INVESTMENT FUNDS INDUSTRY IN ROMANIA

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Abstract

Capital market offers those who study it and those who use it as traders or as investors, a feature similar to a paradox. Her specific routine operations are regulated to the level of detail by laws, instructions, procedures or measures layouts while decisions on investments in securities and portfolio restructuring are taken under perpetual uncertainty. This has a twofold explanation, an objective one and a subjective one. Future prices, as well as successive conditions of stock exchange not necessarily flow from the past, thus one cannot predict their level and over them is hanging the conviction that any selected alternative action is probably the best without having any certainty that that is really correct and rational in an absolute mode. Even if the evaluation of factors influencing prices is a questionable one, there is the likelihood of good choices when doing a basic operation - selling or buying. Factors identified, evaluated and ranked may change in the next period their force of action or even the market structure so that exchange activity is at least difficult to determine. In this category is included the mutual fund industry, whose evolution in Romania was not without risk and has had a tortuous circuit thanks to immature capital markets and market actors but especially due to the permissive legislation during the start phase. A certain progress was recorded in the last 10 years, although the financial crisis made its mark on the capital market and revealed the negative impact of systemic risks.

Keywords: mutual fund, market risk, net asset value, market values, capital gains, securities, portofolio.

J.E.L. Classification: G 11, G 18, G 23.

Introduction

A mutual investment fund is a diversified portofolio of stocks, bonds, or other securities run by an investment management company. Funds must register with the a public authority (CNVM) and must comply with specific requirements. These regulations do not guarantee that a fund will be a profitable entity but they do provide certain safeguards.

The role of a mutual fund is to make investing activity a simple and cheap one. A very important advantage is that money is managed professionally. A specialized team takes buying or/and selling decisions, based on thorough detailed analysis. In addition, as market conditions change, the fund management is restructuring the portfolio so that financial objectives are achieved. The alternative would be to take these decisions by oneself, which would require an extensive knowledge of finance field and of capital market (Cornescu V., Crețoiu Gh., Bucur I., 2007).

Portfolio diversification is another benefit offered by mutual funds. These make investments in various stocks, and each fund investor owns a percentage of all the investments, according to the number of units held. Diversification of investments is one of the basic rules of investment as it leads to risk mitigation.

For example, a fund invests the same amount in the two kinds of stocks, which have different trends: a decrease of 10% and another 10% increase. Portfolio diversification causes the fund to lose nothing. Conversely, if it would have invested only in the first stock it

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would have lost 10%. On the other hand, if he would have invested only in the second stock it would have gained 10%, but the risk assumed would have been higher.

Also, an important advantage of investments in mutual funds is the possibility to withdraw money anytime. Mutual funds are required by law to accept anytime to redeem securities issued. In this case, it is paid a withdrawal fee which depends on the period since the time of purchase of units. If the period is several months, withdrawal fee may be up to 10%. Subsequently, its value decreases and after 12 months many funds do not charge any commission. By this policy fund managing companies encourage investments on medium and long term.

The same idea is also designing tax system. If money is stored for more than one year then the tax due to the state is only 1% of income, compared to 16% otherwise. Investments in mutual funds are not guaranteed by the state and mutual funds are not participating in the deposit insurance fund. Investing in mutual funds is therefore more risky in this regard than a bank deposit of an individual with a value within guaranteed limits. There is the risk that investing in a mutual fund not to have the expected performance and even to lose the amount originally invested, partially or totally.

By making an investment portfolio, mutual funds reduce but not eliminate the market risk consisting of fluctuations in value of financial instruments which had been invested in.
It also can not be overlooked the legal risk through the potential occurrence of legal constraints that lead to decreasing the value of units or suspend their redemption by the fund.
Depending on the chosen time horizon it can be established then the risk which can be assumed. Usually, if the period is longer (over five years) a person may assume major risks while short-term investments require a more prudent approach. A higher risk however offers the opportunity to obtain a higher yield. All mutual funds are risky and do not guarantee recovery of the amount invested. From this perspective, the choice should take into account the sensitivity of the individual to the risks.

1. Investments funds in Romania

After a troubled period in the 90's when investment funds has passed through many difficulties, in the next decade the progress of capital market was quite impressive. On legislative side we have the 297/2004 Law regarding the Collective Investment Institutions (CII) which divided them into two categories: investment funds and investment societies. The most important provisions of this law refer to the organizational and functional aspect of the respective institutions and also an important part to the financial instruments for funds investments, according to the provisions of Directive 2007/16/CE. The authority that regulates and monitorizes the capital market and the institutions involved is The National Securities Commission (CNVM); it authorizes the establishment of any new investment funds and the societies that administrate the funds, the launch of a prospectus as well as the functional aspect of the fund. In 1996 besides CNVM, it was established the National Association of Funds Administrators which is a non governmental organization made up of 21 investment administration societies that administrate 50 opened investment funds and 8 closed investment funds, 5 investment societies and 2 depositary banks; the association having some important objectives: enforcing the capital market, promoting the concept of collective investments, forming and developing the organizational, legal and professional frame; enhancing the access to information for the investors and also for ordinary people (Zăpodeanu Daniela and Cociuba Mihail-Ioan, 2010; CNVM Report, 2012)

For a proper functioning the open investment funds in Romania need three entities: a) the **administration society**, that adopts the decisions regarding the investment fund and manages the investment portfolio; b) **the depositor**, who safely guards all the funds assets and calculates the value of the securities independent of the administration society; c) **the**

distributor: it may be a securities company or a commercial bank, and it has the role to sell the securities.

The open investment funds issue the securities that confer their owners‘ equal wrights and are paid when subscription is made. The securities are bought at the issuing price, their prices are established based on the net assets plus some commissions and could be rebought at the owners request. The rebuying price is made out of the unit value of the net asset calculated by the administration society and certified by the depositor. The unit value of the net assets is calculated daily by reporting the net value of the funds assets to the total funds units in circulation.

The funds investment policy is established by the administration society according to the law and to the prudential conduct. According to the law provisions, the open investment funds may invest in (Olteanu A.2003) :

- exchange securities and other monetary markets‘ instruments in Romania and UE and with the approval of the NSC even in non-member states.
- bonds issued by other collective investment institutions (openede or closed)
- deposits
- derivated financial instruments
- other monetary markets‘ instruments.

The investment funds can be classified according to the liquidity and the risk of the investment**(**Anghelache, Gabriela, 2000):

1.Stocks funds: invest mainly in listed stocks; at least 66 % in stocks

2.Bonds funds: invest maximum 10 % in stocks and the rest in bonds.

3.Mixt funds: invest maximum 66% in stocks, the rest in non risky securities; they have a medium risk and are considered to be good medium and long term investments.

4.Monetary funds: are considered short term investments, having benefits comparable to the interest rates of bank deposits; they usually invest in monetary instruments (treasury bonds, deposits, etc.) more than 90 % and only 10 % in stocks.

5. Other funds: invest in lower exposed stocks than those of the stocks funds. Referring to funds diversification one may mention that, in a few months, Romania is likely to have mutual funds that will take up certain risks and losses which are not currently being covered by the insurance companies, that is what the Minister of Agriculture and Rural Development, Daniel Constantin has recently declared in a working meeting examining the losses incurred by the producers in the wake of the milk market crisis: *The agriculture ministry will step up a range of measures in the upcoming period. Firstly, we need legislation that should set up the mutual funds in Romania and I mean those who cover the risks, or the economic losses or other kind of losses, which are not being covered by the insurance companies. Such mutual funds are operational across Europe and I think it is high time that we set up such funds in Romania too. Legislation is being put to public debate and I hope we'll have the funds set up in a few months, maybe even faster. It is a three-fold responsibility, of the producers first and foremost, since they must contribute too, but also of the member state, i.e. Romania and it is the EU contribution, on the other hand. Had we had mutual funds, today we wouldn't have spoken of such economic losses, because they would have been borne by the mutual funds'*

2. Investment funds performance within 2005-2012 period

Romania is a very conservative market in terms of adoption by investors open-end investment funds - this combined with the fact that the largest managers of funds are subsidiaries of commercial banks, makes the largest investment funds in the market to be monetary and bond funds (sold by banks as alternatives to bank deposits). In the period 2005-2012 we may see a positive evolution of the open fund investments market in Romania, the number of funds members of The Association of the Fund Administrators from Romania increased from 23 to 63, the number of investors from 71,021 to 241.368 and the assets amount from 339 million lei to 8811 million RON. The funds became an convenient alternative for bank deposits, although the financial crisis had a certain negative impact on financial market, that is why many investors showed their choice for investing in the funds with a low degree of risk, with more liquidity and offering a better efficiency (Angela Crina Copil, 2013).

After the crisis the value of the net assets was positively influenced by a certain recovery of the quotations of the listed share and by the significant increase in the number of investors and in the volume of their investments. If at the end of 2009 the amount of net assets of the open fund investments was 3,35 billion RON, representing an increase by 256% over the level recorded at the end of 2008, in 2012 the amount reached 8,81 billion RON, representing a raise of 263% over 2009 level.

On 31.12.2009 the first five funds recorded the following total market shares: Erste Asset Management – 43,08%, Raiffeisen Asset Management –30,23%, BRD Asset Management – 8,49%, BT Asset Management – 4,86% and OTP Asset Management – 3,28% while on 31 January 2013 the market shares were the following: Erste Asset Management – 37,48%, Raiffeisen Asset Management –33,37%,ING Asset Management Bucuresti-12,43% and BRD Asset Management – 7,41%. One can notice that Erste Asset Management is the investment fund with the largest market share in 2009 and also in 2013.

At the end of 2012, the number of all investment funds was 138, of which 117 open investment funds and 21 closed investment funds. Taking into account the amount of administered assets by the investment funds, the largest share was detained by the bond funds (49,4%.) The highest share of the assets administered by the bond funds is explained by the policy of avoiding the systemic risks caused by the financial crisis that shifted the investors interest to investments with a reduced risk rate, as the bonds acquisitions are. At the end of 2012(31 December) the total amount of assets of the investment funds reached 11,21 billion RON, of which 10,79 billion RON was held by open investment funds of and 0,42 billion RON by closed investment funds. The number of investors in the investment funds has significantly increased during the last years reaching to 333.052 at the end of the year 2012, of which 91.684 investors in closed investment funds and 241.368 investors in open investment funds. The assets of the bond funds increased in December 2012 by 174,5% comparing to the beginning of the year, reaching a total of 5,06 billion. RON and only in December 2012 the bond funds attracted net subscriptions of 782.2 million RON. The share funds registered an increase of assets by 16,8% to 577.4 million RON in 2012(CNVM Report 2012).

3. Organization and Functioning of an Investment Fund in Romania

Open-end mutual funds stand ready to issue new units to incoming investors at the current price or „net asset value" (NAV), plus sales charge. They must also stand ready to repurchase or redeem units from existing investors in the fund at NAV, minus redemption charge. The NAV is calculated once per day based on closing market prices.

NAV is generally calculated daily at the close of trading. First, the total market value of all the portfolio holdings are computed. The total of the market values is added to the fund's cash and equivalent holdings. Liabilities (including expenses) are subtracted. The result is total net assets value. Dividing the total net assets by the number of units outstanding gives you the NAV per unit.(Ionescu Adela, 2004)

Total Return

The most important way to tell how well a fund performed is to check its total return, which includes the impact of appreciation, dividends and interest. In Romania a fund's total return is reflected in the fund's NAV. The formula for total return is:

$$TR = \frac{\text{dividends + interest income + capital gains}}{\text{NAV at beginning of period}}$$

Since this is reflected daily in the fund's NAV the important thing is to compare a fund's increase in NAV over a long time period and compare the returns of **similar** funds (funds with the same investment objectives).

Unit Sales Charges Or Expenses Associated With Funds

There are four basic types of fees or expenses associated with funds:

1. Sales charges which is the commission an investor pays a sales agent when purchasing units of the fund.
2. Redemption fees are paid by the investor when units are redeemed
3. Management fee is paid by the investors to the investment management company
4. Costs associated with buying and selling securities in the portofolio.

Sales charges are paid to the sales agent for his/her distribution of the fund's units. When investors calculate their returns they should always include any sales charges they paid in the calculation.

Some fund's charge no sales fees but have redemption fees, while others may have sales charges with no redemption fee and some may charge neither or both.

Average Cost

Cost averaging is investing a fixed amount at regular intervals, regardless of whether the market is up or down.More units are purchased at lower prices and fewer at higher prices.
Fluctuating NAV-based price changes in portfolio held by the fund at market close. You can find prices (NAV) for funding of newspapers. By law, mutual funds must publish at least weekly NAV. This information can also be obtained by contacting the Fund. **(**Anghelache, Gabriela, 2000)

Organizational Structure

Ownership

A mutual fund is a civil society based on a civil contract. Investors in the mutual fund bear the fund's investment risk.

Supervisory Council

This body is responsible for the contractual agreement between the management company and the fund. They safeguard the interests of the individual investors.

The Management Company

Daily administration is handled by the management company, which is usually the same firm that organized the fund. The management company also serves as an investment advisor buying and selling securities for fund's portofolio.

Depository

The depository keeps the fund's assets (stocks, bonds and cash) and usually it's a bank. The depository calculates the fund's NAV. It also handles payments and receipts for the fund's securities transactions.

The depository processes all sales and redemptions of units of participations and maintains shareholder records.

Principal Distribuitor

Usually a management company affiliate, the distribuitor (sometimes called an underwritter) distributes fund units of participation to the public. The distribuitor may act as a wholesaler selling units to securities dealers, who then sell to investors or it might deal directly with the public as a retailer.

Open-end fund's must be distinguished from closed-end-funds .

Closed end funds are diversified, professionally managed portfolios and regularly trade stocks on an exchange. They do not stand ready to issue or redeem shares. A closed-end fund may be bought and sold at a value more (called a premium) or less (called a discount) from its NAV.

The Prospectus

The prospectus is a legal document that discloses certain key information about a fund. Laws and rulles issued by the CNVM governs the minimum content of information in a fund prospectus.

Types of Funds

The primary objective of any fund can fit in one of three *broad* categories(Adela Ionescu,2003):

1. *Income*. The emphasis is on producing a steady flow of dividend payments
2. *Capital Gains*. The manager concentrates on increasing the value of the principal amount through appreciation of the stocks held.
3. *Income and Capital Gains*. Some combination of the first two approaches.

The primary objective of a fund determines what type of securities it invests in.

Conclusions

Investment funds have many advantages:

• Earnings of the funds come from long-term investments, they are higher than those made by bank deposits, because the funds invest in shares or other financial instruments with better returns than interest (when the economy is growing);

• Risks of funds are lower than those of a direct investment in shares, as funds usually make diversified investments in order to reduce risks;

• There are many money market funds and bonds funds offering good gains and flexibility for the periods when the stock markets are declining. These funds are a good alternative to investing in stocks for troubled times or a way to reduce portfolio risks;

• Money invested in a fund may be withdrawn at any time, in whole or partially, without the loss of earnings accumulated up to that point;

• Investing in a managed fund is a good investment offering a good opportunity for an increasing indirect access to shares on the stock exchange for example, without having to analyze yourself what are the best stocks to buy;
• Through an investment fund you have an indirect access to a number of financial instruments that normally you would not be able to use (state bonds for corporate bodies, deposits negotiated directly with bank interest) or that you could use only at certain times and with greater efforts (bonds);
• Investing in a fund helps you understand the capital market mechanisms and then allows you to go ahead and buy penny stock;
•Investment funds are well suited for two key categories:

A. Capital market investors. If you are a stock investor you probably have not given much attention so far to funds. But funds allow you to diversify your investments, reducing the degree of risk of your investment strategy and they are especially important during periods of falling stock market;

B. People who have until now kept savings only in banks or in currency and which have now the possibility of portfolio diversification.

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