

1994

## The Estonian Securities Market Act: A Lesson for Former Republics of the Soviet Union

John J.A. Burke

Follow this and additional works at: <https://scholarship.law.vanderbilt.edu/vjtl>



Part of the [International Trade Law Commons](#), and the [Securities Law Commons](#)

---

### Recommended Citation

John J.A. Burke, The Estonian Securities Market Act: A Lesson for Former Republics of the Soviet Union, 27 *Vanderbilt Law Review* 545 (2021)

Available at: <https://scholarship.law.vanderbilt.edu/vjtl/vol27/iss3/2>

This Article is brought to you for free and open access by Scholarship@Vanderbilt Law. It has been accepted for inclusion in Vanderbilt Journal of Transnational Law by an authorized editor of Scholarship@Vanderbilt Law. For more information, please contact [mark.j.williams@vanderbilt.edu](mailto:mark.j.williams@vanderbilt.edu).

# The Estonian Securities Market Act: A Lesson for Former Republics of the Soviet Union

John J. A. Burke\*

## ABSTRACT

*This Article describes and analyzes the Estonian Securities Market Act, the only securities statute presently in effect in Estonia. Before examining the requirements of that law, the Article provides an overview of the development of a securities market in Estonia, including a description of the securities, exchanges, and professionals that comprise the contemporary market. After providing this context, the Article analyzes the Estonian Securities Market Act. The author concludes that Estonia should not adopt complex securities legislation, but rather should "sample" the laws of other states. This process will allow Estonia to tailor a comprehensive regulatory system to the particular conditions of a nascent securities market.*

## TABLE OF CONTENTS

I.	INTRODUCTION.....	546
II.	THE ESTONIAN SECURITIES MARKET.....	553
	A. <i>The Estonian Securities Market Before the SMA</i> .....	554
	B. <i>The Watershed of 1993</i> .....	557

---

\*Associate Counsel for the New Jersey Law Revision Commission. The author worked with the Ministry of Finance of the Republic of Estonia from September to December 1993. In addition, Mr. Burke will serve as the Legal Advisor to the Director of the Estonian Securities Board from February 8 to December 22, 1994. The author would like to thank Professor Helen Garten, Rutgers Law School, Newark, New Jersey, and Viktor H. Mahhov, Financial Consultant for Broker Baltic, Ltd., for their review of this Article. The author also would like to thank Vahur Lokk, Director of the Securities Board, for his valuable comments. Any mistakes that remain are those of the author.

C.	<i>The Sale of Securities</i> .....	558
D.	<i>Securities Exchanges and Professionals</i> .....	560
E.	<i>Investment Funds</i> .....	561
F.	<i>Registered Securities</i> .....	562
G.	<i>Potential Volume and Market Factors</i> .....	563
III.	EXPLANATION AND ANALYSIS OF THE SMA .....	565
A.	<i>Legislative History</i> .....	565
B.	<i>Structure and Purpose of the SMA</i> .....	567
C.	<i>Scope of the SMA</i> .....	568
D.	<i>Definition of "Security"</i> .....	572
E.	<i>Definitions of "Securities Intermediary," "Issuer," and "Investor"</i> .....	574
F.	<i>Securities Board</i> .....	576
G.	<i>Registration; Resolution; Prospectus; Public Announcement</i> .....	579
H.	<i>Physical Form of the Security</i> .....	584
I.	<i>Reporting Requirements</i> .....	585
J.	<i>Insider Trading</i> .....	586
K.	<i>Licensing</i> .....	588
L.	<i>Liabilities and Remedies</i> .....	590
IV.	EVALUATION OF THE SMA.....	592
V.	THE FUTURE OF THE ESTONIAN SECURITIES MARKET .....	595
VI.	CONCLUSION .....	599

## I. INTRODUCTION

In 1993, the Republic of Estonia enacted the Estonian Republic Securities Market Act (SMA), establishing a legal framework for securities transactions.<sup>1</sup> The SMA was the first statute enacted in Estonia to govern securities. Subsequently, the Estonian government issued three decrees that: establish an Estonian Securities Board (Securities Board or Board), create registration and prospectus requirements for public offerings, and

---

1. Pres. Res., No. 116, art. 543, reprinted in 35 RIIGI TEATAJA 895 (1993), translated in 2 LEGAL ACTS OF ESTONIA 48 (Väljaandja: Riigikantslei 1993) and EESTI VÄÄRTPABERITURGU REGULEERIVAD ÕIGUSAKTID (ESTONIAN SECURITIES MARKET REGULATORY ACTS) (Tallinn, Rahandusministeerium [Estonian Ministry of Finance] trans., 1994) [hereinafter SMA]. Because there are no official English language translations of Estonian law, this article is based on the above unofficial English language translations of the SMA. Legal and economic developments in Estonia change rapidly. Therefore, the facts and law set forth in this Article are current only as of the date of its publication. Observers of Estonian law and markets must ascertain any subsequent changes. Significantly, on September 26, 1994, the government of Mart Larr resigned. As of September 27, 1994, a new government had not been formed.

impose licensing requirements for securities intermediaries.<sup>2</sup> Although Estonia is currently drafting additional securities legislation and considering amendments to the SMA itself, the SMA remains the principal Estonian law regulating securities.

Generally, the SMA governs the primary distribution of securities to the public by requiring the registration of securities with the Securities Board and the publication of a prospectus prior to making a public offering. The SMA governs the secondary market by requiring the licensing of securities intermediaries and securities exchanges. The SMA also imposes reporting requirements on issuers who have public securities, thereby introducing information about issuers into the market. By regulating the timing of public offerings and requiring the release of corporate information, the SMA provides basic order to the securities market.

The SMA is short in length and uncomplicated in structure, particularly in comparison to the complex securities acts of the United States and Canada. The simplicity of the SMA is its strength. Being clear and concise, it enables issuers and other market participants to understand the law and to comply with it. It also reduces transactions costs by limiting the complexity of governmental regulation. Minimizing costs allows small and mid-sized companies to obtain access to capital markets—an advantage unavailable to similar companies in countries with complex systems of securities regulation. Minimizing costs does not adversely affect investor protection as long as the statute delegates adequate enforcement authority to the Securities Board. The simplicity of the SMA provides a solid foundation for an efficient securities marketplace.

However, the SMA does not provide a comprehensive regulatory scheme for securities and contains statutory provisions that pose serious legal obstacles for the operation of securities markets.<sup>3</sup> For example, the SMA prohibits market-making,<sup>4</sup>

---

2. Decree 331, Procedures for the Public Issue of Securities and Procedures for the Registration of a Public Issue of Securities, *adopted* October 29, 1993; Minister's Decree 157, Regarding rules for issuing state operating licenses for professional participants of the securities markets, *adopted* October 25, 1993; Minister's Decree 154, Regarding the Approval of Republic of Estonia's State Securities Board Charter, *adopted* October 21, 1993, *translated in* EESTI VÄÄRTPABERITURGU REGULEERIVAD ÕIGUSAKTID, at 51-63 (ESTONIAN SECURITIES MARKET REGULATORY ACTS) (Tallinn, Rahandusministeerium [Estonian Ministry of Finance] trans., 1994) [hereinafter ESMRA]. Copies of ESMRA may be obtained by sending a written request to the Estonian Securities Board, Kohtu 8, Room 65, Tallinn EE0001 Estonia..

3. The Stock Corporations Statute is an additional source of securities law in Estonia. Stock Corporations Statute, *translated in* PAUL VARUL & VESA A. LAPPALAINEN, VIRON KAUPALLISTA LAINSÄÄDÄNTÖÄ: [ESTONIAN LAW ON BUSINESS] 258-

treats investors as securities professionals,<sup>5</sup> and requires a two-week waiting period between the registration of securities and their sale.<sup>6</sup> Thus, at present, a literal application of the SMA would prohibit securities professionals from buying and selling securities for their accounts, require the licensing of investors, and make it impossible to price debt securities because of the post-registration, two-week waiting period prior to sale. These provisions resulted from imprecise drafting and require either statutory amendment or clarification by rule.

If corrected and implemented by regulation, the SMA would provide a solid foundation for a securities regulatory system and a basis for minimal, effective governmental control of market activity.<sup>7</sup> Corrections and additions to the SMA could be adapted from the European Union (EU) directives regarding securities, and the experience of other Eastern European states with established securities and banking systems, such as the Republics of Hungary and Poland.<sup>8</sup> Enactment of additional legislation to govern securities exchanges and investment funds based on

65 (1992). As part of an effort to draft a commercial code, Estonia is revising the Stock Corporations Statute.

4. SMA, *supra* note 1, art. 24.

5. *Id.* art. 2.

6. *Id.* art. 12.

7. In December 1993, the Ministry of Finance submitted proposed amendments to the SMA to the Ministry of Justice. In 1994, the Ministry of Justice forwarded its written comments to the Ministry of Finance. In response, the Securities Board decided to make major revisions to the SMA. The Securities Division of the Ministry of Finance is currently revising the SMA. Upon completion of the draft, each Ministry will have an opportunity to comment on the draft revision. Ultimately, any revisions must be approved by the Ministry of Justice. The delay in completing the draft of the revised SMA stems from a failure of the drafters to achieve a consensus on proposed amendments and from the lack of staff at the Justice Ministry with a background in securities markets. Kaido Kama, who served as Minister of Justice until May 1994, did not have any legal education or experience. Further, his staff lacked a broad knowledge of commercial law. Mr. Kama was trained as a forest ranger, and lacked any training in law or government. After the Ministry of Justice approves the draft revision, it will send the draft to the Estonian Parliament for final consideration. The present Minister of Justice, Urmas Arumäe, is a lawyer and has substantial business experience.

8. The European Union (EU) is harmonizing its standards for banking and financial services to develop Union-scale capital markets. The EU chose to pursue its goal by means of "mutual recognition regimes." E. Waide Warner, "Mutual Recognition" and Cross-Border Financial Services in the European Community, 55 LAW & CONTEMP. PROBS., 7, 7-8 (1992). This approach is premised on a harmonization of basic standards and operates mainly on the principle of "home country control". Under the mutual recognition regime, a financial firm based in Italy, and subject to primary regulatory control by its home state, may open a branch in Germany. Member states that overregulate would disadvantage their domestic institutions since they would be faced with less regulated competitors. *Id.*

similar policy considerations would provide a comprehensive framework for securities transactions. This minimalist regulatory system would be well-suited to the small and mid-sized companies doing business in Estonia and would avoid overregulation of the securities marketplace.<sup>9</sup>

At present, the importance of the securities market to the Estonian economy is relatively minor. The market is in its early stages of development. The primary market consists of equity and debt securities issued by banks and corporations. Estonia does not have a significant secondary market for trading securities. Despite the enactment of the SMA and the increased volume of publicly issued securities,<sup>10</sup> there is presently no economic need for a stock exchange. As a result, Estonia does not have a stock exchange or an over-the-counter trading market. While some existing institutions use the name "stock exchange," they only auction currency or operate commodities exchanges.<sup>11</sup> The major

---

9. See generally Matthew Gaasenbeek, Report on Present Status of the Estonian Financial Market (Excluding Banking) and Some Recommendations 7-12 (Oct.-Nov. 1993) (unpublished manuscript on file with the author) [hereinafter Gaasenbeek Report]. Mr. Gaasenbeek is president of Northern Crown Capital Corporation, whose headquarters are in Toronto, Canada. He is also a volunteer consultant for the Canadian Executive Service Organization. In 1993, Mr. Gaasenbeek spent four weeks in Estonia providing expert advice to the Estonian Exchange Association on the development of a securities market. Mr. Gaasenbeek suggested designing the market to serve the needs of small and mid-sized companies. He also suggested that Estonia might consider the development of a venture capital market.

10. Viktor Mahhov, a financial consultant of Broker Baltic Ltd., a securities broker in Tallinn, reports that the securities of two private firms have a small secondary market and that secondary trading of privatization vouchers has begun. Mr. Mahhov is one of the most knowledgeable persons in the Estonian securities industry. He gained his knowledge of the Estonian securities industry because Broker Baltic Ltd. and Hansapank acted as intermediaries in some of the transactions involving privatization vouchers. Conversations with Viktor Mahhov, Financial Consultant, Broker Baltic, Ltd. and Broker Baltic Ltd. Trading Data.

11. Estonia introduced the kroon and established strict monetary laws in 1992 to stimulate economic growth. See generally Siim Kallas, *Significance of Monetary Reform in Estonia*, 1 ESTONIAN KROON FIN. ECON., June 1993, at 4-7 [hereinafter Bank of Estonia Finance]. Siim Kallas was the Governor of Eesti Pank (Bank of Estonia). Estonia was the first country of the former Soviet Union to establish its own hard currency. The Estonian kroon is pegged to the Deutsch Mark at the rate of eight Estonian kroons to one Deutsch Mark. See "Three Whales" of *Monetary Reform*, 1 ESTONIAN KROON FIN. ECON., June 1994, at 10-11. The kroon, established contrary to the advice of the World Bank, generally is considered the key to Estonia's economic success, allowing Estonia to re-establish trade relations with Western Europe, particularly Finland and Sweden. In 1993, Estonia's major trading partners were: Finland (6564.9), Russia (4341.5), and Sweden (2098.1) (figures are based in million EEK). EESTI PANK (BANK OF ESTONIA), BULLETIN NO. 1, at 26 (1994) [hereinafter BANK OF ESTONIA 1]. The United States held the tenth position with a total trade of 524.4 million EEK. *Id.* At

obstacles to the creation of a secondary securities market in Estonia are the lack of tradable securities, and a legal infrastructure that is inadequate to secure title to property or to secure lending transactions against real or personal property.<sup>12</sup>

Nevertheless, recent developments signal an increased importance of securities markets in the country's economy. First, the number, size, and value of public offerings of equity and debt securities registered under the SMA, and number and size of investment funds are growing. Second, in 1993 Estonia established a central depository for securities.<sup>13</sup> Third, in May 1994 the members of the central depository expressed their interest in establishing a stock exchange. Fourth, freely negotiable privatization vouchers are expected to expand the volume of tradable securities. Fifth, securities pay a higher rate of return than bank deposits thereby giving investors compelling financial incentives to invest in the securities market. In response to these developments, the Securities Board has drafted a securities exchange act to provide a legal foundation for a stock exchange.

The task of drafting comprehensive securities legislation in order to keep pace with economic developments should be based on the practice of free-sampling from other legal systems. Taking samples from existing legal systems is the quickest and most error-free method of establishing a legal system.<sup>14</sup> This approach

present, Estonia has a trade deficit but according to one foreign observer, this deficit is normal at this stage of Estonia's development due to the need for imported machinery and equipment. EESTI PANK (BANK OF ESTONIA), BULLETIN NO.2, at 21-22 (1994) [hereinafter BANK OF ESTONIA 2]. For a discussion of foreign investment, see also SIAR-BOSSARD INT'L MGMT. CONSULTING, INVEST IN ESTONIA: GUIDELINES FOR FOREIGN INVESTORS 14 (1993).

12. The lack of securities is due to several factors. First, Estonia gained its independence from the Soviet Union in 1991 and has not had enough time to develop a securities market. Second, the Estonian privatization program has not completed its work. Accordingly, there are few domestic issuers which results in an insufficient volume of equity securities. Third, the inability to secure good title to property hinders banks and institutional investors from investing in the domestic economy. This inability stems primarily from the lack of a mortgage registry and lien filing system, which in turn denies investors a method of securing their loans. Fourth, the national government failed to market its debt securities. Consequently, the nation's surplus income is not invested in the securities market, but invested abroad, particularly through German banks. See Gaasenbeek Report, *supra* note 9, at 2. In 1993, Estonia's commercial banks exported 1,227.9 million EEK and imported 1,040.8 million EEK. See BANK OF ESTONIA 1, *supra* note 11, at 23.

13. The Central Depository was formed by the Bank of Estonia, the Ministry of Finance, and several large banks.

14. For example, the Republic of Hungary and the Czech Republic adopted securities legislation prior to the development of a securities market. Samuel Wolff, Paul Thompson, & Daniel Nelson, *Securities Regulation in Central Europe: Hungary and Czechoslovakia*, 21 DENV. J. INT'L L. & POL'Y 103, 104 (1993).

does not mean that Estonia must forego experimentation and copy verbatim the securities law of other States. The securities laws of the United States, Great Britain, and Canada, for example, would be totally inappropriate for Estonia, given the complexity of their legal systems and the different levels of their economic development. Rather, sampling should approximate generally accepted concepts and principles found in any securities legal system with an appropriate degree of difference and innovation. Borrowed provisions then can be modified to conform to Estonia's existing legal system and practices, and to solve concrete problems as they arise in the marketplace. Through sampling, the Estonian securities law would acquire its own identity with the passage of time and historical experience.

The prospect of achieving an effective and minimalist securities regulatory system in Estonia depends largely on government policy and leadership. Though the SMA is based on the theory of regulation by disclosure of information to investors, the Estonian government does not appear to have a distinct regulatory philosophy and has not demonstrated the leadership necessary to develop the securities market along specific lines.<sup>15</sup>

Estonia is revising its legal system to make the transition from a planned economy to a market economy. A capital market is an essential component of a free market economy because it transfers money from savers to producers. The contemporary Estonian securities market has developed outside the legal framework of securities regulation and has not demonstrated a need for extensive legal restrictions. The increase in volume of

---

15. Neither the government of Prime Minister Mart Larr, despite its reputation for free market reform, nor the Bank of Estonia has initiated a program of debt securities, though recent monetary policy considerations may require the Estonian government to do so. The former Ministers of Finance, Madius Urike and Heiki Kranich, did not provide firm leadership to develop the Estonian Securities Board or securities legislation and regulation. The General Director of the Securities Board lacks the academic and practical background necessary to develop a general theory of securities law at this time. In addition, a misguided commitment to nationalism often results in the failure of the Estonian government to take full advantage of expert advice and the existence of foreign regulatory systems. While the role and value of foreign advice in emerging nations poses complex questions, the position that "We cannot take seriously those who do not know the situation," is an overbroad characterization of foreign specialists. See, e.g., Heikki Saller, *Foreign Banks are Neither Longed for Nor Feared*, 2 ESTONIAN KROON FIN. ECON. 15 (1994). Mr. Usin, Chairman of Foreksbank, is quoted as making the foregoing statement in reference to Mr. Gaasenbeek's opposition to computer record-keeping at this stage of Estonia's securities market. *Id.* Although it is true that the remarks of short-term visiting "specialists" often are not based on local conditions, and therefore may be irrelevant, nevertheless common principles of securities law overlap the regulatory systems in diverse countries. It is these "common principles" that are worth taking seriously.



primary issues prior to the enactment of the SMA and the development of investment funds completely outside any regulatory framework suggest that the growth of the market and the success of placing securities is unrelated to legal regulation. However, a securities regulatory system is essential to encourage foreign investment, to provide adequate investor protection, and to minimize the possibility of corruption. The proper role of government in this process is to promote a market that serves Estonia's financial needs and competes against other national markets.

In the short term, the securities market should facilitate economic recovery by making capital available for domestic projects. It should be easy and inexpensive to make a public offering of securities to raise capital. The resulting growth in the economy may spur foreign investment in the emerging securities market and further promote Estonia's transition from a planned economy to a market economy. Extensive regulation of securities markets diverts resources from investment to legal compliance without necessarily improving the efficiency of the market or eliminating market improprieties.<sup>16</sup> In the long term, Estonia should solicit the listing of foreign-registered securities, particularly securities registered in the Scandinavian countries and the member states of the European Union. Likewise, as Estonian firms develop, they may qualify for listing in the exchanges of the Scandinavian countries and the European Union.

The Estonian experience offers valuable lessons for the development of securities markets in the other former republics of the Soviet Union. The substantial economic progress in Estonia makes it a model of economic development.<sup>17</sup> The economic success to date suggests a successful transition from a planned economy to a market economy. The development of a securities market is an important part of this on-going transition. Because

---

16. E.g., George J. Bentson, *Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934*, 63 AM. ECON. REV., 132, 152-53 (1973) (arguing that the disclosure requirements of the United States 1934 Act do not have statistically significant results in providing the market with information nor therefore, with setting the price of securities).

17. The United States Agency for International Aid (AID) terminated its program in Estonia due to Estonia's economic achievements and other political reasons. While in the United States, Estonian Prime Minister Mart Larr remarked that Estonia needed trade, not aid; this comment did not help to ensure the continuation of the AID program in Estonia. Adrian Degraffenried, the Director of AID in Estonia, also appeared unwilling to expand the program in Estonia—at least with regard to technical legal assistance. The AID decision to terminate its program in Estonia cannot be squared with AID's continuing presence in Hungary and Slovenia, two states that are more economically advanced than Estonia.

the other former Soviet republics may look to Estonia as a model of a successful economic transition, they may also benefit from the lessons learned through the development of an Estonian securities market. As such, the SMA—if properly amended—could serve as model legislation for other former Soviet republics.

Part II of the Article provides an overview of the economic realities of the Estonian securities market. Part III examines the main provisions of the SMA, and where appropriate, relevant regulations. Part IV evaluates the SMA and provides recommendations for correcting its defects. Part V discusses the future of the Estonian securities market and recommends that Estonia revise its simple regulatory system by adapting time-tested legal principles. Additional regulation should be drafted only as necessary to adjust to concrete problems as they arise in the Estonian marketplace. Part VI offers concluding remarks about the particular challenge facing Estonia in its development of securities legislation.

## II. THE ESTONIAN SECURITIES MARKET

Understanding the development of Estonian securities legislation requires some knowledge of the economic realities of the Estonian securities marketplace. The economic factors establish the limits of the contemporary securities market, as well as the material conditions upon which any legislation must be based.

A securities market developed in Estonia between 1988, when Estonia declared its autonomy from the Soviet Union, and 1994, when the SMA became effective.<sup>18</sup> The following sections provide a summary of this development, as well as an overview of the current securities market. This Part includes a description of existing securities exchanges, securities professionals, investment funds, and registered securities. It concludes with insights into the potential volume of the Estonian securities market.

---

18. The following references to "securities" are limited to securities that were offered for sale to the public. Those securities that were privately placed or issued as a result of establishing a stock corporation are excluded because Estonian firms generally do not disclose information to the public. Further, as they classify almost all information about their firms as business secrets, this factual account is based on available, but limited primary sources.

### A. The Estonian Securities Market Before the SMA

During a period of independence, which lasted from 1919 to 1940, Estonia witnessed the development of the Tallinn Stock Exchange.<sup>19</sup> This exchange mostly quoted foreign currencies; it never developed into a high-volume securities market. Throughout this period, securities had very limited circulation. Ultimately, the Tallinn Stock Exchange closed in 1940, when the Soviet Union annexed Estonia and terminated the activities of the exchange. Although the Soviet Union prohibited the further issue and trading of securities, it sold and distributed its own "interior loan obligations." Approximately eighty-one million rubles worth of such obligations remain outstanding in Estonia today.<sup>20</sup>

Despite this activity during the Soviet period, a securities market did not develop until 1988, when Estonia began to act autonomously from the Soviet Union. The contemporary Estonian securities market has developed gradually since 1988.<sup>21</sup> The market effectively came into existence in 1991, when several banks began to sell securities.<sup>22</sup> Banks were the first and most important group of issuers to sell securities during the pre-SMA

19. For a history of the Tallinn Stock Exchange, see HELVE LAASIK, TALLINNA BÖRSIKOMITEE TEGEVUS 1872-194, at 7 (THE ACTIVITIES OF THE TALLINN EXCHANGE COMMITTEE, 1872-1944) (Eesti Börsiühingu väljanne, 1994).

20. On January 21, 1992, Estonia terminated the validity of the following three outstanding loan obligations: a 1982 distribution called the "three percent obligation," which had a total value of 55 million rubles; a 1990 municipal-industrial bond issue of a total value of 25 million rubles, designed to be repaid in commodities such as cars, refrigerators and garden tractors; and an additional distribution of 107,000 rubles issued on January 1, 1990. The Soviet Union never repaid the holders of these interior loan obligations. The Estonian Minister of Finance requested that the Russian Ministry of Finance honor these obligations. To date, however, the Russian Ministry has refused to do so.

21. Securities issued prior to June 1992 were denominated in rubles. On June 20, 1992, Estonia replaced the ruble with the Estonian kroon (EEK). See *supra* note 11.

22. The exact sequence of events regarding the emergence of the Estonian securities has not been the subject of an historical study, but the following account provides a general description of its development. While the information set forth in this Article is current as of September 1994, it is not intended to provide a comprehensive description of the Estonian securities market.

Significantly, the emergence of the securities market paralleled the emergence of the commodities markets. Estonia separated regulation of the securities markets from regulation of commodities markets. Commodities markets are extremely profitable and active in Estonia because they provide a market to transfer goods from Russia to Western Europe. Estonia does not have a statute, that corresponds to the SMA governing commodities markets. Although the SMA does not explicitly apply to commodities transactions, legal questions may arise as to whether an investment instrument related to a commodities transaction is a security governed by the SMA. Since Estonia is currently establishing a legal system for commodities and securities markets, it may consider unifying the regulation of all markets under one legal scheme and one governmental authority.

period.<sup>23</sup> They issued securities to raise start-up capital and to meet the minimum capital requirements for a bank license, as established by the Bank of Estonia, the central bank.<sup>24</sup> In 1990, Esttexpank made the first significant securities issue of common stock in Estonia. The following year, Keila Pank followed with a securities issue of common stock.<sup>25</sup> The securities of both banks were considered very liquid because they were redeemable on demand. In 1992, each bank made additional public offerings of common stock in an amount of five million Estonian kroons (EEK).<sup>26</sup> Keila Pank completed the sale of its issue. Esttexpank only sold two million of the five million EEK in common stock that it had offered. While these two banks were the first to issue securities, neither is the largest nor most important bank in Estonia.<sup>27</sup>

Corporations and the Estonian government were the next groups to issue securities. In 1991, a textiles company and a telecommunications firm made the first two corporate bond issues. Baltika, the textiles company, is one of Estonia's most successful and well-known enterprises. Its offerings have sold well because it enjoys a solid, prestigious reputation.<sup>28</sup> AS Levi,

---

23. Several banks attempted to sell securities to raise sufficient capital to meet new minimum capital requirements. Tartu Commercial Bank and UBB already having met the minimum capital requirements issued new shares during 1991. However, both banks ultimately failed. Tartu Commercial failed due to bad loans and UBB failed due to frozen dollars in the Foreign Economic Bank of the former Soviet Union (Vnesheconombank or VEB).

24. The minimum capital requirement for existing banks is six million EEK. EESTI PANK, 1 QUARTERLY REVIEW 30 (1993) [hereinafter BANK OF ESTONIA QUARTERLY 1]. Estonia does not separate commercial banking from investment banking. The minimum capital requirement for banks established in 1994 is fifteen million EEK. The new capital stock minimums for commercial banks are: (1) 15 million EEK by April 1, 1995; (2) 25 million EEK by April 1, 1996; and (3) 35 million EEK by April 15, 1997. EESTI PANK, 3 QUARTERLY REVIEW 5-6 (1993).

25. Mr. Mahhov reports that Kella Pank issued common stock in 1991. At its annual meeting of shareholders, Kella Pank decided to provide payment in dividend reinvestment.

26. Mr. Mahhov reports that the Esttexpank issue began on June 19, 1992, and that the Kella Pank distribution of preferred stock began on December 15, 1992. The initial distribution of Kella Pank preferred stock sold out. In 1993, Kella Pank increased its preferred stock issue to 10 million EEK.

27. There are twenty-one authorized banks in Estonia. BANK OF ESTONIA 1, *supra* note 11, at 33-35. The four largest are: Hansapank, Estonian Social Bank, Hotupank, and Tallinna Pank.

28. Since the introduction of the Estonian kroon, each firm made an additional distribution of securities. In 1992, Baltika made a public offering of 2.5 million EEK in bonds maturing in 1995 and paying an interest rate of 23%. It made a second offering of 635 thousand EEK in bonds that will mature in 1994. Baltika sold two million of the 2.5 million offered for sale because of its solid reputation and prestige.

the telecommunications firm, has much less visibility; its offerings did not sell as well.<sup>29</sup>

The Estonian government made two bond issues in the pre-SMA period; neither was very successful. A first issue was made in 1992 in order to finance the government deficit.<sup>30</sup> However, the government did not establish a plan to finance the bond debt and to repay the holders. As a result, the issue did not succeed, and the government sold only \$85,000 worth of the bonds. In addition to the failure to put forward an effective plan to finance the bonds, the Estonian government failed to account for the public's general distrust and unfamiliarity with securities.

The second government bond issue financed the merger of two insolvent banks, North Estonian Bank and Union Baltic Bank.<sup>31</sup> To solve the banking crisis, the Bank of Estonia concluded that the two banks must merge. This merger occurred on February 8, 1993, forming a new bank, named North Estonian Bank, Ltd. The Estonian government issued bonds in the amount of 300 million EEK to capitalize this new bank and to finance the merger.<sup>32</sup> However, at present there is no market in Estonia for government securities, and this issue has not sold well.<sup>33</sup>

29. AS Levi has started to establish a communications system for Tallinn. All televisions and computers will operate through a common fiber optics network. AS Levi made a public offering of 256,000 EEK in bonds maturing in 1994 and 1997, and three million EEK in preferred stock paying a rate of return between 12% and 23%. Since AS Levi was a new company from Saaremaa, and it was unknown to the market, it sold only approximately 1.5 million EEK of the preferred stock due to its low public visibility. However, AS Levi has entered into an agreement with the municipality of Tallinn and has planned to enter the Latvian and Lithuanian telecommunications markets. On July 1, 1994, AS Levi filed a prospectus with the Securities Board to register its existing privately-placed securities. The prospectus also contained an explanation of the reorganization of the company.

30. The government made the first issue in April 1992, by offering for sale bonds in the total amount of \$10 million. The term of the bond was five years and the rate of interest was 10%. In the summer of 1994, Bankers' Trust purchased approximately \$4 million in Estonian government EEK T-bonds.

31. At the time of the merger, both banks were insolvent because they did not have access to funds deposited with the VEB of the former Soviet Union. On January 18, 1992, the VEB froze \$36 million in Union Baltic's account and \$43 million in North Estonian's account.

32. Mr. Lipstok, the Finance Minister, is considering the development of a government securities issue primarily to raise revenue for the government budget. It appears that Mr. Lipstok favors a domestic issue as opposed to a European or international issue.

33. A special fund called the VEB fund was established to handle the claims of depositors against the VEB bank. BANK OF ESTONIA QUARTERLY 1, *supra* note 24, at 31. The VEB fund issued certificates identifying the rights of owners of funds frozen by VEB bank. If the funds become available, the owners may assert claims to their deposits.

This early period of market development also witnessed the emergence of a securities firm and an exchange association. In 1990, following a conference on securities markets held in Tallinn, Estonia, a securities broker named Broker Baltic Ltd. (Broker Baltic) established an office in that city. In place before Estonia became independent, Broker Baltic has been highly influential in shaping the Estonian securities market. Broker Baltic is presently the senior securities broker in Estonia.<sup>34</sup>

Another significant development occurred in 1991, when a voluntary union of economic and social organizations formed to "develop exchange activities."<sup>35</sup> Known as the Exchange Association of Estonia (EAE), its members consisted of banks, securities professionals, and private firms. From 1991 until the adoption of the SMA in 1993, the EAE served like a governmental entity and coordinated an array of activities related to the development of the securities market. The EAE licensed securities exchanges and securities professionals. In addition, it encouraged the development of securities legislation to regulate the growing market. However, since the adoption of the SMA, the EAE's status as the self-appointed regulator of the securities market and securities profession has eroded.

### B. *The Watershed of 1993*

The year 1993 witnessed a watershed in the Estonian securities market. The number of public offerings increased, investment funds appeared on the market, a securities central depository was created, and Estonia adopted the SMA.

Approximately thirteen issuers made public offerings of securities, and six investment funds were established.<sup>36</sup> The types of securities issued were common stock, preferred stock, bonds, and fund units. The total amount of securities publicly sold in 1993 amounted to 76.5 million EEK, or approximately

---

34. Members of Broker Baltic essentially drafted the SMA. They also exercise an unusual degree of influence over the Securities Board. Juri and Nadezda Tarmak founded Broker Baltic and presently manage the firm. In 1990, the Tarmaks, who were professors of economics at Leningrad University, attended a conference on securities markets in Tallinn. As a result, they decided to establish a brokerage office in Tallinn and to help construct a securities market in Estonia.

35. Statutes of the Exchange Association of Estonia, General Provisions, § 2 (adopted February 15, 1991) (on file with the author). The General Secretary of the EAE is Dr. Aivo Reiner. The EAE office is located at Kuhlbarsti 1, Tallinn EE0104.

36. Viktor Mahhov, *Eestis Väärtpaberituru 1993* (Estonian Securities 1993) (unpublished chart attached at App. A, Table I). The chart provides a description of the issuers, type of security sold, amount sold, and comments.

\$5.6 million.<sup>37</sup> Of the thirteen issuers, six banks accounted for most of the volume of publicly issued securities. Thus, banks continue to dominate the securities market.

Another significant event that occurred in 1993 was the formation of a central securities depository. This entity emerged through the efforts of the Minister of Finance, the Bank of Estonia, and several of Estonia's largest banks.<sup>38</sup> The depository will hold the securities of its members and serve as the clearing and settlement center for securities transactions when Estonia develops a secondary market. At present, however, the central depository remains in the planning and development stage; it is not yet in operation.<sup>39</sup>

Finally, in 1993, Estonia adopted the SMA, its first statute regulating securities. The scope and provisions of that law are discussed *infra* Part III.

### C. The Sale of Securities

As yet, there is no secondary market for securities in Estonia. Consequently, securities are sold mainly on the primary market, where distribution periods may exceed one year; some securities registered under the SMA have shorter distribution periods. All securities issued before the adoption of the SMA contained restrictions against secondary trading. Therefore, investors generally redeem securities by making a redemption demand against their issuer. Alternatively, they may sell the securities to another investor, so long as that sale is consistent with conditions set by the issuer. Securities registered under the SMA must be qualified for trading on the secondary market. Nevertheless, issuers still apply restrictions against the free transfer of securities. The advent of a secondary market should abolish this practice.

The manner and method of selling securities is direct and simple. The issuer sells directly to an investor or uses an intermediary, such as Broker Baltic, to sell its securities. With some exceptions, securities tend to sell rapidly during the initial

37. *Id.* Sotsiaalpank made the largest public offering of securities by selling 10,000,000 EEK of preferred stock. Eesti Borside IF made the largest public offering of fund units in the amount of more than 23,000,000 EEK. It should be noted that Sotsiaalpank filed in August 1994. The Central Bank shut down the bank and, as of September 1994, the Central Bank is the majority owner.

38. Those banks involved included Hansapank, Sotsiaalpank, Tallinnapank, Foreksbank and Hotupank.

39. Foreksbank will provide the physical location and computer technology to operate the depository. To regulate the depository, the Securities Division of the Minister of Finance currently is drafting regulations based on German law.

stage of their distribution. Then, sales and interest fall off. Since most issuers sell directly to an investor, they act both as issuer and broker. At present, Estonia does not have investment banks that buy securities from issuers and resell them to investors through an organized sales group.

Prior to the enactment of the SMA, there was no legal requirement to provide a prospectus to potential investors, though some issuers voluntarily disclosed information to the marketplace. For example, Broker Baltic adopted the custom of preparing an information document that accompanied securities sold on behalf of its clients. In the absence of any legal requirements, however, these information documents were not standardized.

The issuer has considerable discretion in setting the price of securities and placing restrictions on secondary trading.<sup>40</sup> However, certain economic factors impose practical limits on their discretion. First, the basic law of supply and demand affects the price of securities. In simplest terms, an overpriced security will not sell on the primary market. Second, an annual inflation rate of nearly thirty-five percent affects the price of bonds and preferred stock. Investors seek a rate of return near the rate of inflation;<sup>41</sup> therefore, a higher inflation rate requires a lower price to encourage investors to buy securities.

Despite these market pressures, the lack of a secondary market allows issuers to set an artificially high offering price for securities. Additionally, some issuers establish a minimum redemption price. Even if there were a secondary market, this tactic would prevent the market from setting the price of securities.

---

40. Nadezhda Tarmak & Viktor Mahhov, *Securities Market of the Baltic States 2* (Jun. 10, 1993) (unpublished manuscript on file with author). However, in practical terms, the issuer's control of the price of securities is limited by the market. Potential buyers simply will not buy a security at a price exceeding the demand. Thus, the law of supply and demand affects the price of securities in Estonia. For an explanation of the common problems facing the three Baltic nations in the development of securities markets, see Viktor Mahhov and Nadezda Tarmak, *Hard Process of Reinventing the Economic Wheel*, 2 *BALTIC REV.* 20-21 (1993).

41. In 1993, the inflation rate was 35.6%. *BANK OF ESTONIA 1*, *supra* note 11, at 9. However, the inflation rate is not stable. For example, the inflation rate for January 1994 was 5.5%; for February 1994 it was 8.9%. *BANK OF ESTONIA 2*, *supra* note 11, at 9.



#### D. Securities Exchanges and Professionals

As of September 1994, there are two licensed securities exchanges in Estonia: the Tallinn International Stock Exchange<sup>42</sup> and the Baltic Exchange of Intellectual Property.<sup>43</sup> Their licenses were not issued under the SMA, but rather under a pre-SMA decree regulating securities exchanges. However, these exchanges do not actually trade securities because, as already noted, Estonia does not have a secondary market. Although there are strong advocates for the establishment of true securities exchanges, at present, no such exchange exists.<sup>44</sup>

In the pre-SMA period, three securities firms were established: Broker Baltic, Baltic Securities House, and Hansapank.<sup>45</sup> Baltic Securities House sells foreign securities issued in Latvia, Russia, and Lithuania, and has a working relationship with Broker Baltic because the latter operates an investment fund investing in Latvian and other foreign securities. Hansapank, now the largest bank in Estonia, acts as a securities intermediary for some transactions. In one instance during the post-SMA period, Hansapank served as an underwriter for bonds issued by Baltika. Hansapank purchased the bonds and resold them to investors on a subscription list.

In the post-SMA period, the number of securities firms and securities professionals has increased. The SMA requires the licensing of securities professionals, and distinguishes between the licensing of legal and natural persons. The Securities Board has issued qualification certificates to twenty-eight securities professionals and fifteen securities firms, most of the latter being

42. The Tallinn International Stock Exchange is run by Foreksbank. In collaboration with other members of the central depository, it most likely will establish the first stock exchange in Estonia. Rein Usin, the Chairman of the Board and president of Foreksbank, has a deep-rooted commitment to implement the stock exchange, and his influence is substantial.

43. The Baltic Exchange of Intellectual Property lends money to commodities brokers and has ambitions to trade intellectual property.

44. The development of an over-the-counter market is unlikely if Foreksbank establishes a stock exchange since the largest banks and securities firms, thus, would be members of the exchange.

45. In Estonia, the term "securities professional" does not mean an experienced and sophisticated dealer or broker. The legacy of socialism left the Estonian university system and business community without the academic and practical background necessary to comprehend the securities industry. This statement is not meant to suggest that Estonia lacks talented individuals, but rather to emphasize that the level of sophistication with regard to securities is low. To some extent, government officials within the Ministry of Finance benefit from conferences that they have attended at the invitation of foreign states, such as Great Britain, the United States and Germany. Workers in the private sector do not receive foreign government support, and therefore, must fend for themselves.

banks. While the post-SMA licensing program imposes some standards on securities professionals, these requirements are not rigorous. A qualification certificate is issued to a natural person who correctly answers twenty-five of forty questions on a written examination and provides an adequate response to one oral hypothetical question. The test is administered by the General Director of the Estonian Securities Board, two representatives from Broker Baltic, and other representatives from the business community. A qualification certificate is issued to a legal person that employs a natural person who holds a qualification certificate. Because qualification certificates are not actually licenses, the continued practice of issuing them ignores the SMA licensing provisions.

### E. Investment Funds

At present, there are twelve investment funds in Estonia.<sup>46</sup> Although these funds are the fastest growing area of the Estonian securities market, they remained completely unregulated until August 1994.<sup>47</sup> Investment funds emerged in response to the 1993 banking crisis when surviving banks pursued a policy of risk avoidance. Investment funds were willing to provide credit to finance "high risk commercial transactions where commodities were bought from Russia and resold in Estonian or Western countries."<sup>48</sup> These funds appeal to an investor often because their advertised rate of return is exaggerated. For example, investment funds annualize their rates of return on the fund performance for one month. The appeal to the fund promoter is the easy entry into the fund market and the potential for substantial profits. Foreign investors also appear interested in establishing funds in Estonia or the Baltic region, given its proximity to Russia.<sup>49</sup>

---

46. Estonian investment funds are: (1) Baltic Intellectual Property Exchange Investment Fund (BIOBIF), (2) Estonian Exchanges Investment Fund, (3) Estonian Art Fund, (4) Future Insurance Investment Fund, (5) Broker Baltic Investment Fund, (6) Broker Baltic Latvian Investment Fund, (7) KHL Investment Fund, (8) Scan-Am Fund, (9) Momentum Fund, (10) Swiss-GF Fund, (11) Scandia SICAV Investment Fund and (12) PK Investment Fund.

47. The Ministry of Finance is drafting investment fund legislation and rules. On August 12, 1994, the Estonian government issued Decree No. 291 entitled "Approval of Legal Acts Regulating the Activities of Investment Funds" (on file with the author). This decree, which is based on the draft investment legislation, requires investment funds to comply with the provisions of the decree within three months of its effective date.

48. Viktor Mahov, *Investment Funds in Estonia*, 4 BALTIC REV. 44 (1993/94).

49. For example, a Finnish partnership created the FinnGulf Growth Fund to invest in equities in Estonia, Finland, and Russia.

Investment funds in Estonia take either a corporate or contract form. The contract form is the more popular form because under current Estonian income tax law the contract is not a taxable entity.<sup>50</sup> A contract fund is a contract between a management company and a group of investors that have pooled their money. The contract is a non-entity and thus, under Estonian law, not a taxpayer. As they are unregulated, these funds invest in every type of asset including art, foreign securities, and technology. Most funds have not diversified their investments. Only Broker Baltic, ScanAm, Swedinvest, Scandia SICAV, and Swiss GF operate like traditional investment funds by investing in the securities of other issuers. The Estonian Exchanges' Investment Fund and the Baltic Intellectual Property Exchange Investment Fund issue promissory notes to the Estonian commodities exchanges.<sup>51</sup> The Estonian Art Investment fund invests in art objects.<sup>52</sup> If draft investment fund legislation is enacted as presently written, investment funds would be required to diversify investments, but permissible asset categories would still be extremely broad if not unregulated. Estonia has no intention of adopting the U.S. model of imposing limitations on investment funds. However, the draft law contains provisions requiring disclosure between, and separation of, the management company and depository bank.

#### F. Registered Securities

As of June 16, 1994, the Estonian Securities Board registered nine public offerings of securities: bonds for AS Baltika, AS Den

50. The draft Investment Funds Act provides for two types of funds: corporate and contractual. A contractual fund is an open-ended fund based on a contract between the management company and investors. The Estonian Income Tax Law states that "a taxpayer is a natural person or an enterprise." Income Tax Law, § 3(1), *reprinted in* ESTONIAN TAXES 27 (AS Vaba Maa, 1994). Since the Estonian income tax law applies only to natural and legal persons, a contract fund, neither a natural or legal person, is not a taxable entity. The principal drafters of the Investment Fund Act are Veiko Talli and Indrek Prank of the Department of Property Reform within the Ministry of Finance. The British Know-How Fund supported the efforts of several British technical assistants to participate in the development of investment fund legislation. The draft act is expected to be introduced to the Estonian Parliament in September 1994. A government decree permitting the formation of privatization funds is expected to be enacted prior to the statute. A privatization fund is permitted to issue units in return for privatization vouchers, and to use them to privatize state property.

51. Because the commodity exchanges are extremely profitable, the investment funds lend them money.

52. This fund is not very liquid. Redemption takes one month, as an art object might have to be sold to redeem the shares. The redemption of a large block of shares could threaten the solvency of the fund.

Za Dnjom, and Eesti Maapank; preferred stock for Keila Pank; closed-end investment fund units for Eesti Innovatsioonipank; certificates of deposit for Pohja-Eesti Pank; and common stock for Eesti Gaas and Sotsiaalpank. The total value of the registered securities amounted to 230 million EEK. The Baltika bonds and Eesti Gaas common stock sold out almost immediately. However, the total value of these securities amounted only to approximately fourteen million EEK. Sotsiaalpank's public offering of fifty million EEK of common stock has resulted in sales of less than 300 thousand EEK. The Den Za Dnjom bond offering of one million EEK also has not sold well. The Eesti Innovatsioonipank registered public offering of 130 million EEK of fund units has not yet gone to market. The investment community is selective and failed public offerings are inevitable.

### G. Potential Volume and Market Factors

As the preceding narrative suggests, the contemporary Estonian securities market is quite small. The potential volume of the primary market is estimated at fifteen to twenty million EEK per month.<sup>53</sup> The potential volume of a secondary market is estimated at thirteen million EEK per month. This means that the total potential volume of the Estonian market is approximately thirty million EEK per month or \$2.5 million. If brokers charged a two percent commission,<sup>54</sup> they would yield 600 thousand EEK or \$46,000 per month. While this sum could support a small community of three or four brokers, it still demonstrates the small size of the Estonian securities market.

Furthermore, despite this potential volume, the actual trading figures have been less sanguine. The average monthly trading volume of bonds, shares, and fund units in the primary market for the months of August through November 1993 was 8.3 million EEK. In October 1993, the total value of shares traded by Broker Baltic was 250 thousand EEK or \$20,000.<sup>55</sup> This sum yielded a two percent commission of \$400 for the broker.

Another stimulus for the development of the securities market could come from the issuance and circulation of privatization vouchers in Estonia. The Estonian government has issued approximately 8.5 billion EEK worth of privatization vouchers. The privatization vouchers—called “yellow cards”—were issued to Estonian citizens and residents who lived

---

53. These figures are based on conversations with Mr. Mahhov and Aivo Reiner concerning recent trading activity and level of bank deposits.

54. Broker Baltic currently charges this rate.

55. Gaasenbeek Report, *supra* note 9, at 1.

or worked in Estonia. In general, the value of the vouchers is based on the length of employment of its holder. However, the government has issued vouchers with a minimum value to everyone, even including those persons without any work history, such as students. In addition, the Estonian government will issue ten to twelve billion EEK worth of compensation vouchers to those persons whose property was seized during the Soviet annexation period.<sup>56</sup> As both the privatization and compensation vouchers are negotiable, they can be traded like securities. Accordingly, they could provide a basis for a secondary securities market.<sup>57</sup> Privatization securities behave like traditional securities when the equilibrium price is set by supply and demand. However, the actual percentage of Estonian vouchers that will find repose on the securities market is unknown. Most voucher holders intend to use them to privatize their apartments and to buy land. Nonetheless, in spite of these obstacles, the sheer volume of privatization vouchers could provide the economic basis for a secondary market.<sup>58</sup>

Another possible source of funds for the securities market is bank deposits.<sup>59</sup> Bank deposits in Estonia presently total nearly two billion EEK. Given that bank accounts pay two to eight percent interest, investors may choose to transfer their savings to higher paying securities or investment funds. If half of these deposits were allocated for securities purchases, the market would have additional capital of one billion EEK or approximately

56. Conversation with Mr. Uku Hänni of the Department of Property Reform (Tallinn, July 4, 1994). Mr. Hänni admitted that he was not sure of the total value of compensation vouchers that would enter the market. A claimant may exercise the right of restitution of property or a right to compensation vouchers. Assuming one-half of all claimants opt to take compensation vouchers, as Mr. Hänni claims is likely to occur, that would produce ten to twelve billion EEK in additional vouchers. However, at present there is no deadline for the claimant to state a preference between a voucher and restitution of property. In the event that one half of the value of compensation and privatization vouchers entered the securities market, approximately 14 million EEK in securities would enter the market.

57. In Russia, the privatization security is a principal security traded on the Moscow and St. Petersburg markets. "The privatisation vouchers of the Russian Federation made up the second-largest segment of the money market at the end of 1993, falling short only of the VEB bonds. In February 1994 the total value of the vouchers in circulation was estimated at \$2 billion." BANK OF ESTONIA 2, *supra* note 11, at 30.

58. Contrary to the privatization of industry hypothesis, Mr. Mahhov of Broker Baltic argues that it is the issuance and negotiability of privatization vouchers that will give the Estonian markets investment paper to trade. See Viktor Mahhov, *Kommentaar, Erastamisosakutest*, ÄRPÄEV, Nov. 10, 1993, at 31.

59. Deposits at commercial banks as of April 1, 1993 amounted to approximately two billion EEK or \$153 million. ESTI PANK, 2 QUARTERLY REVIEW, 37 (1993).

\$60 million. However, the lack of investment opportunities in Estonia has led to the export of capital to other European states such as Germany.<sup>60</sup> Large investors buy privately placed securities, stunting the development of a public market.

Two final obstacles to the development of a mature securities market are political factors and the lack of public knowledge about securities. For example, in 1991, the rate of inflation was 231 percent; in 1992 it soared over 1,100 percent.<sup>61</sup> While the high rate of inflation resulted from the liberalization of prices in Estonia and Russia—particularly the price of Russian oil—the Estonian government concedes that the disparity between wages and prices constitutes a serious social problem. The average monthly wage in Estonia is equivalent to \$95,<sup>62</sup> while the prices of consumer products are practically identical to those in Western Europe. In addition, the Estonian public is unfamiliar with securities and securities markets. Although public knowledge of securities is improving due to the spread of information in the press and television media, the state of investor confidence in the markets has not yet been tested because the market is in an upward cycle. Bank failures or defaults on corporate bonds could disturb the progress of the capital markets.

### III. EXPLANATION AND ANALYSIS OF THE SMA

Given the relatively small size of the Estonian securities market, there is no need for complex legislation that establishes a complex regulatory scheme. Adopted in 1993, the SMA sets forth a straightforward scheme for regulating the securities market. The ensuing sections describe the framework of this statute, as well as some of its provisions.

#### A. Legislative History

Before the adoption of the SMA in 1993, Estonia had established a rudimentary system for regulating securities. The Stock Corporations Statute, adopted in 1991, permitted the

---

60. See Gaasenbeek Report, *supra* note 9, at 2.

61. BANK OF ESTONIA QUARTERLY 1, *supra* note 24, at 7.

62. BANK OF ESTONIA 1, *supra* note 11, at 13 (average monthly wage for December 1993). The Bank of Estonia report, which concluded that the standard of living improved for the first time in years, ignores the substantial wage-price disparity. The price of many consumer goods in Estonia is equivalent to the price of consumer goods in the United States and Western Europe. The shops are full of goods that most people cannot buy.

formation of stock companies and the issuance of stocks.<sup>63</sup> The Statute defined a share of stock, established requirements for the content and appearance of stocks, and set forth the rights of shareholders. As such, the Stock Corporations Statute was the first major law providing for securities in Estonia.<sup>64</sup>

In addition to the Stock Corporations Statute, Estonia enacted three decrees applicable to securities: Decree 141, adopted July 16, 1991; Decree 6, adopted January 9, 1992; and Decree 51, adopted January 17, 1992.<sup>65</sup> Decrees 6 and 51 established regulations for securities exchanges and trading activities on the exchange. They also imposed specific requirements for the content and appearance of securities. Collectively, the Stock Corporations Statute and these three decrees established a skeletal framework for securities regulation.

In May 1992, mounting international pressure led the Estonian Ministry of Finance to consider drafting a securities market statute.<sup>66</sup> The Ministry of Finance sought the assistance of Broker Baltic, which had already started to draft legislation under the auspices of the EAE.<sup>67</sup> Broker Baltic considered several existing securities laws as models for the Estonian statute. Although it examined the securities laws of the United States, Russia, and Hungary, Broker Baltic did not follow any specific model in drafting the Estonian legislation.<sup>68</sup> Instead, it

63. VARUL & LAPPALAINEN, *supra* note 3, at 258-265.

64. Significantly, it only applied to equity securities.

65. The complete titles of the decrees are as follows: Decree 141, On primary measures for development of the activities of exchanges, *adopted* July 16, 1991 (on file with author); Decree 6, On regulating the activities of exchanges, amendments to the licensing lists (adding exchanges), amendments to 16 July 1991 decree approving the temporary instructions regulating the activities of exchanges and approving the statutes of the Estonian Exchange Council, *adopted* January 9, 1992 (on file with author); Decree 51, On regulating the activities of securities exchanges, approving temporary requirements for the multiple-use (i.e. circulating freely on the Estonian securities exchanges) securities proving property rights (stocks, investment certificates, bonds etc.), *adopted* February 17, 1992, *reprinted in* ESMRA, *supra* note 2, at 64-67. See also Decree 107, Regarding partly canceling Decree No. 6, *adopted* April 14, 1993 (repealed point 2) (on file with author); Decree 98, "To implement Securities Market Act," *adopted* July 1, 1993 (establishing a working group to implement the SMA) (on file with author).

66. International pressure developed to enact commercial laws as a precondition to receive foreign loans.

67. Estonia does not maintain written records tracking the development of legislation. Therefore, the legislative history recounted here is based on conversations with the drafters of the statute, the staff of the Ministry of Finance and members of the Exchange Association of Estonia. Broker Baltic has not indicated to what extent, if any, it followed expert foreign advice.

68. Broker Baltic also considered the securities laws of Poland and Finland. It also consulted with attorneys from the New York law firms of Milbank, Tweed, Hadley & McCloy, and Sullivan & Cromwell.

drafted an act more closely tailored to the needs of the emerging Estonian securities market.

In August 1992, Broker Baltic submitted its final draft of the proposed legislation to the Ministry of Finance, which in turn forwarded the draft to the Ministry of Justice. The Ministry of Justice, which evaluates all proposed legislation, made a few minor corrections to the draft. Then, it introduced the proposed law to the Riigikogu, the Estonian Parliament. The Riigikogu assigned the draft law to its Economic Commission for study and review. The Commission substantially amended the draft. These amendments are the source of the present statutory defects in the SMA.<sup>69</sup> Notwithstanding these problems, the Riigikogu passed the SMA on June 2, 1993. President Lennart Meri promulgated the law on June 14, 1993, and it went into effect one week later. Enforcement of the statute rests with the Ministry of Finance. By the terms of the SMA, all securities professionals must comply with its licensing requirements by November 1, 1993. Significantly, the SMA supersedes neither the Stock Corporations Statute nor the decrees to the extent that these laws are not inconsistent with the SMA.<sup>70</sup>

#### B. Structure and Purpose of the SMA

The SMA consists of five chapters containing a total of thirty articles.<sup>71</sup> Chapter 1 sets forth definitions and general regulations.<sup>72</sup> Chapter 2 establishes registration requirements for the public issuance of securities.<sup>73</sup> Chapter 3 identifies licensing requirements for securities professionals, and mandates disclosure of trading activity by issuers and control persons.<sup>74</sup> Chapter 4 codifies the authority of the Estonian government to

---

69. For example, Article 2(6) of the Broker Baltic draft, defining "securities intermediary," contained the phrase "engaged in the business of" buying and selling securities. The SMA lacks this qualifying language. The absence of this phrase has the effect of making any person trading securities a "securities intermediary." Articles 8 and 9 of the Broker Baltic draft set forth registration and prospectus requirements. The SMA does not specify the contents of the prospectus and fails to provide the Securities Board with any guidance for the development of prospectus criteria. Article 25 of the Broker Baltic draft contained penalties for violations of the statute. The SMA does not set forth any penalties and relies entirely on other law. However, these other laws do not cross-reference the SMA.

70. The four decrees are not particularly important sources of law since they regulate exchanges which do not yet exist in Estonia. However, Decree 51 specifies requirements for security certificates. Decree 51, *supra* note 65.

71. See generally, SMA, *supra* note 1.

72. *Id.* arts. 1-5.

73. *Id.* arts. 6-17.

74. *Id.* arts. 18-24.



regulate the securities markets.<sup>75</sup> Chapter 5 incorporates by reference those provisions of the civil and criminal codes that apply to violations of the SMA; this chapter also establishes November 1, 1993 as the effective date of the SMA.<sup>76</sup>

The purposes of the SMA are to regulate the securities markets and to protect the rights and interests of investors. To accomplish these objectives, the SMA requires disclosure of information and licensing of securities professionals. Issuers of public securities must provide potential investors with access to a prospectus, report significant corporate developments, and file an annual report with the Securities Board. Securities professionals cannot engage in the business of buying and selling securities without a license. However, the SMA does not give the Securities Board extensive administrative authority to enforce the Act. Rather, violations of the SMA are handled in the criminal, civil, and administrative codes.

### C. *Scope of the SMA*

Article 1 of the SMA defines the scope of the statute. It states that the Act regulates "the activities of the securities professionals, the issuers and the investors on the primary and secondary market with publicly traded securities."<sup>77</sup> This definition presumes a secondary market because if there is no secondary market, then no securities are publicly traded. By definition, the SMA only applies to publicly traded securities; it excludes those that are privately placed. The SMA defines the former, but not the latter. Consequently, a private placement of securities is defined by negative implication based on the definition of public distribution. The failure to define private placement leaves unanswered questions regarding the size of private offerings and the method of sale and distribution.

Taken together, Articles 7 and 8 define a public distribution of securities.<sup>78</sup> The SMA's definition of public distribution contains three elements. First, a public distribution is a formal decision of the issuer to make a public offering.<sup>79</sup> Second, it is an issuance of securities to investors whose identity the issuer does

---

75. *Id.* arts. 25-28.

76. *Id.* arts. 29-30.

77. *Id.* art. 1.

78. *Id.* arts. 7-8.

79. Article 6 of the SMA states, "Issue of securities (emission) is a lot of securities issued by a single decision of an issuer. Securities can be issued both in series or singly." *Id.* art. 6. In practice, this requires an issuer to submit to the Securities Board the Minutes of the Meeting of the Board of Directors where the Board made the decision to issue public securities.

not determine prior to the distribution.<sup>80</sup> Third, a public distribution of securities qualifies them for trading on the secondary market, that is, trading activity among anonymous investors subsequent to the public offering.<sup>81</sup> Hence, a public distribution is an offer to sell securities, to the public, that does not contain restrictions prohibiting trading on the secondary market.<sup>82</sup>

It follows from this definition of public distribution that a private distribution of securities is an issuance of securities to a list of predetermined investors whereby, as a result of the primary distribution, the securities cannot be traded on the secondary market unless registered or exempt from registration. Because the SMA does not provide any exemptions or exceptions from registration, securities that are privately placed in Estonia cannot be subsequently traded on the secondary market. The issuer must establish the terms of redemption or sale prior to making a private offering. An issuer of privately placed securities may sell to any natural person or legal entity. The SMA does not distinguish between sophisticated and unsophisticated investors. An issuer thus may make a private distribution of securities to any investor without jeopardizing the private status of the distribution. In addition, an issuer of privately placed securities apparently may restrict secondary transactions forever. The SMA does not contain a provision to bring restricted securities into the public domain.

The SMA does not provide any exemptions from its registration requirements. This omission constitutes a statutory defect. The SMA should explicitly exempt privately placed securities and public offerings having a value that does not

---

80. Article 7 of the SMA states, "Issue of securities is considered public if the securities are subscribed by and sold to investors not determined beforehand personally with the issuer's decision about the issue and if the securities are permitted for public trading according to the conditions of issue." *Id.* art. 7. The concept of previously determined investors has raised some questions. For example, an attorney for an issuer seeking to make a private placement asked the Securities Board if his client could state that the list of predetermined investors consisted of all companies in Estonia. The Securities Board took the position that the SMA requires an issuer seeking to make a private placement to list the individual identity of potential investors.

81. Article 8 of the SMA states, "Public trading of securities is buying and selling securities between the investors not personally determined beforehand by the issuer." *Id.* art. 8. Article 3(2) of the SMA further provides, "Secondary securities market is buying and selling securities after their issuing and initial distribution." *Id.* art. 3(2).

82. The SMA does not explicitly prohibit the placement of some secondary trading restrictions because it states merely that securities must be permitted to be publicly traded. In practice, most securities registered with the Securities Board contain restrictions on subsequent sales, such as notification to the issuer.

warrant application of the SMA. An exemption for private placement should apply to sophisticated investors and institutional investors. However, this exemption should not be so broad as to include unsophisticated investors. First, registration facilitates secondary trading by providing a body of information about the issuer to the public. Second, the disclosure of information backed by government enforcement enhances investor confidence in the market. Third, most investors in Estonia are unsophisticated and need the protection of the securities law. However, because there are few, if any, sophisticated investors in Estonia, it would be impractical to limit private placements to sophisticated investors. A better approach would be to limit the number of non-institutional investors eligible to participate in a private placement of securities.

The SMA also should provide different accounting rules for government securities. While exemptions for the national government and foreign governments may be inappropriate due to the risks of their securities, the SMA, if literally applied, would require the national government to file a registration statement and prospectus, including a balance sheet, with the Securities Board prior to selling securities. In the United States, governments, other than the federal government, must register their securities with the Securities and Exchange Commission; however, they are permitted to follow special accounting rules. Estonia could apply a similar policy for government securities. Yet, it is likely that the national government will exempt itself from registration.

The Estonian Securities Board has taken the position that foreign issuers seeking to make a primary distribution of securities in Estonia must comply with the registration and prospectus requirements. Though the SMA does not explicitly address the question of the primary distribution of foreign-registered securities, the requirement that foreign issuers comply with the statute follows logically from the SMA's disclosure requirements and purpose of investor protection. Foreign registration of securities does not exempt foreign issuers from complying with the SMA regulatory scheme. If foreign issuers were allowed to by-pass the registration and prospectus requirements of the SMA because their securities were registered in their own countries, foreign issuers could deprive Estonian investors of the protection of the SMA. Foreign issuers also would avoid payment of registration fees to the SMA, and would operate outside some provisions of the SMA. While not properly a subject of securities regulation, the sale of foreign securities might lead to an export of capital when Estonia needs to invest its savings in domestic industry.

However, subsequent to economic recovery, policy reasons support a different view. The European Union is harmonizing its standards governing financial services to formulate a common capital market.<sup>83</sup> The European Commission has issued directives establishing minimum standards for securities regulations mandatory for member states. Because Estonia wants to become a member of the European Union, Estonia may wish to consider the adoption of regulatory rules compatible with the minimum standards established for EU member states. While awaiting membership in the European Union, Estonia could enter into "mutual recognition" agreements with Western and Eastern European countries to promote cross-registration of securities. The primary distribution of foreign securities would increase the volume of securities in the Estonian market and begin to give Estonia a reputation as a financial center.

Independent of concerns regarding EU membership, Estonia could recognize the registration and prospectus requirements of foreign states that impose criteria that meet Estonian standards. For example, Estonia could require the distribution of a prospectus-like selling document in the Estonian language for foreign registered securities, a licensing fee, and an agreement to service of process. Establishing an abbreviated filing procedure for foreign-registered securities would protect the disclosure policy of the SMA and enable potential investors to review a prospectus in the Estonian language prior to making an investment decision. This abbreviated procedure also would provide an incentive for foreign issuers to sell their securities in Estonia. Although the Securities Board has interpreted the SMA to have extraterritorial application to foreign issuers, consideration should be given to modifying the registration requirements for well-established foreign issuers.

In practice, the Securities Board has not taken any action regarding the sale of foreign securities in Estonia. For example, one securities firm, Swedinvest, markets securities traded on the Stockholm Stock Exchange. Another securities firm, Baltic Securities House, sells securities issued in Latvia and Russia. However, none of these securities are registered in Estonia. At present, Baltic Securities House does not have a license from the Securities Board authorizing it to sell securities in Estonia. The failure to act on the sale of foreign securities in Estonia stems from the lack of empirical information about the activities of these

---

83. "The directives issued by the European Community (EC) in the area of securities regulation are intended to facilitate international trading of securities and promote the image of integrity in the European markets." Note, *Improving Securities Regulation in the EC: The French Example*, 17 N.C.J. INT'L & COM. REG. 509-10 (1992).

securities firms and the lack of a distinct regulatory philosophy to guide the action of the Securities Board.

#### D. Definition of "Security"

The SMA's definition of a "security," found in Article 4, contains three parts. First, a security is a document incorporating a "private right" that gives its owner the right to exercise this private right; this phrase means that a security creates a contract, property, or other right.<sup>84</sup> Second, certain payment instruments, such as checks and bills, are excluded from the definition of security; however, because the SMA uses "etc." in defining the exact class of excluded commercial paper, this provision is unclear.<sup>85</sup> The third element of the SMA that defines the term "security" consists of three illustrations of paper that may constitute a security. A security may be: equity paper, debt paper, or paper certifying rights or obligations to buy or sell securities, such as options. Here again, the statute uses "etc." when providing examples of each class of security.<sup>86</sup>

The SMA's definition of a security is overly broad. First, it encompasses writings that are not securities. For example, a laundry receipt falls within the technical definition of a security because the receipt is a document that gives its holder a right to claim the laundry after payment of the obligation. The laundry receipt does not fit within the exclusion for commercial paper; nor is it excluded from the three classes of securities identified in the statute, because arguably the laundry receipt is debt paper. Second, the definition of security includes "certificates of deposit."<sup>87</sup> This term may apply to bank deposits, thereby interfering with bank deposit collection. The definition of security also may apply to bank loans. If the SMA applies to bank loans, a

84. SMA, *supra* note 1, art. 4. The SMA does not define the term "private right," but it may be inferred from the list of securities that the term refers to rights of contract, property or other rights, depending upon the conditions of the issue and Estonian law.

85. SMA, *supra* note 1, art. 4(1) ("This act does not regulate the circulation of legal tenders (bill, cheque, etc.) given according to provide rights").

86. SMA, *supra* note 1, art. 4(2). The text of art. 4(2) reads in full as follows:

(2) Securities are classified:

- 1) Securities proving rights to property (share, stock of investment fund etc.)
- 2) Securities proving debt obligation (debenture, bond, certificate of deposit etc.)
- 3) Securities proving rights or obligations to buy or sell (options etc.)

87. *Id.*

start-up company could neither make a public distribution nor obtain a bank loan. In addition, the SMA definition of security is ambiguous. The persistent use of the term "etc." makes the statutory definition uncertain. Specifically, the exclusion for commercial paper and the illustrative list of securities lose their value as definitional guides.

The definition of security is further complicated by Decree 331, which sets forth printing requirements for securities.<sup>88</sup> In contrast to the SMA's document requirement, Decree 331 states that "[s]ecurities may also be issued on electronic accounts."<sup>89</sup> The Ministry of Finance originally interpreted the term "document" to require the existence of a piece of paper. The conflict between the SMA's requirement that a security must be a document and Decree 331's recognition of securities in the form of electronic accounts has been resolved by interpreting the term "document" in the SMA to include electronic accounts. This contradiction entered the law because the drafters of Decree 331 did not make certain that the decree conformed to the SMA. Subsequently, government officials and the business community reconsidered the issue and decided to recognize the existence of non-paper securities.

The specifications for appearance and content of securities contained in Decree 331 might be inferred as setting forth a less comprehensive definition of security than the SMA.<sup>90</sup> The decree

---

88. Decree 331, Part III, *reprinted in ESMRA*, supra note 2, at 54.

89. *Id.*

90. Compare text of SMA, supra note 1, art. 4, with Decree 331, supra note 2, pt. III, §§ 9-12, *reprinted in ESMRA*, supra note 2. Decree 331 reads:

9. A security shall be aesthetically designed.

10. A security shall contain:

- 1) official name and address of the issuer;
- 2) logo of the issuer;
- 3) serial number and the nominal value of a security;
- 4) name of the owner of the security;
- 5) date of issuing the security, total number of securities and the amount of fixed assets on the date of issue;
- 6) information on the primary distributor and a note of remise of proprietorship;
- 7) obligations of the issuer;
- 8) information on redemption of re-sale;
- 9) signatures of the board representatives and the managing director of the issuer.

11. Securities may also be issued on electronic accounts or as certificates which must include the following data:

- 1) official name and address of the issuer;
- 2) serial number and nominal value of a security;
- 3) name of the owner of the security;
- 4) date of issuing the security, total of securities and the amount of fixed assets on the date of issue;

merely assumes that when an issuer makes a public offering of a document meeting the definitional requirements of Article 4, then the security must conform to the specific physical requirements of the regulation unless issued in electronic form. The regulation does not enable issuers to determine when they must comply with the statute, but rather provides only minimum requirements for issuers that have decided to make a public offering according to the SMA. If the regulatory definition were to limit the scope of the statute, securities such as investment contracts and novel financial products not conforming to the appearance and content requirements of the regulation would fall outside the scope of the SMA. The regulatory definition of security would limit securities to stocks, bonds, and options that meet the printing requirements of the regulation. However, this interpretation of the regulation is not plausible because the regulation primarily establishes prospectus requirements and was not intended to alter the statutory definition of security.

Notwithstanding the difficulty of defining a security, the SMA may be read in light of its overall purposes of investor protection and regulation of securities markets to yield a workable definition. Traditional investment paper such as stocks, bonds, and options are subject to the SMA. Given the breadth of the term "security," the SMA also covers other financial products traded in the securities market and devices such as "investment contracts." Consequently, in Estonia, issuers and counsel must determine whether investment vehicles intended for public sale qualify as securities under the SMA. If the investment vehicle is a written contract giving its owner equity rights in an enterprise, creditor rights against a debtor, or the right to buy or sell securities, then the investment vehicle is considered a security. The issuer then must also comply with the SMA's registration and prospectus requirements.

#### *E. Definitions of "Securities Intermediary," "Issuer," and "Investor"*

The SMA's definitions of the terms "securities intermediary," "issuer," and "investor" pose additional problems of legal interpretation. A "securities intermediary" is defined as a natural person or legal entity engaged in buying and selling securities.<sup>91</sup>

- 
- 5) information on the primary distribution;
  - 6) information on the repurchase and re-sale;
  - 7) signatures of the board representative and the managing director of the issue.

91. There is some difference in the text of the two translations of the SMA cited *supra* note 1. The ESMRA translation of the SMA defines a securities

This definition does not require the person or entity to be engaged "in the business of" buying or selling securities.<sup>92</sup> Therefore, it includes investors. As the SMA requires securities intermediaries to obtain a license under Article 20, an investor who sells or buys a security without a license would seem to violate the SMA.<sup>93</sup> Obviously, when the legislature enacted the SMA, it did not intend this result. However, it is the result that follows from the exact words of the statute.

The definition of "investor" provides a means to resolve this problem, though it introduces an unrelated ambiguity. An "investor" is a legal entity or natural person owning a security or who is obliged to buy a security.<sup>94</sup> Because the SMA distinguishes between investors and professional market participants, it may be inferred that the definition of "securities professional" does not include investors. Otherwise, the separate definition of "investor" is rendered meaningless. However, the phrase "obliged to buy a security" complicates the definition of the term "investor." This phrase apparently means that the investor has entered into a contract to purchase a security. It would be preferable simply to state that an investor is a person who buys or sells securities for a personal account.

Similarly, the definition of the term "issuer" is poorly drafted. It states that an "issuer" is a "legal entity or a person issuing securities according to enacted order and assuming concurring obligations before the investors and the intermediaries."<sup>95</sup> If read literally, this definition includes only issuers complying with the SMA and its regulatory requirements, and excludes non-complying issuers. That would mean that issuers failing to comply with the SMA were not subject to the statute. As the legislature could not have intended such a result, the definition of "issuer" cannot follow from the literal meaning of its words. Rather, given the purposes of the statute, the definition of "issuer"

---

intermediary as "a legal entity or a person engaged in buying and selling securities." SMA, *supra* note 1, art. 2(1)(2) in ESMRA, *supra* note 2, at 44. It should be noted that the translation appearing in LEGAL ACTS OF ESTONIA states: "A securities intermediary is a legal entity or natural person buying or selling securities." LEGAL ACTS OF ESTONIA, *supra* note 1, at 1. The choice of the word "engaged" in the Ministry of Finance translation is the result of the Ministry of Finance being informed that the phrase "engaged in the business of" is a necessary part of the definition of a securities professional.

92. SMA, *supra* note 1, art. 2(1)(2).

93. *Id.* art. 20.

94. The SMA states, that an "[i]nvestor is a legal entity or a person owning a security or who has issued an obligation to buy securities." SMA, *supra* note 1, art. 2(3).

95. SMA, *supra* note 1, art. 2(2).



encompasses any natural person or legal entity that has decided to make a public distribution of securities in Estonia.

#### F. Securities Board

The SMA also provides for the creation of a Securities Board<sup>96</sup> to control the activities of professional participants in the securities market.<sup>97</sup> In general, the SMA authorizes the Securities Board to register public securities, to license professional participants in the marketplace, to propose securities legislation, and to help develop the securities industry in Estonia. The SMA also empowers the Board to draft rules to implement the statute.<sup>98</sup> However, the Board lacks general authority to promulgate regulations necessary to enforce the SMA. Such rules necessary to implement the statute must be adopted by the government of Estonia, meaning the Prime Minister, the Minister of Justice, and the Minister of Finance.<sup>99</sup>

On October 25, 1993, the Estonian government issued a decree that officially established the Securities Board.<sup>100</sup> The decree set forth a charter for the Securities Board, defining it as "a state budgetary organization that is responsible for carrying out supervision in compliance with the Securities Market Act, the present statute and other normative acts."<sup>101</sup> Further, the decree provided that the Board has authority to "organize control over the fulfillment of the Securities Market Act and the normative acts

96. *Id.* art. 5. (Control over securities is exercised by an office of supervision under the field of management of the Ministry of Finance).

97. *Id.* art. 25.

98. This authority is set forth in seven different articles of the SMA. See Article 11(4) (dealing with changes in the prospectus during the primary distribution period); Article 12(2) (dealing with changes in the condition of the public offer); Article 13 (dealing with redemption of securities); Article 14(1)(suspension of public securities); Article 15(2) (dealing with annual report announcement); Article 19(3)(working premises); Article 21(2) (dealing with working premises). The Securities Board is responsible for drafting these rules and the Minister of Finance has the authority to enact them into law by issuing a decree. ESMRA, *supra* note 2, at 46-49. The Securities Board drafted rules for each Article, but the Minister of Finance has not enacted them yet. The present Minister, appointed in June 1994, is Andres Lipstok. He is the third Minister of Finance since December 1993; his predecessors were Madis Urike and Heiki Kranich.

99. There are three articles in the SMA that set forth this division of authority. Article 9(1) (registration); Article 12(1) (announcement of the public offering) and Article 18(2) (licensing of securities professionals). SMA, *supra* note 1, arts. 9(1), 12(1), 18(2).

100. Charter of the State Securities Board of the Republic of Estonia, *approved by* Minister's Decree No. 154, Oct. 21, 1993, *translated in* ESMRA, *supra* note 2, at 61-63.

101. *Id.*

regulating the securities market."<sup>102</sup> It also empowered the Board to "enforce its own decrees and regulations in accordance with the existing normative acts and the present statute and to check their fulfillment."<sup>103</sup> The decree thus gave the Board authority to make regulations and to enforce them. However, this authority is limited by the SMA and other relevant law.

Although the Board's authority is limited to the letter of the SMA, the SMA confers several significant powers on the Securities Board. Most significantly, the SMA empowers the Board to stop a public offering. The Board may stop a public offering of securities upon the occurrence of one of three events: (1) the distribution violates the SMA or the prospectus terms; (2) the information in the registration statement is found to be incorrect; or (3) information about the issuer has the capacity to affect the "market conjuncture" of the security.<sup>104</sup> This provision establishes the Board's most significant enforcement power. However, unlike the SEC in the United States, the Board lacks statutory authority to hold hearings and to impose penalties when there is evidence that a person has violated the SMA.<sup>105</sup> The legal system in Estonia does not permit government agencies, such as the Securities Board, to hold administrative hearings and act like a court. The Board must refer civil violations of the SMA to the administrative court system; there, an administrative court judge enforces the SMA, upholds relevant regulations, and imposes fines and punishments. The Board must refer criminal violations of the SMA to the appropriate prosecutor for enforcement.<sup>106</sup>

---

102. *Id.* pt. II (setting forth the functions of the Securities Board). Section 5(1) states that the Securities Board "organizes control over the fulfillment of the Securities Market Act and the normative acts regulating the securities market." *Id.*

103. *Id.* § (7)(1).

104. The SMA does not define the term "market conjuncture." Nor is there consensus within the Estonian financial community regarding the meaning of the term. The SMA should be amended to clarify the significance of this term. SMA, *supra* note 1, art. 14(3). Article 14 of the SMA also gives the Securities Board authority to stop a public distribution. *Id.*

105. *See* SMA, *supra* note 1, art. 14. The proposed rule to implement Article 14 contains a provision permitting the Securities Board to require the alleged violator to submit a written or oral explanation of its actions prior to the issuance of a suspension order.

106. Estonia is revising its civil and criminal codes, which currently lack any provisions for securities regulations. Each code must be amended to address the particular problems of issuing and trading securities because when the drafts of the civil and criminal codes first were prepared they did not contain provisions for securities regulation. The Ministry of Justice is considering proposed amendments to these codes that would prohibit certain activities with regard to securities. Estonia's decision not to include anti-fraud or similar provisions in the SMA raises the possibility that the amended civil and criminal codes may not

While the SMA authorizes the Board to stop a public offering, the effect of this power is limited by the Board's lack of adjudicative power.

The licensing power of the Securities Board is its second most significant statutory power. Article 18 of the SMA authorizes the Board to license all securities professionals, and Article 20 authorizes revocation under circumstances specified in the SMA.<sup>107</sup> Although the Securities Board lacks authority to hold hearings, to issue cease and desist orders, or to impose penalties for most violations of the SMA, the Board can use its licensing power to control the behavior of securities brokers, dealers, and exchanges.<sup>108</sup> At present, qualification certificates for securities professionals are issued for an indeterminate period. Licenses for securities exchanges are issued for one year. If the Board issued licenses and made them valid for only one year—renewable annually on notice—the Board would have adequate power to regulate the conduct of a securities professional without establishing an overly complex regulatory system.<sup>109</sup>

The Securities Board is in its formative stage of development. Vahur Lökk, appointed by the Minister of Finance on January 1, 1994, is the General Director of the Securities Board.<sup>110</sup> Since taking office, he has appointed an assistant director, a legal advisor, a general specialist, and two additional advisors to the Board.<sup>111</sup> Mr. Lökk and his staff are establishing the procedures and practices of the office, and the legal advisor develops proposed legislation and rules, and provides legal counsel to the General Director. The assistant director reviews the registration applications, assists in the development of legislation and rules,

contain a complete statement of law against market offenses. This policy choice deprives the Board of flexibility to define improper conduct by regulation.

107. SMA, *supra* note 1, arts. 18, 20.

108. *See id.*

109. I have suggested this proposal to the Ministry of Finance. British investment fund specialists also support this idea.

110. Prior to Mr. Lökk's appointment, the Securities Division within the Ministry of Finance performed the functions of the Securities Board. The staff of the Securities Division is headed by Hilma Naaber, Securities Paper Referee, and Tauno Kangur. In addition to revising the SMA, the Securities Division is drafting a depository law. The actual drafting process for the SMA revision is dominated by Mr. Mahhov and Ms. Tarmak. As of July 1994, Broker Baltic essentially has co-opted the drafting process from the Securities Division.

111. The Assistant Director is Arno Puskar; the Legal Advisor is John J. A. Burke; the General Specialist is Toivo Ellakvere; and the additional Advisors are Imre Sade and Jaanus Kaljulaid. Mr. Puskar, an Estonian-American, is on a one year leave of absence from Bankers' Trust where he is a securities analyst. Mr. Ellakvere is a student of economics at Tartu University. Mr. Sade is a graduate of the Economics Department of Tartu University. He and Mr. Kaljulaid received training from the U.S. Securities Exchange Commission on how to conduct inspections of securities firms.

develops office policy, and with the advice of the legal advisor, answers questions posed by issuers and securities professionals regarding compliance with the law. The advisors are expected to conduct inspections of securities professionals and securities firms. The role of the general specialist is not defined; he tends to assist other staff members. Collectively, the Securities Board and its staff are setting up a regulatory system to enforce the SMA.

The Securities Board has prepared a draft Securities Exchange Act, and has adopted two rules needed to implement the SMA.<sup>112</sup> The Securities Division of the Ministry of Finance, in conjunction with the Securities Board, has prepared a revised SMA. The Securities Division is also drafting a securities depository law. The Privatization Department within the Ministry of Finance has prepared a draft Investment Funds Act and the Privatization Investment Fund Decree. The Ministry of Justice must review and approve all draft laws before they are submitted to the Estonian Parliament. Because the Ministry of Justice lacks personnel that understand securities, and because the degree of coordination among the Ministries is low, the legislative process is slow and prone to error.<sup>113</sup>

#### G. Registration; Resolution; Prospectus; Public Announcement

An issuer proposing to make a public offering must file a registration application with the Securities Board.<sup>114</sup> This application requires a copy of the issuer's corporate charter, its resolution to make a public offering, and a prospectus.<sup>115</sup> Following the submission of a complete application, the Securities Board must give the issuer a registration certificate within thirty days.<sup>116</sup> During this period, the Board does not conduct a merit

---

112. The two rules are: (1) Securities Board Order No. 8 specifying office requirements for securities professionals and implementing Articles 19(3) and 21(2) of the SMA, and (2) Securities Board Order No. 9 specifying the authority of the Securities Board to suspend a public offering and implementing Article 14(1) of the SMA and setting forth the duty to keep current a prospectus during the period of primary distribution, and implementing Article 11(4). Order No. 9 also specifies how investors may request a stock redemption, thus implementing Article 13 of the SMA. These orders are on file with the author.

113. An internal memorandum of the Ministry of Finance states that the SMA requires regulations concerning: (1) the order of licensing, (2) the registration and public issue of securities, (3) the prospectus requirements, (4) the carrying out securities trading, (5) the qualification requirements for securities professionals, (6) the termination of a public issue, (7) the securities exchange act, and (8) the securities register and securities depository. (Memorandum of the Ministry of Finance, on file with the author).

114. SMA, *supra* note 1, art. 9.

115. *Id.* art. 10

116. *Id.* art. 10(3).

review of the offering. Instead, it reviews the application to ensure the completeness of the information provided. This practice is consistent with the underlying policy of the SMA of allowing the investor to evaluate the merits of the security. Once the Board approves the registration application, it is a matter of public record.

When an issuer receives a registration certificate, the SMA requires the issuer to make a public announcement of the offering.<sup>117</sup> The announcement must be made in an Estonian newspaper with a daily circulation of at least thirty-five thousand.<sup>118</sup> The issuer then may distribute the prospectus. The public announcement identifies where potential investors may obtain copies of a prospectus. However, the SMA does not establish a detailed procedure for making the prospectus "publicly available." The SMA does not require delivery of the prospectus to the purchaser of the security.<sup>119</sup> In practice, the issuer makes a prospectus available for review at the place of the selling agent.

After the public announcement is made, the issuer may advertise the public offering.<sup>120</sup> Advertisement is limited to information contained in the prospectus. The SMA thereby prohibits "free writing," a practice permitted under U.S. law.<sup>121</sup> The sale and distribution of securities cannot occur until two weeks after the issuer made the public announcement and made the prospectus available to potential investors.<sup>122</sup> Either the issuer, or another person, may participate in these activities.<sup>123</sup> This two-week waiting period, combined with the earlier thirty-day waiting period, compels an issuer to wait for a total of forty-five days.

This forty-five day, statutory waiting period is unjustified.<sup>124</sup> The initial thirty-day waiting period itself is too long because the

117. *Id.* art. 12.

118. Decree 331, *supra* note 2, at pt. 4, § 13 reprinted in ESMRA, *supra* note 2, at 55. This is an odd requirement, as there are no newspapers in Estonia with a circulation of more than 35,000. The provision derives from similar provisions used during the Soviet period when there were fewer newspapers with wider circulations.

119. A proposed amendment to the SMA requires the delivery of a prospectus to the buyer at the time of delivery of the security. The draft Investment Funds Act requires a signed receipt of the prospectus by the purchaser.

120. SMA, *supra* note 1, art. 12.

121. See generally LARRY D. SODERQUIST, SECURITIES REGULATION 71-72 (3d ed. 1994) (discussing "free writing" under U.S. securities law).

122. SMA, *supra* note 1, art. (2)(1).

123. *Id.* art. (2)(1).

124. Proposed amendments to the SMA allow limited advertising during the thirty-day registration waiting period and eliminate the subsequent two-week waiting period.

Securities Board does not conduct a merit review of the registration application. During this waiting period, an issuer cannot make a public announcement concerning the issue to condition the market for the receipt of the securities. The later two-week interval, between the registration of a security and its date of distribution, complicates the setting of the price and frustrates the distribution process when the issuer has already received state approval for the sale of its securities. The SMA forbids even the publication of a "tombstone" advertisement during the pre-certification period.<sup>125</sup> This two-stage waiting period neither protects investors nor fosters the development of the securities market.

The application requirements are set forth in Article 10 of the SMA and Decree 331.<sup>126</sup> Article 10 requires the application to contain: the name and address of the issuer, the type of securities, the beginning and ending dates of the primary distribution period, the nominal amount of the issue, and the name and address of the person who will distribute the security. Decree 331 further specifies that the filing fee is 0.1% of the nominal value of the issue, but that fee may not exceed fifty thousand EEK or approximately \$3500. The Securities Board may ask the issuer to correct inaccurate information in the application. However, in practice, the Board does not determine the accuracy of information in the prospectus. Thus, in theory, Decree 331 contradicts the non-merit review policy of the SMA. When the prospectus is incomplete, the Board uses the equivalent of a deficiency letter to notify the applicant of the need to amend the registration application.<sup>127</sup>

Decree 331 specifies the requirements for the corporate resolution and the prospectus. The corporate resolution contains six parts: the purpose of the issue, the type of securities, the quantity of securities, the date of the issue, the expected rate of return, and relevant rights and responsibilities.<sup>128</sup> A corporate resolution embodying the decision of an issuer to make a public offering satisfies the statutory requirements of the SMA.

---

125. In U.S. law, a "tombstone ad" is not considered a prospectus and its use is permitted during the writing and post-effective period. Rule 134 authorizes an expanded "identifying statement." The tombstone ad permits "the name of the issuer, title of security, its price, a statement of the source of a Section 10 prospectus, and the identity of persons by whom orders will be executed." R. JENNINGS, H. MARSH AND J. COFFEE, *SECURITIES REGULATION—CASES AND MATERIALS* 127 (7th ed. 1992).

126. SMA, *supra* note 1, art. 10; Decree 331, *supra* note 2.

127. Decree 331, *supra* note 2, § 8.

128. *Id.* § 1. Decree 331 does not explain the rights and responsibilities to which it refers. It would appear that the issuer must explain its obligations and its rights and do the same for the ultimate owner of the security.

Specifically, it meets the definition for "issuance of securities," which requires an issuer's decision to make a public offering.<sup>129</sup> Decree 331 lists twenty-nine separate criteria for the prospectus. The prospectus contains all material information about the issuer and the conditions of the issue.<sup>130</sup> The information in the prospectus must be accurate as of the effective date of the registration. The issuer must publish the prospectus in the Estonian language, though the issuer may publish it in other languages as well. The issuer must prepare an easy-to-read prospectus so that the average investor can understand it. The prospectus explains the business plan, identifies the level of risk of the investment, and describes the instrument for sale. The technical data includes an audited balance sheet and a profit-and-loss statement. In June 1994, Estonia enacted an accounting law based on generally accepted accounting principles; thus, the financial statements will permit comparative analysis by the market.<sup>131</sup>

A provision of Decree 331 appears to preclude the registration of securities by a company without a substantial operating history. The provision requires the issuer to provide balance sheets and profit-and-loss statements for the prior three years of operation.<sup>132</sup> Decree 331 does not contain an exemption from this requirement. Consequently, a start-up company without three years' operating history would not appear to have access to the securities market. Despite the literal meaning of this provision, a start-up company made the first registered issue in Estonia. The Securities Board has adopted the interpretation that a start-up company has zero financial statements for the preceding three years. While this interpretation opens the market to new, and possibly innovative, businesses the language of the Decree is poorly worded.

The SMA also requires the issuer to report to the Securities Board any changes in information contained in the prospectus that occur during the primary distribution.<sup>133</sup> The issuer also must announce these changes to the public. Because the primary distribution periods in Estonia are long, the SMA imposes

129. SMA, *supra* note 1, art. 6.

130. *Id.* art. 11(3).

131. The accounting law was passed by the Parliament of the Republic of Estonia on June 8, 1994. The official Riigi Teataja citation is not yet available. The Accounting Law is based on internationally accepted accounting principles, specifically the Fourth EU Company Directive and the principles, standards and guidelines approved by the International Accounting Standards Committee. *Id.* § 3(13).

132. Decree 331, *supra* note 2, pt. II, § 6.6.

133. SMA, *supra* note 1, art. 11(4).

a substantial, continuous reporting requirement on issuers.<sup>134</sup> As explained below, the issuer may change conditions of the issue only with the consent of the Securities Board. Changing the conditions of the issue entitles prior purchasers to rescind the sale of the security and to obtain a refund of the purchase price, interest, and dividends. The SMA does not define the phrase "terms of the issue," and the Securities Board has decided not to draft a rule clarifying its meaning; the Board anticipates that the revised SMA will omit this provision.

The Securities Board may refuse to register an application for three reasons: (1) the issue contradicts the SMA or related acts, (2) the information contained in the application is incomplete or fails to conform to the requirements of law, and (3) the securities are inconsistent with the requirements of Decree 51 specifying the paper requirements for security certificates. The Securities Board notifies the issuer of deficiencies in the application and allows the issuer to correct them. If the Securities Board refuses to register the issue, the Securities Board refunds half of the filing fee to the issuer.

Issuers and securities intermediaries are liable for false information published during the public offering.<sup>135</sup> Article 16 states that the issuer is liable for false information contained in the registration statement, prospectus, and published data regarding an issue of securities during the primary distribution. Experts and other persons who prepare the registration statement, prospectus, and related publications are not liable for errors in these documents. The policy of the SMA to limit liability on the registration statement, prospectus, and published data concerning the primary distribution conforms to the level of marketplace development in Estonia.<sup>136</sup> A broader range of liability—such as that imposed by Section 11 of the United States Securities Act of 1933<sup>137</sup>—does not make sense in a society that does not have investment banks, large law firms, or accounting concerns. In addition, the efficacy of such regulations is debatable, and the cost of "due diligence" requirements could not

---

134. *Id.*

135. *Id.* art. 16.

136. In his criticism of U.S. securities law, Professor Cox suggests that a thorough analysis of the costs and benefits of Section 11 liability is required in the American market. James D. Cox, *Rethinking U.S. Securities Laws in the Shadow of International Regulatory Competition*, 55 LAW & CONTEMP. PROBS. 157, 195-97 (1992). In Estonia, stiff penalties like those of Section 11 would hinder the development of investment banking. For example, the absolute liability that Section 11 imposes on the issuer would be completely inappropriate in Estonia where an issuer might cite a statistic from a government report and learn later that the report was wrong.

137. 15 U.S.C. § 771c (1992).



be justified in the Estonian market.<sup>138</sup> However, as discussed below, the SMA does not contain liability provisions.

Article 17 states that, during the primary distribution, the issuer and the securities intermediaries selling the securities have an obligation to assure "equal conditions for all the potential investors to obtain information."<sup>139</sup> Article 17 promotes full disclosure of material information concerning a primary distribution of securities. It requires issuers to take practical steps to make certain that all investors have an equal opportunity to obtain a copy of a prospectus. It requires securities intermediaries to offer advice and information on equal terms to the public. Exactly how issuers and securities intermediaries discharge their respective Article 17 obligations will develop over time.

#### H. Physical Form of the Security

While the SMA is silent with regard to the physical characteristics of a security, Decree 331 sets forth elaborate requirements for the appearance and content of securities.<sup>140</sup> Perhaps because a security is an "element of national culture,"<sup>141</sup> the Decree requires that the physical security document contain the following nine items: (1) the legal name and address of the issuer, (2) the issuer's logo, (3) series number and nominal value of the security, (4) name of the owner, (5) the date of its issuance, the total number of securities and the amount of fixed assets of the issuer as of that date, (6) information on the distributor, (7) obligations of the issuer, (8) information on repurchase and resale and (9) signatures of a representative of the board of directors and a managing director.<sup>142</sup>

The Estonian government has also set forth special paper requirements for security certificates in Decree 51. That decree states that "[a] security shall be printed by a licensed producer on special paper, the attainability of which to a forger is

138. However, the alternative argument for expanded due diligence is appealing. Expanded due diligence may be necessary to establish a market that people can trust. In addition, it is likely that in Estonia most distributions will take place through a small community of large brokers. Therefore, there is good reason to hold them liable for statements made in the prospectus.

139. SMA, *supra* note 1, art. 17.

140. Decree 331, *supra* note 2, pt. III; see also Decree 51, *supra* note 65 (specifying paper quality, size, color of security and printing techniques).

141. Decree 51, *supra* note 65, § 8 ("A security is a similar element of national culture like money, national costumes, etc., for which reason its aesthetic appearance must correspond to our cultural levels and principles").

142. Decree 331, *supra* note 2, pt. III.

foreclosed.”<sup>143</sup> It also sets forth special requirements for the weight and rag fibre content of the paper, among other things.<sup>144</sup>

The investment community in Estonia strongly opposed these requirements because they raise the cost of making a public issue. The regulations also altered the practice of issuing a simple certificate to the purchaser of a security. The regulations apparently overlook the fact that Estonia does not have a printer that can produce documents meeting the regulation's requirements. Nonetheless, the Securities Board maintains that these physical requirements reduce the risk of forgery and fraud. While fraud is widely acknowledged as a problem in Estonia, the regulation will not prevent forgery. Further, it imposes an unnecessary cost on issuers and presents another obstacle to the development of the securities market.

### I. Reporting Requirements

The SMA compels issuers to file an annual report with the Securities Board.<sup>145</sup> These reports must be prepared by independent auditors and contain their certification. Consistent with the SMA's disclosure policy, the issuer must make the annual report available to investors, and must make a public announcement regarding it. Although the SMA does not require quarterly reports, a proposed regulation would require issuers to file an interim financial report in addition to the annual report. The legal basis of the proposed regulation derives from Article 27, which authorizes the Securities Board to demand reports from the issuer other than those specified in the SMA.<sup>146</sup>

The SMA also requires the issuer to report significant corporate developments to the Securities Board, to the stock exchanges where to the security is listed and traded, and to the public.<sup>147</sup> The SMA lists four events that can trigger the reporting requirement: (1) restrictions placed on the issuer's bank account; (2) bankruptcy or “sanctions caused by its financial activities;” (3)

---

143. Decree 51, *supra* note 65, § 6.

144. Decree 51 then specifies that the “paper's unit weight shall be at 90 gr/m<sup>2</sup> and the content of the rag fibre at least 50 percent.” *Id.* To diminish the risk of forgery, Decree 51 states that “[t]he existence of a reagent is advisable in the paper to make the use of the so-called ink-death (e.g. natriumhypocloride etc.) impossible.” *Id.* This decree also specifies the colors of certificates depending on the total number of printed certificates. *Id.* § 7.

145. SMA, *supra* note 1, art. 15.

146. The SMA states that “[t]he issuers and the securities professionals are obliged to submit the SS on its request additional data characterizing their activities in addition to reports and data submitted according to statistics law.” *Id.* art. 27.

147. *Id.* art. 15(3).

the commencement, postponement, cessation or change of the issuer's "main activities;" and (4) the filing of legal proceedings against the issuer.<sup>148</sup> If the issuer publishes incorrect information regarding these events, and the incorrect information has the capacity to affect the price of the security, then the issuer is obligated to publish a correction within two days from the date that the incorrect information was reported.<sup>149</sup>

The SMA's reporting requirement under Article 15(3), though somewhat analogous to 8K reports under U.S. law,<sup>150</sup> is difficult to apply without clarification by rule. For example, the meaning of the phrase "sanctions caused by its financial activities" is not self-evident. Similar ambiguity pervades subsection three referring to changes in the issuer's main activities. Whether such changes include a merger is not apparent, though a merger would appear to alter the activities of the issuer. Article 15(4) introduces uncertainty into what should be a clear requirement to report correct information to the market. Unless all other things remain equal, the issuer cannot determine whether the incorrect information reported under Article 15(3) caused a rise or decline in the price of its securities within two days from the filing of the report containing the incorrect information. The price of securities depends on various and complex factors that may be totally unrelated to an inaccurate Article 15(3) report. The causal connection between information and prices always presents a difficult empirical and legal question. Therefore, Article 15(4) should not predicate reporting correct information on the basis of price changes.

### J. Insider Trading

The SMA does not prohibit insider trading. However, it does require issuers and persons identified as "close relatives" of the issuer to report their trades. Article 22 states that the issuer, the issuer's close relatives, and securities professionals are obligated to register their trades with the Securities Board within three days of the date they are made.<sup>151</sup> The term "close relatives" means the following persons: (1) a legal entity that owns securities providing more than ten percent of the voting rights; (2) a natural person who owns securities providing more than five percent of the voting rights; (3) relatives of persons in subsection

---

148. *Id.*

149. *Id.* art. 15(4).

150. Compare SMA, *supra* note 1, art. 15(3) with 15 U.S.C. § 78m(a) (1992); see generally SODERQUIST, *supra* note 121, at 322-23 (describing reporting requirements under the U.S. Securities Exchange Act of 1934).

151. SMA, *supra* note 1, art. 22.

2 entitled to inherit in the "first and second grade in the line of succession;" (4) persons performing a task for the issuer within the last six months and having access to issuer's information; and (5) the staff of the Securities Board.<sup>152</sup> Article 23(2) also requires "close relatives" to report their transactions to the issuer and to the stock exchange where the security is listed and traded not later than three business days after the date of the transaction.<sup>153</sup>

Although the efficient capital market theory provides a basis for allowing insider trading, the decision to permit insider trading creates the impression that the market is not a level playing field, because non-insiders do not have access to inside information that affects the price of securities. Reporting requirements and professional analyses of issuers and the securities market are just as likely to introduce material information to the market as the trading activities of insiders. The legislative history of the SMA does not contain any theoretical discussion justifying the absence of any bar on insider trading. A recent EU directive that bans insider trading provides an additional reason to regulate this practice. Making the SMA consistent with the EU directive seems consistent with Estonia's long term goal of becoming a member of the European Union.<sup>154</sup> Prohibiting insider trading also would increase public confidence in the securities market and decrease the opportunity of management to serve its self-interest at the expense of shareholders.

Article 24 is a misguided attempt to prohibit dealer trading on inside information for personal profit. Article 24 provides: "Professional participants of the securities market or their staff who directly deal with securities of the issuer, have no right to operate with the identified securities by themselves or through brokers." Taken literally, Article 24 forbids market-making and the buying and selling of securities for the account of the dealer. The literal meaning of the SMA forbids an essential activity of the securities dealer. Allowing market makers to repurchase securities would solve the immediate problem of redemption of

---

152. *Id.* art. 23. Broker Baltic's draft of the SMA prohibited inside trading. Later, a problem arose concerning the definition of the phrase "use of inside information." A subsequent proposal provided for reporting requirements and restricted the resale of securities bought on inside information. These securities could not be sold for six months. However, the SMA does not contain this provision.

153. *Id.* art. 23(2).

154. See Council Directive 89/592 of 13 November 1989 on Coordinating Regulations on Insider Dealing, art. 32, 1989 O.J. (L 334) 30. For a general explanation see Thomas Lee Hazen, *Defining Illegal Insider Trading—Lessons from the European Community Directive on Insider Trading*, 55 LAW & CONTEMP. PROBS. 231 (1992).

securities in the current market because it would free issuers from having to do so. Article 24 probably was intended to prohibit insider trading by securities dealers having access to insider information of the issuer. The Estonian legislature must amend the SMA to correct this defect.

### K. *Licensing*

Chapter 3 governs the licensing of securities professionals and Articles 18, 19, and 20 set forth the specific licensing requirements.<sup>155</sup> Article 18 requires every professional participant in the market to have a license.<sup>156</sup> Professional participants in the market are: stock exchanges, securities intermediaries, and investment funds. The SMA does not identify the criteria necessary to obtain a license. Rather, the SMA states that the license application must contain the professional background and prior financial experience of persons responsible for the licensed activity. Decree 157 contains rules governing the issuance of licenses to professional participants in the marketplace, but it applies only to legal entities. It requires the applicant to submit the following to the Securities Board: the professional participant's charter, an employment contract with a natural person holding a qualification certificate issued by the Securities Board, and evidence of adequate office premises.<sup>157</sup> Decree 157 also forbids a broker from accepting securities "for sale in the value that would exceed three times the value of his property or bank deposits."<sup>158</sup> There is no decree governing the issuance of licenses or qualification certificates to natural persons. Despite the SMA mandate to license all professional participants in the marketplace, no broker has such a license to act as a professional participant in the marketplace.<sup>159</sup>

In equal disregard of the SMA mandate to license professional participants in the marketplace is the failure to license investment funds. The General Director has not acted to enforce the SMA against investment funds, despite the SMA language and the advice of staff. The failure to enforce the statute stems from a lack of leadership and is based on the rationale that the enactment of the draft Investment Funds Act will provide a comprehensive law to govern investment funds. The problem

---

155. SMA, *supra* note 1, arts. 18-20.

156. *Id.* art. 18.

157. Minister's Decree 157, *supra* note 2.

158. *Id.*

159. In addition, subsequent to the enactment of Decree 157, Mr. Lokk, Ms. Naaber, Viktor Mahhov, Rein Usin, Aivo Reiner, and others issued qualification certificates to themselves without taking any qualifying examination.

with this position is that it violates the SMA and disregards the risk of investment funds. Investment fund units are not registered under the SMA because they do not trade on the secondary market. Therefore, the public does not receive a prospectus setting forth information about the issuer, its investment objectives, and financial condition. As a result, investment funds tend to make exaggerated claims about rates of return and guarantees of payment. For example, some funds advertise themselves as pension funds despite the fact that the Estonian income tax law does not contain any deferred taxation provisions. In Estonia, there is absolutely no difference between a so-called pension fund and any other fund.

Article 19 sets forth the grounds for refusing to issue a license.<sup>160</sup> They are: (1) the applicant who is a natural person is unqualified, (2) the applicant that is a legal entity lacks the possibility to employ professional specialists, (3) the applicant lacks adequate physical facilities to operate a securities business,<sup>161</sup> and (4) the applicant fails to satisfy requirements established by the Securities Board and the SMA.<sup>162</sup> The second and third grounds are intended to prevent applicants from pocketing licenses without the intent to use them. The fourth is a general catch-all provision, but is void of content because the SMA largely does not specify any criteria for obtaining a license.

Article 20 states the circumstances under which the Securities Board may cancel or suspend a license.<sup>163</sup> It provides three grounds: (1) the licensed person violates the rules of the license, (2) the licensed person violates the SMA or other related legal acts, and (3) the licensed person "discredits" himself.<sup>164</sup> Because the SMA does not confer rulemaking authority with respect to Article 20, the Securities Board cannot define these critical events or the meaning of terms such as "discredits himself." Although Article 20(2) authorizes the Securities Board to suspend the license of a securities professional until the latter corrects the reason for the suspension, the SMA does not indicate whether the Securities Board may suspend without a hearing.<sup>165</sup>

---

160. SMA, *supra* note 1, art. 19.

161. The Securities Board has drafted a regulation to implement Article 19(3) of the SMA concerning the adequacy of working premises.

162. SMA, *supra* note 1, art. 19.

163. *Id.* art. 20.

164. *Id.* art. 20(1).

165. *Id.* art. 20(2).

### L. *Liabilities and Remedies*

In general, the SMA does not provide remedies for statutory violations. Two exceptions are set forth in Articles 13 and 14(3).<sup>166</sup> The SMA relies on criminal, civil, and administrative remedies outside the SMA to enforce violations of its provisions. This reliance on other law to provide remedies for statutory violations has roots in past Estonian legal practices. However, it is an unfortunate policy choice with regard to the SMA. The decision to place the remedies for civil and criminal violations of the SMA in the appropriate sections of the civil and criminal codes requires a level of coordination among diverse statutes that is unlikely to occur during Estonia's period of legal reform. The original drafts of the revised civil and criminal codes do not address market offenses. The failure to provide a rational, coherent, and easily identifiable scheme of remedies within the SMA represents a missed opportunity and derives from blind adherence to tradition.

Article 29 states that penalties for violations of the SMA are found in the criminal and civil codes.<sup>167</sup> This reference does not contain specific citations to the civil and criminal codes, and as a result, does not help identify the range of penalties and remedies. The reference is absent because the present law does not contain remedies for securities violations. To correct this problem, the Ministries of Finance and Justice are recommending appropriate amendments to the draft civil and criminal codes. This process has the potential to create mistakes because the Ministries have not appointed a single person to ensure that the penalty provisions for market offenses under the SMA, the civil code, and the criminal code are consistent. While the Ministry of Justice has decided to amend the SMA to include penalties for its violation, the draft revisions do not contain a full statement of liability provisions.

However, Article 13 and Article 14(3) are exceptions to this general approach of relying on other law to provide remedies for statutory violations.<sup>168</sup> Article 13 provides that when an issuer changes the terms of the offer during the primary distribution, the purchaser has a right to rescind and demand back the purchase price.<sup>169</sup> The Securities Board has decided not to draft a proposed rule to implement Article 13 because a consensus cannot be reached regarding what constitutes a change in the

---

166. *Id.* arts. 13, 14(3).

167. *Id.* art. 29.

168. *Id.* arts. 13, 14(3).

169. *Id.* art. 13.

term of an issue, and it is expected that the revised SMA will not contain this provision. Article 14(3), on the other hand, provides that when the issuer prematurely terminates the public offering, the issuer must pay all expenditures and losses to purchasers. The Securities Board has drafted a proposed rule to implement Article 14, which gives investors a right of redemption if the Securities Board suspends the public offering under Article 14. The right of redemption entitles the investor to recover the purchase price of the security plus interest payable on a debt security, dividends, or income declared on an equity security.

However, Article 14 does not define the damages to which an investor is entitled when the issuer suspends the public offering. It is expected that the revised SMA will provide for an identical remedy of right of redemption for investors when a public offering is suspended either by decision of the Securities Board or by the issuer. Nevertheless, under the SMA, an important question is the amount and type of losses the purchaser is entitled to recover when the issuer suspends the public offering. In an analogous area, the proposed Sales of Goods Act limits damages to actual losses, and prohibits the recovery of consequential damages unless they are foreseeable by the breaching party.<sup>170</sup> The proposed Sales of Goods Act applies to securities and, if enacted, would exclude consequential damages unless the person who breached the contract had knowledge of special circumstances and should have foreseen the consequences of the breach.

The draft revisions to the SMA include penalties for violating the statute. However, these penalties are not severe. The drafters' approach is to establish fines for the activity of legal entities that violate SMA provisions. For example, the proposed fine for a failure to register publicly sold securities ranges from five hundred EEK to ten thousand EEK, or from \$50 to \$800. For the deliberate release of incorrect information, the maximum fine is thirty thousand EEK or about \$2,500. Even in Estonia's developing securities market, the amount of these fines is extremely small and may not deter misconduct on the market. The draft revisions subject natural persons to liability under the civil code for violations of the SMA. While it was recommended

---

170. The proposed Sales of Goods Act is based on the Swedish Sales of Goods Act and, in case of conflicts, is superseded by the Vienna Convention. Professor Peter Byrne of Georgetown Law School, who directed the post-graduate work of the Estonian student who drafted the law while spending a year at Georgetown Law Center, reports that Professor Paul Varul, Head of the Chair of Civil and Commercial Law has accepted the draft with minor changes.



that the draft revisions include the remedy of disgorgement of profits, the drafters opted to omit such a penalty.<sup>171</sup>

#### IV. EVALUATION OF THE SMA

The SMA regulates the securities market by disclosing information to market participants and by licensing the activities of securities professionals. The SMA does not require an extensive compliance system to implement its purposes. While the SMA contains several defects that require correction, the statute nevertheless is a good starting point to establish a securities regulatory system. It is simple, easy to implement, and if corrected, it would provide adequate protection to investors and standardize public offerings. The Ministry of Justice has decided to amend the SMA to correct its defects. The quality of these revisions will depend on the ability of the drafters to produce a coherent, concise, and well-balanced securities statute.

There are eight principal problems with the SMA: (1) the flawed definitions of securities professional, investor, and issuer; (2) the overbroad definition of security; (3) the lack of exemptions for the national government and small offerings; (4) the failure to define a private placement; (5) the unnecessary two-week waiting period subsequent to registration; (6) the failure to prohibit insider trading; (7) the failure to address issues such as manipulation, stabilization, and foreign securities; and (8) the absence of comprehensive liability provisions. Additionally, Decree 157 fails to provide for licensing of natural persons as securities professionals. Finally, the Decree's prohibition against the sale of securities with a value of more than three times the value of the property and bank deposits of the broker effectively would prevent any broker from selling government securities.

The most cost-effective and error-free method of repairing the SMA is to take sample provisions from foreign jurisdictions and to approximate the EU directives for capital markets.<sup>172</sup> The EU

---

171. Additionally, the draft Investment Funds Act does not contain penalty provisions, nor does the SMA take into account violations of the Draft Investment Funds Act. There are no special liability provisions for violations of the Investment Funds Act because the draft Investment Funds Act does not contain any penalty provisions, and the draft SMA penalties do not take into account violations of the Draft Investment Funds Act.

172. The relevant directives are: Council Directive 80/390, O.J. (L/100) 1 (the listing particulars directive); Council Directive 89/298, 1980 O.J. (L124) 8 (the prospectus directive); Council Directive 88/627, 1988 O.J. (L348) 62 (the major holder disclosure directive); Council Directive 93/6, 1993 O.J. (L1441) 1 (the capital adequacy directive which was an amended proposal for a Thirteenth Council Directive on Company Law concerning takeover and other general bids);

directives provide a model to define securities, to establish exemptions, to prohibit insider trading, to define take-overs, and to require disclosure by major holders. The securities laws of Hungary and Poland provide a model to define basic terms such as securities professional. The securities laws of the United States provide a model to define stabilization and manipulation, in addition to guidance regarding penalty provisions. Estonia could establish a high-quality statute by improving the SMA on the basis of time-tested legislative models, by incorporating appropriate modifications to account for the economic realities of the Estonian securities market, and by taking measured innovative steps. The resulting law could serve as a cornerstone for an Estonian securities regulatory system.

At present, the Securities Division of the Ministry of Finance is drafting revisions to the SMA. The main participants of the drafting committee are Viktor Mahhov and Nadjia Tarmak from Broker Baltic, and Vahur Lokk of the Securities Board. However, the principal drafter is a recent law school graduate who has not studied securities legislation and does not have a background in economics. Why such an improperly qualified candidate was appointed the principal drafter of the revisions is not clear.

The drafting committee has refused to model the SMA revisions on the EU directives, despite the fact that Estonia has expressed a desire to join the European Union, or on statutes of foreign jurisdictions.<sup>173</sup> The refusal is based on the perception that there is a need to create a statute with an Estonian identity. The concept that it is totally unnecessary to create a securities statute from scratch, given the fact that scores of nations have successfully designed and implemented them, does not soften the resistance to borrow from foreign jurisdictions.

While drafting a statute on a clean slate may not be theoretically unsound, the draft revisions that this method has produced have been neither precisely drawn nor free from error. For example, an April 1994 revision that was submitted to the Ministry of Justice contained several significant problems. First, it left the definition of a security essentially unchanged, even though its shortcomings had been discussed throughout the

---

Council Directive 85/611, 1985 O.J. (L375) 3 (the UCITS directive); and Council Directive 85/592, 1989 O.J. (L334) 30 (the directive on insider trading).

173. A report by the Ministry of Economic Affairs states that "Estonia's long term goal is to gain admission to the European Economic Community." MINISTRY OF ECONOMIC AFFAIRS, ESTONIAN ECONOMIC SURVEY 1993-1994 7 (1994). The report concludes, "Estonia's economic and law-making policy must be based on a policy meeting the standards of the European Union. This is to help Estonia to become an acceptable partner for union and to prevent the future necessity to revise laws hastily passed." *Id.*

drafting process. Second, the draft did not contain any special provisions for national government securities. Third, the draft did not provide the Securities Board with any flexibility to suspend public offerings, even though the need for flexibility was thoroughly discussed and argued. Fourth, although some drafters argued that the private placement exemption should be based on an institutional exemption because Estonia does not have sophisticated investors, the definition of private placement was limited to a restricted circle of investors regardless of their sophistication. Fifth, the draft provision against insider trading was poorly written despite the fact that the drafting committee was given the language of the EU directive. Sixth, the draft did not contain any provisions to govern manipulation and stabilization. These problems suggest that the current drafting process will not repair existing defects in the SMA.

This criticism does not mean that the SMA should be amended simply to make it more complex. Except for current proposals to regulate investment funds and securities exchanges, Estonia should not enact additional legislation to control the securities market and securities professionals. A better approach would be to delegate authority to the Securities Board to promulgate rules needed to implement the SMA. This approach would allow the Board to adjust the regulatory scheme as necessary to address specific problems as they arise. It would give Estonia an opportunity to tailor a regulatory system to the specific needs and problems of its securities market. This approach also would encourage the growth of the Estonian securities market. Given the embryonic state of the securities market in Estonia, and the adequacy of the legal framework established by the SMA, the regulatory system should be kept at a minimum.

A tendency to overregulate is already evident. Decree 331, establishing prospectus requirements, resembles similar provisions in the securities laws of the United States and the European Union.<sup>174</sup> The demands of Decree 331 require professional preparation of a prospectus. Small domestic issuers may not be able to raise capital without retaining legal counsel or a securities professional. The cost of compliance, particularly the need for audited statements, may prevent some issuers from entering the market.

It is not clear whether Estonia needed a prospectus requirement of this sort for all issuers of securities. Prior to the SMA, issuers distributed a prospectus-like document to sell their

---

174. See Securities Act of 1933, § 10, 15 U.S.C. § 77aa (1992) and Council Directive 89/298, 1989 O.J. (L124) 8 (EU Directive).

securities. The empirical evidence does not indicate that these documents, prepared in response to market demand, failed to protect investors. Nor is it certain that investors read or understand the statutory prospectus. As such, the costs of complying with Decree 51, which specifies physical requirements of security certificates, probably exceed the benefits of reducing the incidence of forgery. A better approach would have been to create a multi-tiered system of compliance based on the size and sophistication of the issuer. Under such a system, large issuers, like banks, would have been required to comply with prospectus requirements like those set forth in the EU Directive. Smaller issuers would only have to comply with a more abbreviated prospectus requirement.<sup>175</sup>

The argument that a low-disclosure market yields securities of low value and results in over-investment in order to acquire relevant information does not apply to the current Estonian securities market. First, the public's lack of trust in the securities market has forced issuers to release enough information to investors in order to induce the latter to buy securities. Second, the immediate problem in Estonia is an inadequate volume of securities. The relationship between the value of securities and mandatory disclosure laws is a question that may arise in the future, and can be resolved then. Third, given market conditions, issuer expectation in a low-cost market protective of proprietary information outweighs investor expectation in a rigorously regulated market. Excessive mandatory disclosure laws may hamper the development of the securities market.

## V. THE FUTURE OF THE ESTONIAN SECURITIES MARKET

The future development of the Estonian securities market will depend on three factors: the privatization of property, the negotiability of privatization securities, and public policy. First, privatization of property is a necessary condition for the creation of the securities market.<sup>176</sup> Companies must be privatized so that

---

175. This argument does not address the fact that most unsophisticated investors do not read the prospectus. Nor does it recognize that many investors who do read a prospectus often do not understand it. The preparation of these documents has become a fine legal art; also the expertised portion of the prospectus generally is inaccessible to the average reader. Given this phenomenon, Estonia should reconsider the use of the standard prospectus for small and mid-sized companies.

176. At present, the state owns and operates a substantial number of Estonian industries. In addition, except for private houses and cooperative apartments, the state owns all residential housing. The Law of the Republic of

ownership may be transferred to the public. Privatization should result in the issuance of equity and debt securities.<sup>177</sup> The privatization process also must include the development of legislation to allow lenders to secure loans against real and personal property because the lack of securities leads to credit losses and consequently to an unwillingness to lend.<sup>178</sup> Without a law for mortgages and secured transactions, banks will lend only on condition of a high rate of interest and may continue to export capital to foreign markets.

Second, privatization securities will augment the volume of product on the securities market and permit average Estonians to buy shares in private companies. The privatization securities would allow market participants to set prices and to trade in substantial volume because the state has authorized their negotiability. The cash derived from privatization securities could be used to finance new small businesses. While there are political, legal, and practical problems with trading privatization securities, the registration of privatization securities would facilitate the growth of a securities market by a rapid increase in volume.

The Estonian government already has issued and distributed privatization vouchers to those entitled to hold them. Under the SMA definition, these privatization vouchers qualify as securities because they are electronic accounts giving private rights to their owners. However, these vouchers have not been registered with the Securities Board because, when originally issued, they were not meant to have been traded. Nonetheless, the government has granted Estonian citizens and legal residents the right to trade these vouchers.<sup>179</sup> The trade of these vouchers has created a small secondary market. A single privatization voucher has a value of approximately three hundred EEK per year. At present,

Estonia on Privatisation Art. 639 was enacted in 1993. See 45 RÜGI TEATAJA Part I (1993). The Privatisation process in Estonia is administered by the Privatisation Agency, a Governmental institution established by the Law and subordinated to the Ministry of Finance. SIAR-BOSSARD, *supra* note 11, at 18. However, privatization is proceeding gradually. In total, approximately 1,000 small enterprises have been privatized. Memorandum by Erastamisagentuur, Privatization in Estonia Summary (1994) (two-page memorandum on file with the author). In 1993, the agency privatized 243 enterprises with a total value of 124,718,100 EEK. *Id.* In 1994, the privatization agency entered into eighty-six contracts with a total value of 481,776,601 EEK. *Id.*

177. Well-known companies like Kalev Chocolate are appropriate starting places for the privatization process since public ownership of these companies would be popular.

178. See Gaasenbeek Report, *supra* note 9, at 2.

179. On June 30, 1994, the Estonian Parliament enacted a law on the free alienation of privatization vouchers. They are freely transferable among Estonian citizens and legal residents.

the asked price for a one-year voucher is two hundred EEK and the bid price is approximately fifty EEK. Broker Baltic and Hansapank have begun to act as intermediaries in some secondary market transactions involving privatization vouchers. The Government recently has decided to make all privatization vouchers freely tradable. These developments suggest that trading privatization vouchers may catalyze the emergence of a secondary market.

Third, the policy of the Estonian government influences the development of the securities market by providing government support for the market. The Estonian government can directly support the development of the securities market by selling bonds when the need for such financing arises. Based on the failure of the government to place its prior issue of government securities, this alternative would require the government to demonstrate its ability to repay its debt and to alter its marketing methods. The Estonian government also can work with the private sector to create a goal for its market by taking into account the needs of the domestic economy and the competition for funds presented by other securities markets.

The contemporary Estonian securities market developed largely without any legal framework. It emerged from economic demand. The Estonian market consists of banks, some large companies, small businesses, and investment funds. Most companies are either newly established enterprises or former state-owned industries that were recently privatized. These companies need capital to purchase equipment, to upgrade the condition of their plants, and to improve the quality of their product to compete on the world market. While bank loans may satisfy the capital requirements for some of these emerging industries, the securities market should provide an alternative source of funds for long-term capital. Securities markets should function to transfer surplus income from savers to company owners for the purpose of establishing a free market economy. A securities market will compete directly with the banks for funds. This competition may drive down bank interest rates, thereby benefiting the borrowing community.

A regulatory system for securities provides order and timing to market events and stabilizes some market activity. Government regulation also generates confidence in the market by attempting to reduce fraud and to protect unsophisticated investors. The further development of a securities market in Estonia thus requires the presence of a legal order. However, it does not necessitate a complex regulatory scheme. Therefore, the Estonian government should adopt the least amount of regulation necessary both to create a legal structure for primary and secondary markets and to attract foreign capital. Self-regulatory

organizations subject to government oversight would reduce the level of public legislation necessary to create a regulatory environment for securities. If Estonia develops a securities exchange with the approval of the Securities Board, it should establish listing requirements for securities. The lack of consumer problems in the pre-SMA period provides evidence to support this private sector approach.

While impossible to predict the development of a stock exchange in Estonia, it is most probable that only one will emerge. The members of the central depository are likely to form the first stock exchange in Estonia. Forekspank is likely to provide its physical location. Forekspank has rejected the advice of one foreign expert to base the stock exchange on a paper bookkeeping system.<sup>180</sup> Rather, Forekspank has opted to develop or purchase a computer program to run the stock exchange. Companies listed on the stock exchange are likely to be Estonia's largest banks and private firms. This group will not amount to more than ten listed issuers. By listing the best Estonian companies and disseminating information about them, the stock exchange can develop investor confidence in the market and establish a performance record.

In addition, assuming the free negotiability of privatization vouchers, public trading in vouchers will provide the necessary volume of securities to operate an exchange. Subsequently, the securities of smaller companies may be listed for trading on the exchange. The emergence of such a stock exchange would facilitate the transition from a planned economy to a market economy by helping businesses upgrade the quality of their plants, equipment, and products. A small capitalization market is a model to emulate. Such a market provides small or new companies with a means to acquire start-up capital, and usually requires minimal listing, revenue, and accounting standards.<sup>181</sup> While a public market for small businesses must offer inducements in terms of less regulation and cost that are not available in larger markets, it does not obviate the role of government. Governmental supervision of the market is needed to identify promoters attempting to perpetrate fraud on the market, and to provide structure to the marketplace. The SMA does not impede the development of a capital market along these lines. The SMA is foremost a disclosure statute that contains some provisions to regulate the marketplace. Though the SMA

---

180. See Gaasenbeek Report, *supra* note 9, at 5.

181. The OTC Bulletin Board of the National Association of Securities Dealers Automated Index (NASDAQ) system is an example of such a market in screen-based form.

poses some legal problems, its overall simple approach promotes the efficient regulation of the nascent Estonian securities market. The plan to enact additional legislation to govern investment funds and securities exchanges demonstrates that Estonia will have adequate regulatory control of the securities markets. Appropriate "sampling" provides a short-cut to complete the construction of the securities regulatory system and allows the securities market to develop within the guidelines of a legal framework.

Establishing a minimal regulatory system gives Estonia flexibility to alter the character of the securities market when its initial function of supporting domestic economic recovery is complete. Low listing standards and minimal regulatory requirements create conditions for an international exchange. Estonia may opt to solicit listings from the Baltic states, Russia, and the European Union. Estonia may provide a forum for linking foreign lenders and foreign borrowers when a foreign business is unable to make a public offering in its domestic market because of compliance costs and listing requirements. Some of the resulting increased capital in Estonia would be available for local companies. Estonia also may opt to form an alliance with Latvia and Lithuania and to create a "Baltic securities market."<sup>182</sup>

## VI. CONCLUSION

Whether Estonia can sustain an independent securities market will be determined by future economic and political developments. The existing European securities markets may preclude the need for an additional securities market in Estonia. It is unlikely that every former Soviet republic can maintain its own separate securities market. Therefore, the initial challenge for Estonia is to apply the financial power of its securities market to accelerate the transition from a planned economy to a free market economy. The future challenge for Estonia will be to carve a niche for its own securities market within the world marketplace.

Legal regulation of the securities markets poses a difficult problem because the various aims of legal regulation are often contradictory. No legislation has achieved a perfect balance between reliance on market forces and government guidance of

---

182. The governments of Estonia and Latvia discussed this possible alliance but acknowledged that such a regional market cannot exist in the near future due to economic conditions.



the marketplace. If Estonia makes a successful transition from a planned economy to a market economy, and develops a securities market to assist in this process, Estonia would show less economically advanced former republics of Soviet Union that such a transition is possible.

# APPENDIX A

## TABLE 1

VÄÄRTABERTIBURU EESTIS 1993  
(kroonides)

Emitent	Väärtpaper	Avalikult müüdüd	Märkused
Esttexpank	lühiajaksiajal	5 miljonit	
Innovatsioonipank	lühiajaksiajal	2.5 miljonit	+ veel 4.5 MM pangga oma aktsionäridele
Invent	lühiajaksiajal	0.8 miljonit	
Lekto	lühiajaksiajal	0 ?	
Kella Pank	ellisaajaksiajal	8 + 3.5 miljonit	= esmaslevitamine + tagaslosetatud aktsiate uuesti müük. Jänuuar '94 müüdüd 1 MM.
Krediidipank	ellisaajaksiajal	1.5 miljonit (2 MM)	
Sotsiaajipank	ellisaajaksiajal	10 miljonit	
AS Levi	ellisaajaksiajal	1.5 miljonit	
Baltika	völaajaksiajal	2.5 + 0.3 miljonit	umbes 0.3 MM = müük järelturul
AS Levi	völaajaksiajal	0.1 miljonit ?	müük järelturul
Maapank	völaajaksiajal	0.03 miljonit	
AS Erak	völaajaksiajal	0.3 miljonit	
Tartu Kongresside Keskus	völaajaksiajal	?	
Eesti Börside IF	ühikud	23 + 3 miljonit	= aktiivat väärtus + väljavöetud raha
Broker Baltic IF	invest.sertifikaadi	2 + 0.5 miljonit	= aktiivat väärtus + väljavöetud raha
Scandia SICAV	osakud	3 miljonit	Eestist raha välismaistesse vp-sse
BIOBIF	aktsiajal	1 miljonit	valja vöetud pole
Scan-Am Fond	fondtosakud	2 miljonit	väljavöetud pole
AS Swedinvest (mallkeirifirma)		1.5 miljonit ?	Eestist raha välismaistesse vp-sse
Balti Väärtpaperite Majo (maakler)		0.5 miljonit ?	Eestist raha välismaistesse vp-sse
KOKKU		76.5 miljonit	

TABLE I: TRANSLATION OF TERMS

Vaartpaberiturg Eesti = The Estonian Securities Market	Maakerifirma = Broker firm
Lihtaktsiad = common stock	Maakler = Broker
Eellsaktsiad = preferred stock	Emitent = Issuer
Volakirjad = bonds	Vaartpaber = securities
Uhikud = unit	Avalikult Muudud = publicly sold
Invest Sertifikaadid = investment certificate	Markused = Remarks
Aktsiad = stock	Kokku = Total
Fondiosakud = fund share	