**Prepared by**
**Finance Latvia Association**
**Financial Instruments Market and**
**Investment Services Committee**
**April, 2019**

FINANCE LATVIA ASSOCIATION

# PROPOSALS FOR INCREASING INVESTMENT IN THE BALTICS

## WORKING PAPER FOR DISCUSSION

**The Financial Instruments Market and Investment Services Committee at the Finance Latvia Association has drafted a working paper to facilitate discussions with partners from the public and private sector, aiming to attract more investment to Latvia and the Baltics.**

**1. Investment in alternative real estate investment funds should be distinguished from investment in other kinds of alternative investment funds.** Amendments should be made to the Law on State Funded Pensions, modifying restrictions on investment in alternative investment funds and putting a separate limit on investment in real estate (e.g. 10% of investment plan assets for investment in alternative investment funds that invest in real estate; 10% of investment plan assets for other kinds of investment in alternative investment funds). Estonia currently allows direct investment in real estate; there, neither direct nor indirect real estate investments are considered to be investments in capital securities (unlike in Latvia), and they are exempt from the limit applicable to shares (capital securities). The final report entitled “Structural Reform Support Service — Local Currency and Capital Markets Initiative Technical Cooperation Framework” drawn up by the European Bank for Reconstruction and Development, and presented to the Ministry of Finance on 1st April this year, mentions that listing real estate investment funds on Nasdaq Baltic might be a way to encourage capital market development.

**2. Currently, alternative investment funds (hedge funds) that invest in debt instruments rather than capital financial instruments are becoming more common.** These funds exhibit a different, substantially more conservative risk profile, presenting lower risk compared to any other kinds of investments equivalent to capital securities. For this reason, investments in such hedge funds should be distinguished from other investments in alternative investment funds, and it should be further stated that they are equivalent to investments in debt instruments rather than capital financial instruments. Overall investments in hedge funds that only invest in debt instruments could constitute up to 30% of total assets for a given investment plan.

**3. Discussion should commence regarding how to introduce better corporate governance at joint-stock companies,** and measures should be considered such as appointing an independent council member to every joint-stock company subject to the Financial Instrument Market Law and introducing additional requirements to improve governance at joint-stock companies specified in the Commercial Law. One such measure could be a public register of shareholders, coupled with regulations that would oblige the board of a company to develop essential policies towards good corporate governance, and would oblige the council to approve them.

**4. The issue of reports on the dependency of groups of companies and of balance sheet value prior to share buyback offers should be addressed.** “Reports on dependency” must not be a mere formality. As for balance sheet value reduction, there have been cases in practice where in a given year a company gradually arrives at a poorer operational and financial performance, thereby reducing the buyback value it offers to minority shareholders. It should therefore be specified that a share buyback must be assessed over a longer period of time, and other solutions should be discussed so that a company leaving the regulated market cannot cause disproportionate losses to minority shareholders (in particular, to pension funds).

**5. Financial institutions should be obliged to carefully assess the purpose of a corporate loan.** If a company’s assets are serving as collateral for a loan or a guarantee to promote the private aims of the largest shareholder(s), as opposed to the company and its best interests as such, then minority shareholders may suffer substantial losses, which might in some cases qualify as fraud.

**6. Sanctions should not be imposed in the event of technical violations during a share buyback, in which some investment restrictions were exceeded.**