







ALPHA BANK

## **Capital markets and private pension funds in Eastern European Member States**

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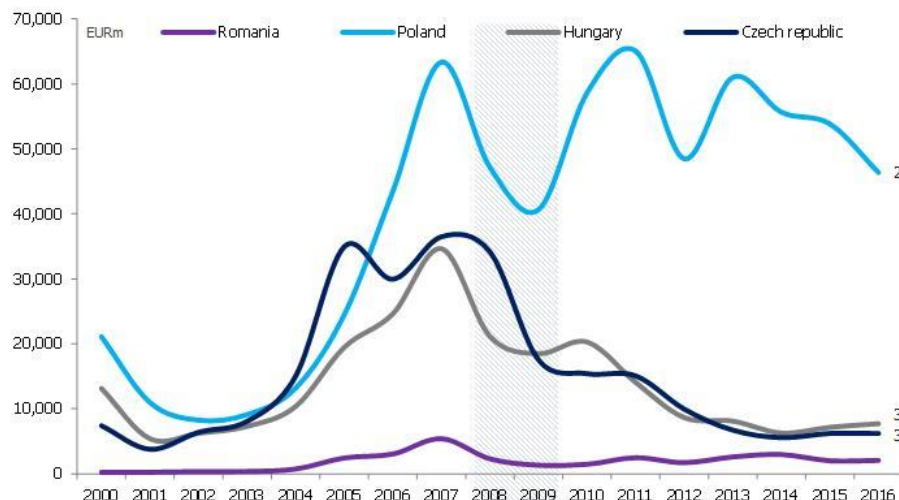
**June 2017**

# Income differentials partially explain financial development gap

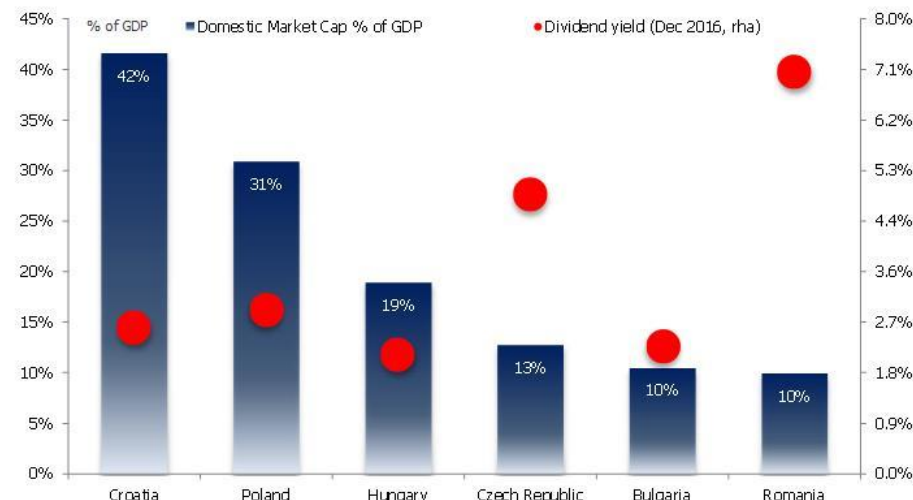
|                                    |  |  |             |  |  |  |              |             |
|------------------------------------|---|---|-------------|--|---|---|--------------|-------------|
|                                    | % GDP   |   | EZ/RO       |  | % GDP   |   | EZ/RO        |             |
| <b>Households financial assets</b> | <b>71.7%</b>  | <b>214.5%</b>   | <b>3.0x</b> |  | <b>Pension funds assets</b>   | <b>4.4%</b>   | <b>22.5%</b> | <b>5.1x</b> |
| Currency                           | 5.0%  | 5.6%  | 1.1x        |  | Currency and bank deposits  | 0.3%  | 1.8%         | 6.4x        |
| Bank deposits                      | 22.0%   | 66.0%   | 3.0x        |  | Shares  | 0.7%  | 2.9%         | 4.5x        |
| Listed shares                      | 1.2%  | 9.1%  | 7.6x        |  | Debt securities   | 3.0%  | 5.4%         | 1.8x        |
| Unlisted shares & other equities   | 11.5%   | 29.2%   | 2.5x        |  | Investment funds  | 0.4%  | 10.1%        | 23.5x       |
| Investment funds                   | 3.0%  | 19.2%   | 6.4x        |  | Loans   | 0.0%  | 0.5%         | N/M         |
| Life insurance and pension schemes | 5.3%  | 67.7%   | 12.8x       |  | Others  | 0.0%  | 1.7%         | N/M         |
| Non-life insurance                 | 0.3%  | 5.3%  | 17.6x       |  |   |   |              |             |
| Debt securities                    | 0.9%  | 7.2%  | 7.9x        |  |   |   |              |             |
| Loans                              | 0.1%  | 0.6%  | 8.0x        |  |   |   |              |             |
| Other accounts receivables         | 22.5%   | 4.4%  | 0.5x        |  |   |   |              |             |

# Romanian capital market lags behind regional peers...

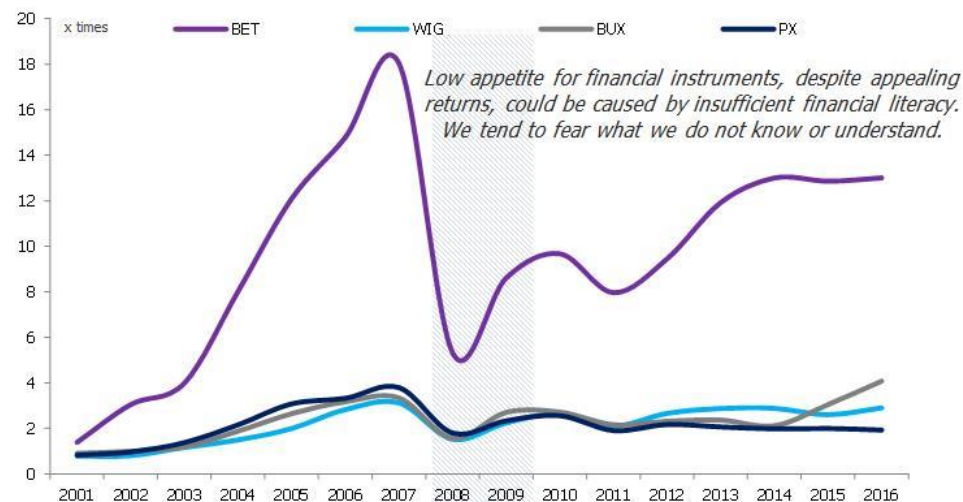
## Lowest traded equity turnover in the region...



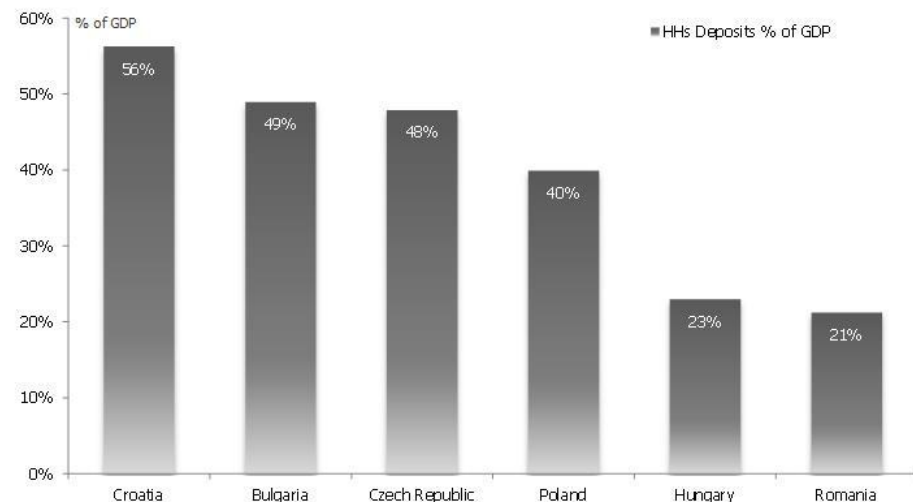
**The lowest market capitalisation to GDP in the region**, despite having the most attractive dividend yield in 2017 (second most appealing over the past ten years)



## ...despite the most appealing returns (cumulated since 2000)



## Room for growth in bank deposits



## ...with an almost inexistent listed fixed-income market

### Overview of bond market: Romania vs. Poland

|  | Total number of listed bond issues |                        | Government bonds |                        | Corporate bonds |                      | Local administration bonds |                     | Co-operative bonds |                        |
|--|------------------------------------|------------------------|------------------|------------------------|-----------------|----------------------|----------------------------|---------------------|--------------------|------------------------|
|  | #: 78                              | EUR: 5b<br>3.1% GDP    | #: 25            | EUR: 4b<br>2.4% GDP    | #: 15           | EUR: 1b<br>0.3% GDP  | #: 36                      | EUR: 1b<br>0.4% GDP | -                  | -                      |
|  | #: 597                             | EUR: 177b<br>41.8% GDP | #: 41            | EUR: 157b<br>37.1% GDP | #: 458          | EUR: 19b<br>4.5% GDP | #: 63                      | EUR: 1b<br>0.2% GDP | #: 35              | EUR: 0.1b<br>0.03% GDP |

### Structure of Romania's listed bonds

#### Outstanding amount of listed fixed-income instruments

Total outstanding value: EUR 5.3b

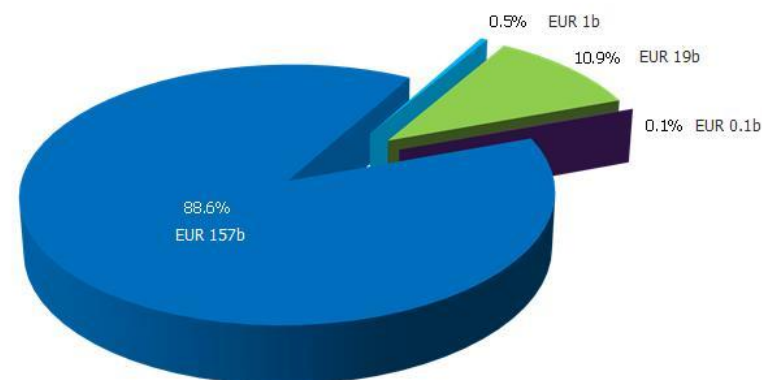


■ Government bonds ■ Local administration bonds ■ Corporate bonds

### Structure of Poland's listed bonds

#### Outstanding amount of listed fixed-income instruments






Total outstanding value: EUR 177.5b



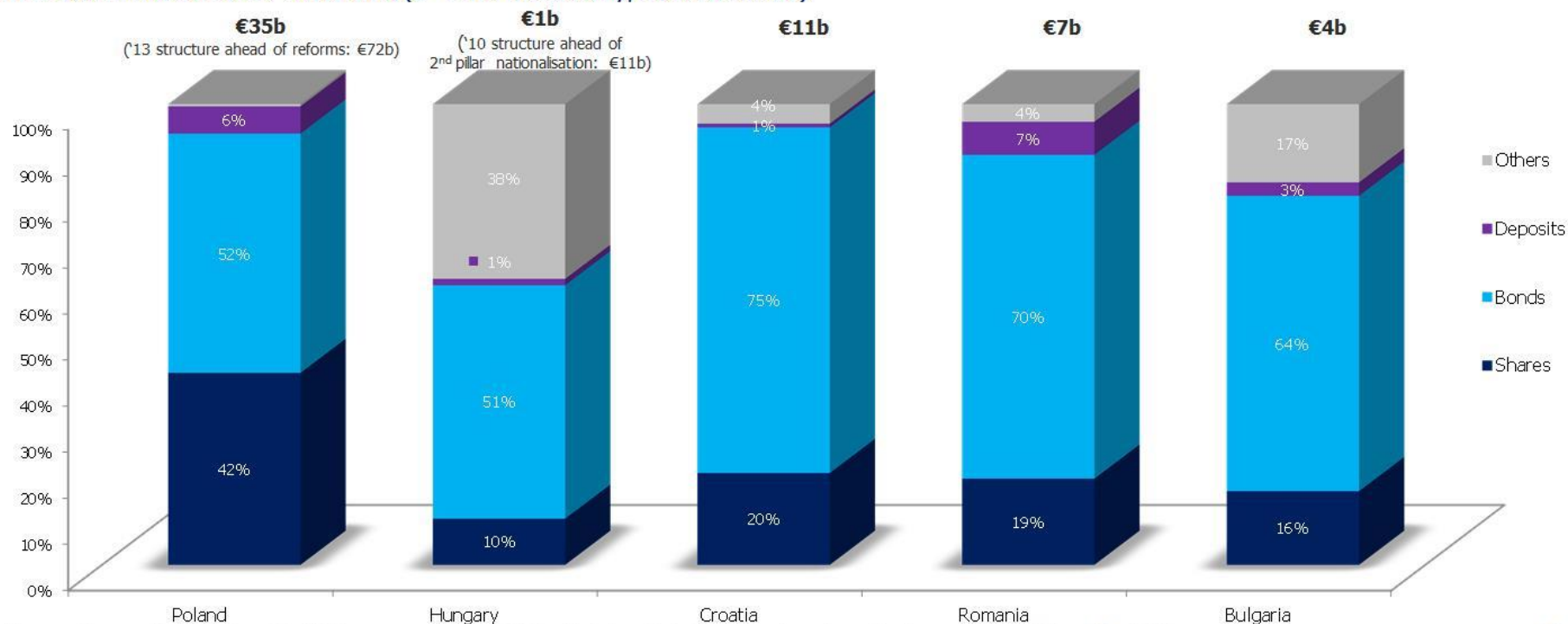
■ Government bonds ■ Local administration bonds ■ Corporate bonds ■ Co-operative bonds



## Romania has the youngest private pension fund system in the region...

|                                     |   |   |   |   |   |
|-------------------------------------|---|---|---|---|---|
|                                     |  |  |  |  |  |
| 2 <sup>nd</sup> pillar introduction | ✓   | ✓   | ✓   | ✓   | ✓   |
|                                     | 1999  | 1998  | 2002  | 2007  | 2002  |
| Emerging market                     | ✓   | ✓   | ✗   | ✗   | ✗   |
|                                     | 1995  | 1996  |   |   |   |
| OECD accession                      | ✓   | ✓   | ✗   | ✗   | ✗   |
|                                     | 1996  | 1996  |   |   |   |
| Market Cap. %GDP                    | •   | •   | •   | •   | •   |
|                                     | 31%   | 19%   | 42%   | 10%   | 10%   |
| Pension funds AUM % GDP             | •   | •   | •   | •   | •   |
|                                     | 8%  | 1%  | 25%   | 4%  | 9%  |

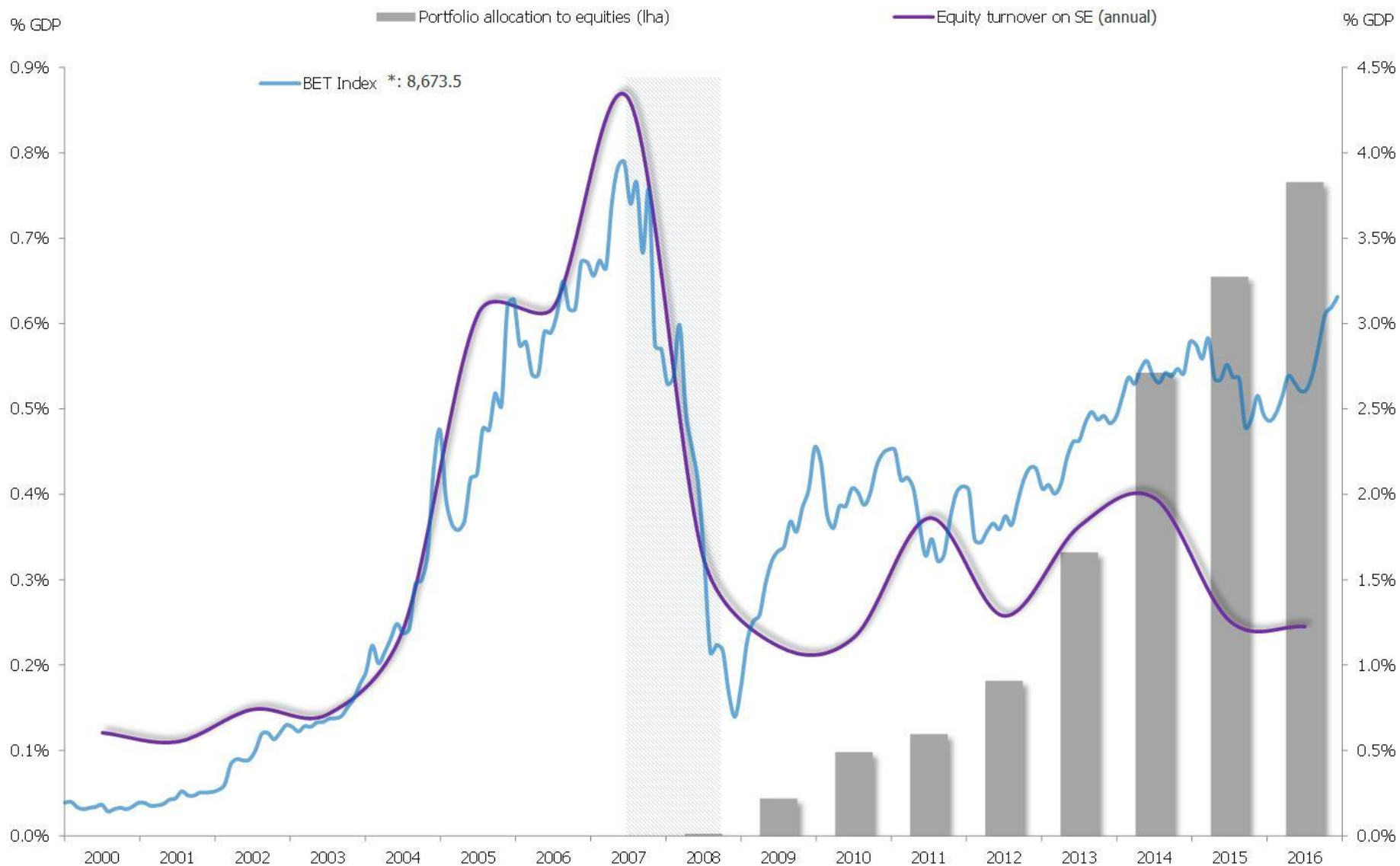
### Pension funds total investments structure (2<sup>nd</sup> Pillar assets only, 2016 overview)



## ...but its expansion of equity investments could boost capital development

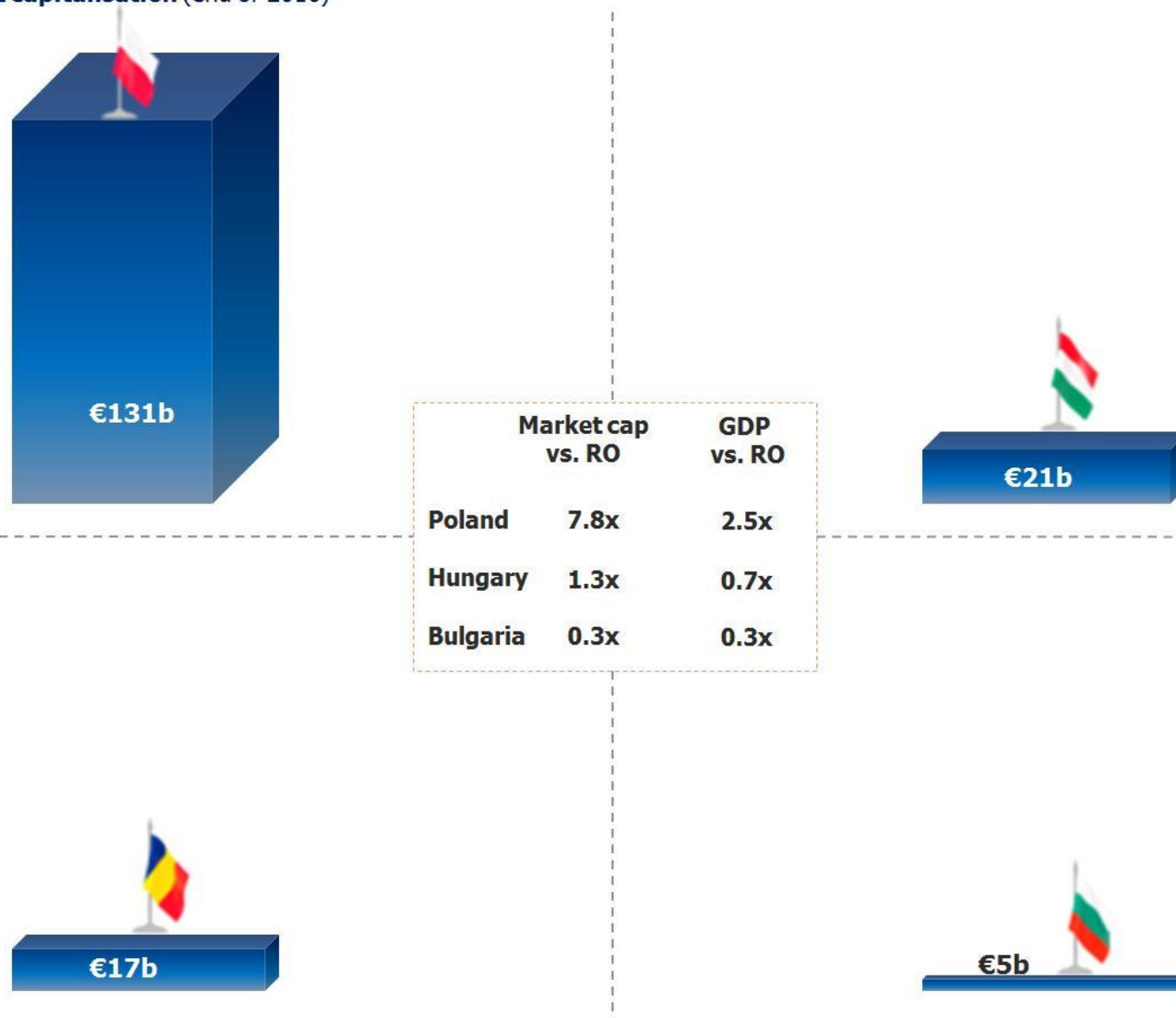


Second pillar system was introduced in 2007

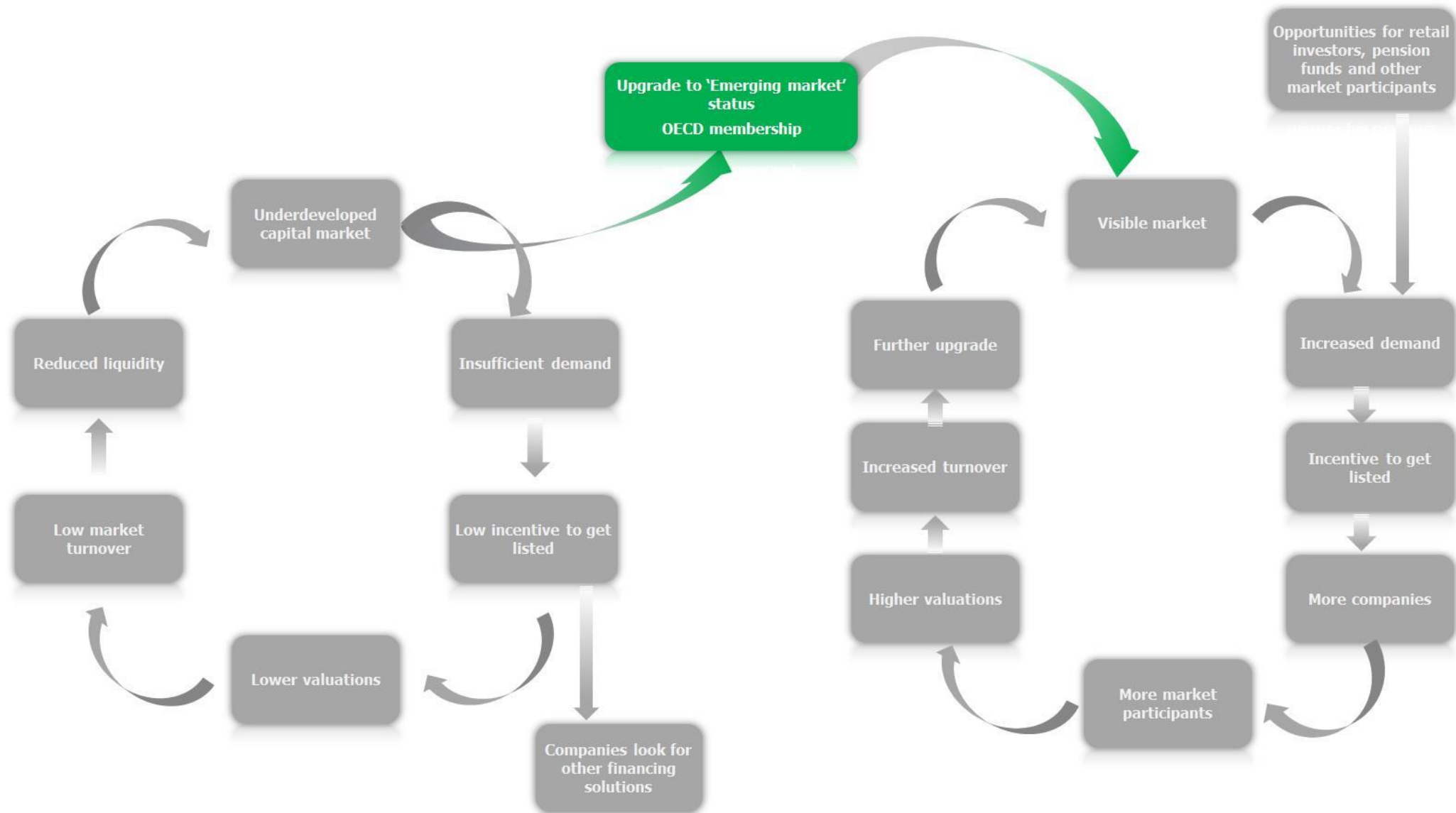


## ...creating room for an accelerated catching up process

Domestic market capitalisation (end of 2016)



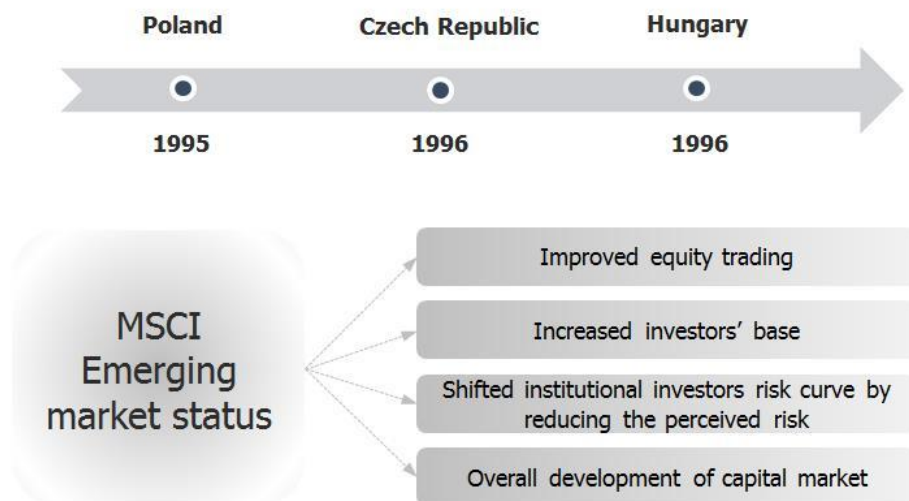
# The overall picture of capital market: RO needs to escape from the vicious circle...



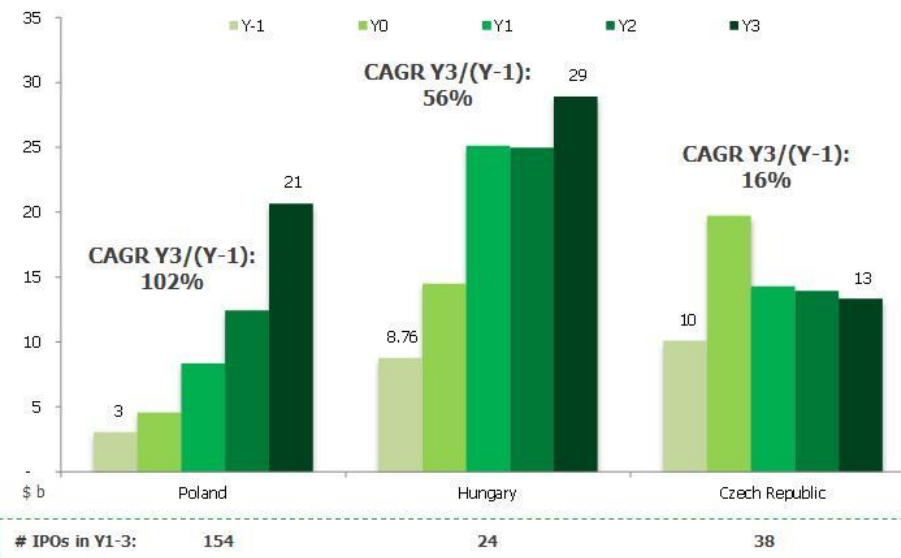


## ...by following the road of early movers...

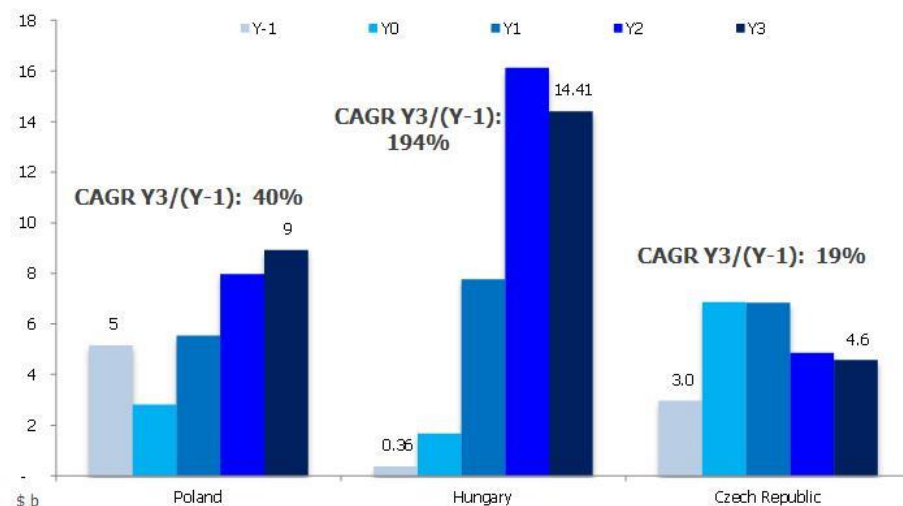
The functioning of regional financial markets was improved by the upgrade to Emerging Market status



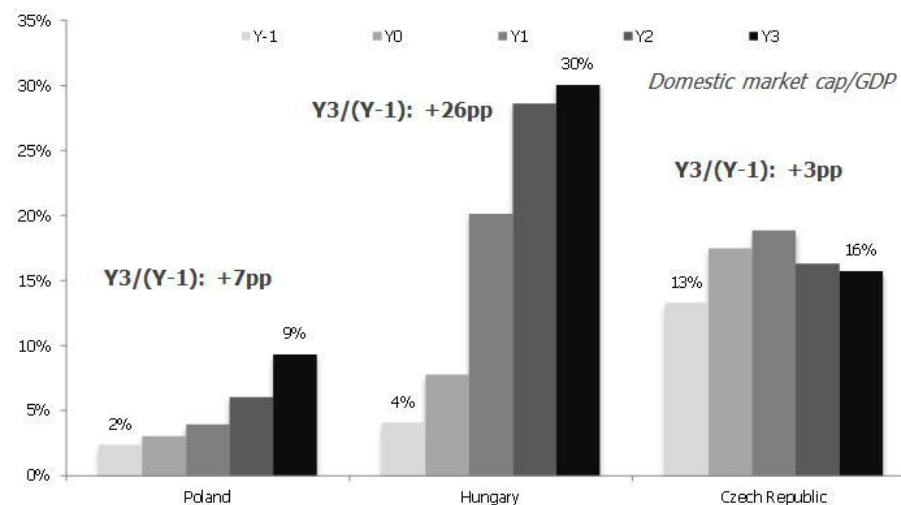
### Enhanced market capitalisation



### Strong advance of equity turnover



### Development of capital market



# ...and making steps towards 'Emerging Market' status...

## Where do we stand...

Currently, according to the assessment of all major institutions, Romania is a **Frontier Market**...

...due to:



- ❖ Low free-float of listed companies
- ❖ Reduced total market liquidity
- ❖ Reduced ability to do sizeable investments

**Bucharest Stock Exchange medium-term business strategy focused on:**



- ❖ Improving market liquidity and attracting new potential issuers
- ❖ Channeling all efforts on placing local capital market on the watch-lists of international index providers



**In 2016, Romanian capital market has been put on FTSE Watch-list as a prior step before a potential upgrade to Emerging Market status.** The assessment is made annually

- ❖ The upgrade will depend on the progress in terms of market liquidity and presence on the market of larger companies with significant individual liquidity

## Main criteria required for an upgrade...

### MSCI

The upgrade to "Emerging market" status requires a minimum 12-month watch before any upgrade (a potential candidate is placed on a "watch-list"). The review is made annually and conclusions are disseminated every June. Currently, we have the 3 companies that meet the required quantitative criteria (albeit only marginally)

#### Qualitative criteria

#### Quantitative criteria:

Minimum 3 companies:

✓ Company size of at least USD 1,269m →

Potential candidates\*

TLV SNG BRD SNP

✓ Free float value of at least USD 635m →

TLV SNG BRD SNP

✓ Annualised Traded Value Ratio of minimum 15%

TLV - BRD SNP

*\*Company size and free float value based on May 11, 2017 closing prices; ATVR (annual traded value ratio) computed based on February – April trading data. Note that ATVR computation depends on MSCI's free-float definition. MSCI will only consider a market for upgrade if a change in classification status can be viewed as irreversible. Currently, ATVRs modestly exceed the minimum required 15%.*

### S&P

#### Initial Eligibility Criteria met:

#### Current status:

✓ Full domestic market capitalisation over USD 2.5b → USD 22.6b

✓ Domestic annual turnover value over USD 1b → USD 2.06b

✓ Exchange development ratio (Market cap/GDP) over 5% → 13.4%

**According to upgrade methodology, once initial eligibility criteria is met, an in-depth study of additional qualitative and quantitative criteria is conducted** (referring to economic and political conditions alongside related investment conditions)

*Domestic market capitalisation as of May 11, 2017; 2016 domestic annual turnover value*

### FTSE

✓ **Qualitative criteria met:** fair and non-prejudicial treatment of minority shareholders, free and well-developed foreign exchange market, transaction costs - implicit and explicit costs to be reasonable and competitive

#### Other criteria for country classification to be met:

✗ Stock lending permission

✗ Custody - Omnibus account facilities available to international investors

✗ Liquidity - broad market liquidity to support sizeable global investments



## ...while increasing the investment absorption capacity of capital market



**Attract new companies on the market, support new issuances of corporate bonds and encourage new listings of government bonds**

- ❖ Promote the financing of Romanian businesses via local stock exchange market
- ❖ Support new bond listings with adequate nominal values in order to be appealing to retail investors also

**Improve market liquidity**

- ❖ Support and encourage market making activities in order to increase efficiency of local market

**Impose corporate governance transparency**

**Securitisation**

**Bring all market stakeholders together to review market structure**

- ❖ Only through a greater understanding and appreciation of different stakeholders' needs and perspectives can the market community achieve consensus and develop private and public initiatives to maintain and grow a healthy capital market
- ❖ Support interaction between all stakeholders: companies, retail investors, private pension funds, State, local authorities, stock exchange market operator

**Standardise regulations to become part of the Capital market Union**

**Promote minority shareholders' protection**

**Enforce legal and effective creditor rights**

**Introduce new products and eliminate any restrictions**

**Increase financial literacy levels:**

- ❖ Romania has the lowest financial literacy level among EU countries, according to S&P study in 2015
- ❖ Elevated need for accessible, professional and long-term impacting financial education

**Improve media coverage and awareness among retail investors**

- ❖ Clear and transparent communication via different media channels
- ❖ Simplifying messages to clients

**Provide fiscal stimulus**

- ❖ In Czech Republic, 3<sup>rd</sup> pillar contributions may be deducted from tax base in an amount equal to contributions paid but no larger than CZK 12k/year.
- ❖ In Poland, 3<sup>rd</sup> pillar contributions have tax benefits: IKE's (individual retirement accounts) profits are exempted for capital gains tax while IKZE (individual pension insurance accounts) contributions are tax deductible

## Conclusion remarks

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- Capital market needs support when optimism gathers steam
- An integrated approach taking into account demand, supply and market infrastructure should be considered
- The bottlenecks should be resolved and new products offered
- Experiences of regional peers show that the upgrade to Emerging market status alongside introduction of private pension funds and OECD membership is a big push for the capital market development.
- The upgrade to emerging market status creates demand by lowering institutional investors risk curve and putting local stocks on the radar of foreign investment funds.
- Pension funds expansion must be supported through strengthened capital market absorption capacity via more IPOs, higher transparency and improved corporate governance.

**Thank you!**