the BSE was, for the first ten months of this year, of 4 million USD (average daily turnover of ~ 0.8 USD million).

The companies listed on the BSE are split as follows:

- The "transparency" tier or the "Plus" tier, recently instituted by the BSE.

Companies from the "first" or the "second" tier agree to comply voluntary, in addition to the requirements of the "first" or "second" tier, to a new set of rules and requirements which will determine a significant improvement of their transparency, disclosure and corporate governance principles. The companies willing to be listed on the "Plus tier" have the obligation to adopt, among others, a "Code of corporate governance" (see below the main provisions of the Code).

In autumn 2002, one company was promoted to the "Transparency tier", namely Electroaparataj (a company with a market capitalization of approx. 7 million USD,

owned by foreign investment funds). Electroaparataj is currently traded on the "second tier" of the BSE.

- "First tier", where the so-called "blue chips" are listed and traded (19 companies listed, 14 companies traded, as of Oct 14, 2002).

- "Second tier", where the rest of the companies are listed and traded (46 companies listed, 30 companies traded as of October 14, 2002).

- "Financial Investment Funds" tier, where five very large local investment funds are listed and traded (please see below).

- "Un-listed" tier.

- "Municipal bonds" tier.

The BSE has two main indexes: (i) Bucharest Exchange Trading Index (BET) and (ii) Bucharest Exchange Trading Index, a composite index (BET-C). The BET is computed on the average quotations of the 10 most liquid stocks on the first tier and was launched on September 19, 1997, with an initial value of 1,000 points.

The BET index increased by 105.4%, in USD, in the period January – October 2002. See the Appendix 1, for the composition of the BET Index.

Rasdaq(OTC) market

The Rasdaq/OTC market started to operate in October 1996. The OTC market uses the Romanian version of the US-NASDAQ system, Rasdaq. The Rasdaq market represents the result of a common project developed by the Romanian and USA Governments (the USA Government was represented by USAID). The transaction system used by Nasdaq was used as a model for the Rasdaq system.

The main indicators provided for the Rasdaq market, by the ANSVM (the association of the securities companies trading on the Rasdaq market), at the "Capital markets awards" – Oct 2002, are as follows:

Number of companies listed	4900
Total number of companies traded (1996 – 2002)	4520
Total turnover (1996 – 2002)	1.35 bill. USD
Number of companies privatized through Rasdaq	172
Capitalization	1.8 bill. USD
Index performance (Jan – Sept 2002)	+ 37%

Source: ANSVM / Rasdaq - October 2002

The Rasdaq market operates with one official index, launched on July 31, 1998.

The main significant events on the Rasdaq market, in the last year:

- A new ANSVM Board was elected, committed to improve the transparency, credibility and the overall activity of the Rasdaq market;

- "Rules no. 2/ 2002 regarding the transparency and the integrity of the Rasdaq market" were issued in October 2002. The rules established:

  (i) the three "tiers" of the Rasdaq market;
  (ii) the listing requirements for the three tiers;
  (iii) the rules regarding the trading activities (settlement of the price, variation of price etc.).

  The issuers have to comply with some specific requirements, for each tier. The three tiers are: (i) "First" Tier; (ii) "Second" tier; (iii) "Base" tier.

  At the beginning, all the companies would be automatically listed on the "base" tier. Issuers have to voluntary require to be promoted to the "first" or "second" tier.

  The issuers listed on the "First" and "Second" tier have the obligation to provide to the market current, annual, half-annual and quarterly reports (if the quarterly reports are required by shareholders).

- On October 29, 2002, the first 32 companies were listed on the first and second tier:

  First tier companies are: Alprom Slatina, Ana-Imep Pitesti, Electromagnetica Bucuresti, Iproeb Bistrita, Petrotub Roman, Romarta Bucuresti, Santierul Naval Braila, Severnav Dr. Turnu Severin, Socep Constanta.

  For the second tier, 23 companies were listed.

  Two new indices were launched by the Rasdaq market – RAQ I and RAQ II.

  From the total number of companies listed on the Rasdaq market, 20 companies are eligible to be listed on the first tier and 90 companies are eligible to be listed on the second tier. However, at this moment, only 9 and respectively 23 companies voluntarily got listed to the first and second tiers.

- The first event "Capital Market Awards" has been very successfully organized by the ANSVM.

Financial Investment Funds (SIFs)

The SIFs are functioning as joint stock companies. They are self - managed funds, with fixed capital which is 100% private. The SIFs were established in 1993 as "Private Ownership Funds" and then, they have been re-organized in accordance with the provisions of the Law 133/1996 which transformed the "Private Ownership Funds" into "Financial Investment Funds" (SIFs). They also function based on the provisions of the Ordinance 26/2002, Ordinance 24/1993 approved by Law 83/1994, Rules of the NSC no.9/1996, Law no. 164/1999 for approval of the Emergency Ordinance 54/1998.

The main activities of SIFs are: (i) management of portfolio of shares for the companies where they invested; (ii) investments, in order to maximize the value of its shares etc..

The five SIFs are:

1. Banat-Crisan Investment Fund
2. Moldova Investment Fund
3. Muntenia Investment Manager SA
4. Oltenia Investment Fund
5. Transilvania Investment Fund

Until October 23, 2002, the five SIFs had a total market capitalization of approx. USD 275 million. However, their total Net Asset Values, represented approx. USD 610 million.

The total number of companies in the portfolio of the five SIFs was of 2106, on September 31, 2002 (See Appendix 5). Of the 2106 companies in their portfolio, more than 50% companies were listed on the Bucharest Stock Exchange and on the Rasdaq market. Based on the Appendix 2:

- the five SIFs own less than 5% ownership in 16.38% of the 2106 companies;
- the five SIFs own between 5% to 33% in 65% of the 2106 companies;
- the five SIFs own between 33% to 50% in 9.78% of the 2106 companies;
- the five SIFs own more than 50% in 8.84% of the 2106 companies.

According to the by-laws of the five SIFs, no juridical or physical person can acquire shares in SIFs if, as a result of this acquisition, the respective person will own more than 0.1% of the total number of shares of the respective SIF. However, this threshold is about to be increased, based on the rumors circulating in the market, to 1%.

Foreign Investment funds

Foreign investment funds invested in listed companies, based on some general estimates, more than USD 250 million, over the last 5-6 years. These funds, like the SIFs, own minority, control or majority positions in companies listed on the BSE and Rasdaq.

Pension funds, mutual funds, insurance companies etc.

There are no private pension funds established in Romania.

The existing mutual funds would invest primarily in TBills and bank deposits. The mutual funds are small players in the capital market.

The insurance companies are very small players in the capital market.

Romanian Association of Shareholders (RAS)

The Romanian Shareholders' Association is a non-profit and non-governmental organization of Romanian Companies' shareholders. It was founded in October 2000 and it is located in Bucharest.

The objectives of the RAS are:

(i) To support the harmonization of the Romanian institutional and legal framework with the EU's standards on issues such as minority shareholder protection and transparency of the capital market;

(ii) To inform and educate shareholders on issues like their rights and how to protect themselves against the management's abuses;

(iii) To become a member and to cooperate with the Euroshareholders Group.

The mission of the RAS is to serve and protect the interests of the Romanian Companies' shareholders. Their aim is to introduce and enforce the principles of the corporate governance issued by the OECD within Romanian economic environment. The RAS was accepted as a member by the International Corporate Governance Network and as an associate member of the European Group " Euroshareholders". It was created by the five SIFs (mentioned above) and one individual.

Currently approx. 100 individuals and about 16 juridical companies joined the founders, in the association.

The RAS fully subscribed to the Principles of Corporate Governance issued by OECD and with the Euroshareholders' Recommendations.

As provided in its by-laws:

"The Association shall act in the interests of its members, for the purpose of:

a) Protecting the interests of the minority shareholders;

b) Promoting by specific means the principles of equity between the shareholders of a corporation regardless of the stake of the capital stock they own, the transparency, the equal, current and timely information of all shareholders;
c) Promoting the international standards of corporate governance recommended by the Organization for Economic and Cooperation Development ("OECD"), the standard financial and accounting reporting and the adhesion of Romania to OECD principles."

The main two disputes between minority and majority shareholders, in Romania, would be:

(i) The compliance with the principle of maximizing shareholders value;

(ii) Fair price at which a public offer should be made by a strategic investor for closing /de-listing the company from BSE or Rasdaq market.

"Financial Market Reform in Romania" (FMR)

"The Financial Market Reform" in Romania is a USAID project administered by Deloitte Touche Tohmatsu Emerging Markets. The project is implemented on behalf of USAID under a two-year technical assistance contract with Deloitte Touche Emerging Markets (USA). A core team of capital markets experts is located in Bucharest, and began work in November 2001.

The project delivery system is unique, as no single entity public or private is the host beneficiary. The beneficiary institutions include, and are no limited to, the main capital market institutions such us, the Senate Sub-Commissions of Capital Markets, National Securities Commission, BSE, Rasdaq, UNOPC, ARA (Romanian Shareholders Association), APAPS (Authority for Privatization and Management of State Ownership), and others.

The USAID mission's strategic objective is to create a more competitive and market responsive financial sector. The results will expand and strengthen private markets and encourage more transparent and accountable government and private institutions. The technical assistance experts also work with host institutions to develop self-funding and revenue-producing mechanisms for future sustainability of the institutions and the services they provide to investors and issuers."
Source: FMR/ October 2002.

The FMR worked closely, in the last one year, to learn about market successes and problems, to develop detailed work plans with BSE and Rasdaq, to provide comments on pending capital markets and pension legislation to Legislative Council and Senate Capital Markets Sub- Committee charged with preparing legislation. It also worked to prepare analyses for the Senate Committee covering international best practices for minority shareholders rights, investment funds etc.

The FMR drafted regulations for NSC covering intermediary operations, market operations, investor protections, share registration etc.. At the FMR recommendation, the NSC provided four weeks “sunshine” period for comment by market participants on new regulation.

The FMR prepared a Feasibility Study documenting existing problems and recommended solutions to transform Rasdaq into a normal capital market; assisted and supported Rasdaq market personnel to remove from the market hundreds of companies that do not comply with basic standards for public trading; advised Apaps for selecting brokers for privatization transactions on capital markets, etc..

Appendix 3

Corporate Governance in Romania

In Romania, the concept of the corporate governance is a relatively new one.

However, in the last years, the business community started to become more aware of this concept. Moreover, the concept started to be implemented by different companies.

The **"Companies' Law"** was adopted in 1990 based on the Continental European model of the corporate governance. The "Companies Law" was set up to be applied by all types of commercial companies: state /private owned, domestic/foreign, small/large etc..

The chapter IV of the law is entirely dedicated to joint stock companies. Under this chapter, there are the following sub-chapters: (i) Shares; (ii) General Shareholders Meetings (GSMs); (iii) Boards of Directors; (iv) Censors; (v) Bonds; (vi) Registries and the balance sheet.

The "Companies Law" is defining the General Shareholders Meeting (GSM) as the supreme organism of the corporate governance system which designates a Board of Directors (known also as administrators) with an overall responsibility for the administration of the company and a Censor's Committee for supervision.

The "Companies Law" is the first pillar of the corporate governance system in Romania and to a large extent it seems to meet the international standards.

In 1994 the Romanian Parliament approved the **"Law no. 52 regarding securities and stock exchanges"**. The law regulated the National Securities Commission, the establishment and functioning of the securities markets, together with the institutions and operations specific to such markets, for the purpose of mobilizing the savings by means of securities, under conditions appropriate for the protection of investors. The law clearly defined terms such as: issuer, publicly traded company, public offers, control and majority position, takeover, confidential information etc..

Unlike the "Companies law" which was inspired by the continental model and the Romanian Commercial Code, the Law 52/1994 was absolutely a new piece of legislation. For drafting the law, assistance was received from the Canadian and British experts.

After 1994, due to the market developments, minority shareholders started to be more and more active in protecting their rights. In the year 2000, the Emergency Ordinance 229/2000 concerning minority shareholders' protection, brought a lot of new proposals, considered normal by the minority shareholders in order to better protect their rights. However, the Ordinance was heavily disputed between the minority and majority shareholders and did have a short life.

In order to harmonize the securities legislation with the European Directives, in 2002, the National Securities Commission issued new securities legislation. In April 2002 the Emergency Government Ordinance no. 28/2002 regarding securities, financial services and regulated markets was issued. Then, in the summer, the ordinance was approved through the Law no. 525/ 2002 (**hereinafter the Ordinance 28/2002 and the Law 525/2002 will be referred as to the "Romanian Securities Law**").

The Companies Law is prevailing for the corporate governance, with the exception of the derogation of the securities law and its new provisions for listed companies.

Here we have a selection of the new articles and amendments of the new "Romanian Securities Law":

- Some terms and expressions were amended: significant shareholder (from 5% to 10%), control and majority position (for the control and majority positions the definition was enlarged);

- Some new terms and expressions were introduced: futures, options, report contracts, absolute majority (at 75%), short selling, cumulative voting, trading of rights etc.;

- New attributions of the members of the Board of Directors were introduced, in the takeover process and also in the corporate governance process (please see the chapter: "Duties and powers of the Boards of Directors");

- The chapter on Investors Protection was significantly improved; this chapter is segmented as follows:

    (i) general principles;
    (ii) special rules regarding publicly owned companies;
    (iii) market transparency and equality of investors, with five sub-sections:

        - market transparency
        - financial auditors
        - insider trading and market manipulation
        - mandatory takeover
        - mandatory withdrawal from the market
        - Compensation Fund for investors

- The chapter regarding the securities companies was split in two: (i) securities companies with their headquarter in Romania; (ii) securities companies with headquarter outside Romania;

- The concept of SROs (Self Regulatory Organizations) was defined;

- The whole chapter regarding the National Securities Commission was eliminated and approved separately in the NSC by-laws.

Although the new securities legislation was very recently issued, the conflict between the majority and the minority shareholders increased again, this time on the subject referring to the mandatory withdrawal from the market, more specifically on the method of calculating the price at which the mandatory public offer has to be made (at 90% shareholding).

In the last two years, in parallel, business and professional associations started to issue opinions, "codes", **debates on corporate governance** issues and for the first time, due also to the coverage of the media, they have started to have a larger impact.

However, coming back to the corporate governance aspects, The Corporate Governance Initiative for Economic Democracy in Romania, was the first systematic effort, organized at a large scale in the period 2000-2001, to bring corporate governance issues into the public debate. The project was conducted by the International Center for Entrepreneurial Studies in collaboration with the Strategic Alliance of the Business Associations. They initiated seminars, conferences, papers for debating the corporate governance principles and they organized workshops in different cities.

A very important milestone in the process of increasing the corporate governance awareness was the "SouthEastern Europe Corporate Governance Conference", which was organized last year in September, by the OECD, and was hosted by the Bucharest Stock Exchange and the National Securities Commission. Although the predominant theme of the Conference was "Shareholders rights and equitable treatment", extensive discussions were held also on all the principles of the corporate governance.

The OECD issued, at the end of the Conference, a report called: "Corporate Governance in Romania – preliminary conclusions and recommendations", a very comprehensive report, very useful not only for the "corporate governance agents" but also for the Romanian authorities.

Last year the Bucharest Stock Exchange initiated the **"Transparency tier",** or the so-called "Plus tier", where companies can apply for listing. In this respect the companies have to adopt a Code of Corporate Governance. By the end of October 2002, one company joined the "Plus tier".

The BSE, in its effort to attract listed companies for the "Plus tier", initiated in October this year a meeting with BSE issuers to discuss the Code of Corporate Governance which has to be adopted by any company joining the "Plus tier". Therefore, representatives of the Board of Directors/ Management were invited for a discussion on the "Code".

The main provisions of the **"Code of Corporate Governance"** issued by the Bucharest Stock Exchange are:

- It is mandatory by the management and Board members to have ready the GSM materials, 15 days before the date of the GSM.

- The issuer has to have a Web site, on the Internet, both in Romanian and English, where at least the following info should be presented: (i) quarterly, half-annually and annually financial results, including their appendices; (ii) current reports for the significant events, half-annual and annual reports; (iii) all the convocations and decisions of the GSM; (iv) the forms for the powers of attorneys, needed for the GSM; (v) special reports on trading activity of members of the Board of directors and management; (vi) any other public information which might be considered by the Bucharest Stock Exchange.

- Financial reports have to be submitted earlier to the Bucharest Stock Exchange, and therefore to its shareholders; they also have to be submitted in Romanian and in English.

- The issuers have to provide the following mandatory information in the annual report: identification if the independent members of the Board of Directors (based on declarations of these members), (ii) a list of persons entitled to be in permanent contact with investors, (iii) participation of each member of the Board to the meetings of the Board.

- The issuers have to present monthly: (i) the trading activity of the members of the Board of Directors; (ii) cross ownership respectively: a) any participation of more than 5% of the issuer in the ownership structure of any company, b) any participation of a company where the issuer is shareholder, in the shares of the issuer, if the participation is more than 5%; (iii) commercial transactions concluded between the issuer and members of the Board, employees, shareholders or any "related party"; (iv) details about how the preemptive rights were exercised;

- The issuers are obliged to meet at least once a year with the financial analysts, securities companies and investors.

- Dividends: they have to be paid in maximum 90 days from the date when the GSM is held.

- At least one member of the Board of directors has to be an independent director:

  The **independent directors** are defined as the persons who: (i) are not relatives with the members of the management and with the significant shareholders (>10%); (ii) are not employees or directors of the majority shareholder; (iii) are not receiving any compensations, with the exception of the Board fee, from the issuer or its affiliates; (iv) are not a party in any contract concluded with the issuer.

- Conflict of interests: the directors and executive managers of the issuers are restricted to: (i) be directors, executive managers, censors of any competitor or company having

the same object of activity; (ii) to exercise any commercial activity similar with the issuers activity.

The issuers which are willing to get listed on the "Plus tier", will have to sign a "letter of understanding" with the Bucharest Stock Exchange. The issuer has to commit to amend the constitutive act of the company with the principles of the Code of the Corporate Governance, in three months after signing this letter of understanding.

In Romania, all the efforts made by the Bucharest Stock Exchange and recently by the Rasdaq market, are directed towards promoting the OECD principles of corporate governance, respectively:

(v) the corporate governance framework should protect shareholder' rights
(vi) the equitable treatment of shareholders
(vii) the role of stakeholders in corporate governance
(viii) disclosure and transparency
(ix) the responsibilities of the Board of Directors

After the adoption of the new "Romanian Securities Law", this year, which is clearly providing support articles to sustain the corporate governance in Romania, there are still disputes between the minority and majority shareholders on how far and in what details these regulations should be built. On one hand, the minority shareholders believe that the new Romanian Securities Law is providing a very good base for the improvement of the corporate governance in Romania. On the other hand, the Foreign Investors Council (composed mainly from strategic investors and foreign venture capital funds) believes that in some cases the new Romanian securities legislation has introduced some arguable provisions.

Appendix 4

Bucharest Stock Exchange

"First" tier stocks

23-Oct-02

Company's name	Filed of activity	Majority shareholder (>51%)	Market cap.(mill $)	Weight in BET Index *)
ALRO	Aluminum processing	APAPS (state owned company)	113.00	5.00%
ANTIBIOTICE	Pharmaceuticals	APAPS (state owned company)	24.30	4.79%
ARCTIC	White goods/ refrigerators	EBRD 31.8%; Societe Generale Romania Fund 25.5%	19.00	3.44%
AZOMURES	Fertilizers	Transworld Fertilizers Holding Luxemburg (Turkish investors)	31.20	7.47%
BRD - SOCIETE GENERALE GROUP	Banking	Societe Generale	576.00	25.00%
BANCA TRANSILVANIA	Banking	EBRD 15%; local & foreign investment funds	70.00	8.20%
OLTCHIM	Chemicals / PVC	APAPS (state owned company)	8.00	2.55%
OTELINOX	Metallurgy	Samsung Deutschland GMBH	17.50	7.20%
RAFINARIA ASTRA ROMANA	oil extraction and processing	Asirom (insurance company) 37.6%; Interagro 24.5%	22.80	
ROLAST	Rubber	Foreign Investment Funds (Romanian Investment Fund, Romanian American Enterprise Fund, Romanian Investment Company)	9.00	
RULMENTUL BRASOV	ball bearings	APAPS (state owned company)	3.90	
SNP PETROM	oil extraction & processing	APAPS (state owned company)	1,530.00	25.00%
TERAPIA	Pharmaceuticals	Foreign investment Funds (Romanian Investment Company, Romanian Investment Fund, Broadhurst Inv. Ltd, Labrador)	40.00	11.34%
TURBOMECANICA	Aircraft engines	MEBO (Management & employee buy out)	13.00	
Total capitalization			**2477.7**	

FINANCIAL INVESTMENT FUNDS (SIFs)

Appendix 5

As of September 31, 2002

	SIF Banat-Crisana	SIF Moldova	SIF Transilvania	SIF Muntenia	SIF Oltenia	Total no. of companies	Percentage structure
Portfolio of SIFs:							
Companies listed on the BSE	18	9	11	22	19	79	3.75%
Companies listed on Rasdaq	372	145	263	154	113	1047	49.72%
Non listed companies	225	187	145	122	51	730	34.66%
Other companies	19	84	9	55	83	250	11.87%
Total number of companies:	**634**	**425**	**428**	**353**	**266**	**2106**	**100.00%**
BSE - Bucharest Stock Exchange							
Ownership participation of SIFs:							
Companies where SIFs own less than 5% ownership	95	47	41	111	51	345	16.38%
Companies where SIFs own between 5% to 33%	447	290	257	217	158	1369	65.00%
Companies where SIFs own between 33% to 50%	38	51	84	4	29	206	9.78%
Companies where SIFs own more than 50%	54	37	46	21	28	186	8.83%
Total number of companies:	**634**	**425**	**428**	**353**	**266**	**2106**	**100.00%**