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DEVELOPING SECURITIES MARKETS AND NON-BANK FINANCIAL INSTITUTIONS IN UKRAINE: KEY IMPEDIMENTS AND POLICY REFORM PRIORITIES AHEAD

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ANNEX I Policy Reform Priorities: Synthetic Action Matrix

LIST OF ACRONYMS USED

AFSP	World Bank Access to Financial Services Project
ATCI	USAID Access To Credit Initiative
CIT	Corporate Income Tax
CLC	Commercial Law Center
CMP	USAID Capital Markets Project
CSE	Communal Services Enterprises
DVP	Delivery vs Payment
EU	European Union
FIRST	World Bank Financial Sector Reform and Strengthening Program
FOP	Free of Payment
FSR	State Commission for Regulation of Financial Services Markets or Financial Services Regulator
FX	Foreign Exchange
G-30	The Group of Thirty
GDP	Gross Domestic Product
IFRS	International Financial Reporting Standards
JII	Joint Investment Institutions (similar to mutual funds)
JSC	Joint Stock Company
LTV	Loan-to-value
MFS	The Interregional Depository and Clearing/Settlement Organization, Mizhregionalny Fondovy Sojuz
MOF	Ministry of Finance
MOU	Memorandum of Understanding
NBFI	Non-Bank Financial Institutions
NBU	The National Bank of Ukraine
NDU	National Depository of Ukraine
NSPFs	Non-State Pension Funds
OTC	Over-the-Counter
PD	Primary Dealers
PFTS	PFTS Stock Exchange, Persha Fondova Torgova Systema (First Securities Trading System)
PPP	Public-Private Partnerships
PTAP	Programmatic Technical Assistance Partnership
Repo	Repurchase Agreement
ROSC	Reports on the Observance of Standards and Codes
SDMD	the Financial Policy and Debt Management Department of the Ministry of Finance
SMI	State Mortgage Institution
SNG	Sub-National Government
SPV	Special Purpose Vehicles
SSMSC	Securities and Stock Market State Commission
UAH	Ukrainian Currency – Hryvnia
UIT	Unit Investment Trusts
USAID	U.S. Agency for International Development

EXECUTIVE SUMMARY

- Ukrainian securities markets and Non-Bank Financial Institutions (NBFIs) have grown rapidly in recent years, but market development is far from even, with key segments remaining underdeveloped. Low market liquidity and the high degree of fragmentation of market infrastructure result in poor price discovery, making the valuation of many Ukrainian securities by institutional investors highly problematic. These weaknesses constrain market development and create significant risks for investors.

- The development of a well-regulated, broad, deep and transparent securities market as well as of a sound NBFI sector is critical for Ukraine to sustain rapid growth over the medium-term and to ensure its successful integration into the European Union (EU) single financial market over the long-term. Of particular importance is the development of politically independent and financially autonomous securities market and NBFI regulators in line with international standards, so that they can qualify for mutual recognition by regulators in EU member States as part of the EU accession process. This will also be critical to establish the essential conditions for the successful introduction of second pillar pensions.

- The development of the Ukrainian securities market and NBFI sector faces a number of fundamental impediments that need to be addressed through bold policy reforms across a broad spectrum.

- *First*, the authorities should consider strengthening the market regulatory and supervisory framework. Key measures would include (i) empowering the regulators to trace the ultimate controllers of NBFIs and securities markets participants and carry out economic, fiscal and criminal background checks on these controllers; (ii) taking the regulators out of the executive branch of government and transforming them into specialized agencies with the same status as the National Bank of Ukraine (NBU), or alternatively integrating them into NBU; and (iii) establishing multi-year twinning programs with counterpart regulatory agencies in European countries, with the support of multilateral and bilateral donors.

- *Second*, the authorities should consider designing and implementing a strategy and action plan to strengthen government debt management and government debt market development. The implementation of the action plan could be supported by multilateral and bilateral donors.

- *Third*, the authorities should consider undertaking a comprehensive reform of the legal and regulatory framework for the sub-national debt market, focusing on (i) increasing sub-national government (SNG) fiscal autonomy, (ii) improving the legal and regulatory framework for SNG borrowing, (iii) removing distortions in

the structure of market incentives, (iv) improving market transparency, (v) establishing a bankruptcy framework for SNGs, and (vi) strictly monitoring connected party lending between banks and SNGs.

- *Fourth*, the authorities should consider supporting the development of the equities market through the adoption of the Joint Stock Company (JSC) Law and associated regulations, in particular to ensure effective disclosure of listed companies controllers, effective protection of minority shareholders, improving financial disclosure, and strengthening the role and accountability of supervisory and management boards.

- *Fifth*, the authorities should consider supporting the development of the market for asset-backed securities, in particular through reviewing NBU regulations for risk management of foreign currency and high loan-to-value (LTV) mortgages by banks, adopting a revised legal and regulatory framework for mortgage bonds, privatizing the State Mortgage Institution (SMI) and pricing State guarantees of SMI bonds to market, and adopting a Law on Securitization.

- *Sixth*, the authorities should consider strengthening securities market infrastructure. In particular, the regulatory authorities should consider (i) tightening information disclosure requirements for first-tier securities on PFTS stock exchange; (ii) requiring all stock exchanges to establish independent compliance departments reporting to their supervisory boards, (iii) carrying out a re-licensing of all stock exchanges that do not meet a minimum level of activity and (iv) requiring that all off-exchange trades be reported electronically to PFTS. Further, the authorities should consider strengthening the clearing and settlement system through (i) adopting legislation on multilateral netting, central stock depository and stock lending and borrowing procedures, (ii) adopting regulations to prohibit any legal entity or individual from acquiring (directly or indirectly) more than 5% of shares in any clearing and settlement company, and to allow MFS Depository to open correspondent accounts with depositories abroad. In addition, the authorities should consider streamlining the registrar and custodian system, strengthening the accounting and auditing framework, issuing regulations for the valuation of infrequently traded stocks, and simplifying NBU and Government controls on foreign currency transactions for securities market participants.

- *Seventh*, the authorities should consider supporting the development of investment funds through (i) revising the Law on Joint Investment Institutions (JIIs) to allow the establishment of investment funds with compartments and funds-of-funds and the participation of retail investors in Unit Investment Trusts (UITs), (ii) ensuring the political independence and financial autonomy of SSMSC as mentioned above (iii) carrying out a re-licensing of investment funds focusing on tracing and checking their ultimate controllers; (iv) implementing the reforms required to strengthen market infrastructure as mentioned above; (v) developing the

regulatory framework for risk-based supervision of JIIs, and (vi) exercising oversight over the corporate governance of JIIs.

- *Eight*, the authorities should consider supporting the development of voluntary non-state pension funds (NSPFs) through (i) ensuring the political independence of the regulators as mentioned above; (ii) carrying out a thorough re-licensing of NSPFs focusing on tracing and checking their ultimate controllers; (iii) implementing the reforms required to strengthen market infrastructure as mentioned above; (iv) developing the regulatory framework for risk-based supervision on NSPFs by the regulator, and (v) exercising oversight over the corporate governance of NSPFs.

- *Ninth*, the authorities should consider creating the essential capital market conditions for the successful introduction of second pillar pensions, including (i) carrying out a detailed assessment of the benefits, costs and risks of alternative financing strategies of the cost of transition to the second pillar; (ii) strengthening the governance framework for the second pillar to ensure that technical criteria prevail in the selection of asset managers and the definition of investment policies, under the supervision of the regulator; (iii) implementing the reforms required to ensure the political independence of the regulators as presented above; (iv) implementing the reforms required to strengthen market infrastructure as presented above; (v) establishing clear limitations on use of pension fund assets and incentives to attract international asset managers; and (vi) implementing a comprehensive strategy and action plan to develop the government debt market as discussed above; and

- *Tenth*, to support the development of the insurance sector through the revision of the legal and regulatory framework for insurance, carrying out a re-licensing of insurance companies focusing on tracing and checking their ultimate controllers; reforming the taxation framework for non-life insurers, implementing a re-insurance policy based on prudential rules, corporate governance requirements and supervision, and revising the Law on Non-State Pensions to allow full competition between all contractual savings institutions subject to satisfactory safeguards.

- Addressing this policy reform agenda will require careful prioritization and sequencing of actions over the short, medium and long-term. The Annex I to this paper proposes a sequenced road map to implement this reform agenda.(See below). The USAID and the World Bank stand ready to support the Government to design and implement the proposed policy reform agenda and action plan through a broad range of instruments, including Development Policy Loans, the proposed Programmatic Technical Assistance Partnership (PTAP), the World Bank Access to Financial Services Project (AFSP), ongoing USAID Projects including the Capital Markets Project (CMP), the Access to Credit Initiative (ATCI), Commercial Law Center (CLC) and possible additional TA grants

through the Financial Sector Reform and Strengthening (FIRST) Program managed by the World Bank.

I: BACKGROUND

1. Ukrainian securities markets and Non-Bank Financial Institutions (NBFIs) have grown rapidly in recent years, albeit from a low base. Securities market capitalization increased from 6% of GDP in 2000 to 42% in 2006. New issuances of corporate bonds went up from nearly zero in 2000 to above 4% of GDP in 2006. The number of Joint Investment Institutions (JII) grew from 29 in 2003 to 519 in 2006. Net assets under management by JII were estimated at UAH 14 bln in 2006, of which 90% were venture funds. Non-venture funds are mostly closed, undiversified corporate funds. There are currently 79 non-state pension funds (NSPFs) in operation, with total net assets under management of UAH 137 mln in 2006. The number of insurance companies increased from 283 in 2000 to 411 in 2006, and insurance premiums grew from 1.3% of GDP to over 2.5% of GDP over the period.

2. However, market development is far from even, with key segments remaining underdeveloped. Securities market liquidity is low (5.5 % of GDP) and remains highly concentrated on a few large securities, with the ten largest companies accounting for more than 50% of trades on PFTS stock exchange. The issuance of government bonds is sporadic and the amount of government bonds outstanding has been steadily declining from about 6% of GDP in 2000 to less than 1.5% of GDP in 2006. The secondary market in government bonds is non-existent and there is no reliable government bond yield curve. Municipal bonds issuance remains very limited at 0.5% of GDP annually. The first issue of a mortgage bond took place in 2006. There is no market in asset-backed securities and derivative instruments. The insurance industry is dominated by tax optimization schemes, and the share of classical insurance in total insurance premiums was only about 30% in 2006.

3. Moreover, the securities market infrastructure is highly fragmented. There are 10 stock exchanges and trading information systems, but all activity is concentrated at one stock exchange. The largest organized exchange is PFTS, which started operations in1997 and accounts for 96% of trading on organized markets. PFTS stock exchange sales volume doubled since 2003 and reached UAH 27 bln in 2006. The number of companies whose shares are traded on PFTS exceeds the average level of European exchanges and was equal to 300 companies, with a market capitalization of UAH 223 bln in 2006. PTFS's technology can accommodate both quote-driven and order-driven markets. However, delivery-*vs*-payment (DVP) is not used in practice, and almost all trades take place free-of-payment (FOP), with the money side of the transactions settled outside organized exchanges. The rest takes place over-the-counter (OTC) and is not reported to the market. It is estimated that only 6% of trades took place through the organized market in 2006. The clearing and settlement of non-government securities has been conducted by MFS Depository since 1998. MFS is a non-for-profit, market-owned organization in the form of a joint-stock company with about 90 stockholders. As of 2006, the amount of shares registered at MFS amounted to UAH 126 bln. In 1999, the Government established the National Depository of Ukraine (NDU) as a joint stock company owned 86% by the State and 14% by private owners, and the regulator granted it a license as a depository in 2006. The amount of securities registered at the NDU is

insignificant. For the vast majority of securities, the record of ownership is kept with registrars in documentary form. At the end of 2006, there were 354 self-standing registrars in addition to over 700 registrars at joint-stock companies. Few registrars are considered truly independent by market participants.

4 Narrow free float resulting from inadequate privatization strategies and adverse corporate and currency legislation result in a low market liquidity and poor price discovery, making the valuation of Ukrainian securities by institutional investors highly problematic. These weaknesses constrain further market development and create significant risks for investors.

II: RATIONALE

5. The development of a well-regulated, broad, deep and transparent securities market as well as a sound and diversified NBFI sector is critical for Ukraine to sustain rapid growth over the medium-term, and in particular:

- To enable banks to efficiently manage risks, using a broad range of hedging and securitization instruments;
- To broaden access to finance by the Government for national infrastructure investments;
- To broaden access to finance by sub-national governments and their corporations for local infrastructure investments;
- To broaden access to finance by enterprises, including small and medium enterprises;
- To broaden access to residential housing finance by households;
- To provide the foundation for the successful introduction of private pensions, in particular the mandatory second pillar; and
- To provide access to households and enterprises to a broad range of insurance products.

6. In the long term, the development of a strong securities market and NBFI sector is critical to ensure the successful integration of Ukraine into the European Union (EU) single financial market. Of particular importance is the development of securities market and NBFI regulators in line with international standards so that they can qualify for mutual recognition by regulators of EU member States as part of the EU accession process.

7. The objective of this paper is to analyze the key impediments to capital markets development in Ukraine, to identify priority policy and institutional reforms to address these impediments, and to provide a road map to the authorities to implement the proposed reforms through a carefully structured sequence of short, medium and long-term actions. The paper also identifies the areas where multilateral and bilateral donor support is already being provided to the government and suggests areas where further support could be useful in the future.

8. In this way, the paper aims to contribute to the effort of the authorities to develop a strong capital market that would help enhance financial sector stability, broaden the sources of financing for central and local government, enterprises and households, diversify domestic assets available for institutional and retail investors, and facilitate the future integration of Ukraine's financial sector in the EU single financial market. More proximately, the paper also aims to contribute to the effort of the authorities to create the capital market conditions necessary for the successful introduction of second pillar pensions as part of the reform of the country's pension system.

III: KEY DEVELOPMENT IMPEDIMENTS AND POLICY REFORM PRIORITIES AHEAD

9. The development of the Ukrainian securities markets and NBFI sector faces a number of fundamental impediments that will need to be addressed through bold policy reforms across a broad spectrum. This section discusses these impediments and identifies priority policy reforms going forward.

III.1 Strengthening the market regulatory and supervisory framework

10. The securities market and NBFI regulatory and supervisory framework suffers from major weaknesses. Addressing these weaknesses ought to be a policy priority to mitigate risks in a growing market but also lay the foundation for its further stable growth going forward. The main weaknesses are briefly summarized and recommendations listed below.

(i) Empowering market regulators to trace and check ultimate controllers of securities market participants and NBFIs

11. Under existing legislation, securities market and NBFI regulators do not have the power to trace the ultimate controllers of securities markets participants and NBFIs, and to request criminal, economic, and fiscal records of these controllers. Without the ability to compile complete background information on securities markets participants and NBFIs, the regulators have no way of keeping criminal, economic and fiscal violators out of the market, no way of ascertaining market participants compliance with capital and solvency requirements on a consolidated basis, and no way of exercising effective oversight over illegal market practices such as self-dealing and insider trading. As a

result, participation in the Ukrainian capital market is subject to very high financial, business and reputational risks.

12. The existing Draft Amendments to the Law of Ukraine "On Financial Services and State Regulation of Financial Services Markets" ("the Draft Amendments") fail to rectify this situation for three reasons. *First*, there is uncertainty as to whether the Draft Amendments empower the regulators to trace ultimate controllers through the entire chain of controlling legal entities. *Second*, the Draft Amendments apply only to controllers that acquire a financial entity or increase their stake in a financial entity following the entry into force of the Amendments, not to existing controllers of financial entities. And *third*, the Draft Amendments contain a narrow definition of controllers, specifically limiting the circle of controllers to family members.

13. To address these issues, the authorities should consider to take the following actions:

- To revise the Draft Amendments to ensure that (i) they effectively empower regulators to trace ultimate controllers all the way through the chain of control; (ii) they effectively empower regulators to request complete financial, economic and criminal records of all controllers from all relevant Ministries and State law enforcement and security agencies; and (iii) the definition of controller is broadened in accordance with international standards, to include company directors and all entities (legal or physical) that exercise control, directly or indirectly, over the corporation;

- To require the regulators to establish Memorandums of Understanding (MOUs) on exchange of economic, fiscal and criminal information with relevant agencies abroad.

(ii) Strengthening the Securities and Stock Market State Commission (SSMSC)

14. As a collective body of the central executive, SSMSC lacks operational independence and is subject to political and commercial interference. It is dependent on the State budget for its funding and is seriously under-resourced. It has a shortage of skilled staff, particularly at senior management level, and its systems are only partially automated. Commissioners and staff do not have adequate legal protection when acting in good faith in discharging their duties. Supervision by SSMSC is limited to reviewing the regular reports submitted by market intermediaries, and it has very few staff to be able to effectively monitor and control the large number of regulated entities. It does not have mechanisms in place to respond quickly to broker failure to be able to protect client assets or limit potential disruption to the market. SSMSC oversight of the exchanges is limited and it has no ability to monitor OTC transactions. SSMSC has limited investigation and enforcement powers. Investigations and enforcement where breaches of securities laws are alleged by regulated entities or any other person are undertaken at the discretion of State law enforcement agencies and may not have high priority.

15. To address these issues, the authorities should consider to undertake a comprehensive reform of SSMSC, focusing on the following actions:

- To increase the political independence and financial autonomy of SSMSC by transforming it into a specialized agency outside the central executive body, with a status similar to the National Bank of Ukraine (NBU), or alternatively to integrate SSMSC into the NBU;

- Under the first option, to allow SSMSC to retain the proceeds of fees collected from market participants, and to carry over budget surpluses from one year to the next, subject to full disclosure of its budget and external audit of its accounts by recognized international auditors ; to allow SSMSC to fix staff salary and benefits structure in accordance with a set of private sector benchmarks and adjust them accordingly; and to provide SSMSC staff with the same legal immunity as staff from the NBU; and

- Once its autonomy and independence as a specialized agency has been established, to abolish the requirement that regulations issued by SSMSC be approved by the State Committee on Regulatory Policy and Entrepreneurship, as in the case of the NBU.

16. In parallel, SSMSC would benefit from establishing a multi-year twinning program with a securities exchange commission in a European country, with the support of multilateral and bilateral donors. This program would focus on strengthening the procedures and practices of SSMSC in the areas of licensing, risk-based supervision and enforcement in line with international standards, on the oversight of corporate governance principles and practices by joint stock companies (JSCs), and on supporting further development of the legal and regulatory framework for securities markets in line with international standards, through information sharing, technical advice, in-house and international training programs, and IT support.

(iii) Strengthening the State Commission for Regulation of Financial Services Markets (FSR)

17. As a collective body of the central executive, FSR has limited operational independence and is subject to political and commercial interference. It is funded by the State budget, has no financial autonomy, and is seriously under-funded. Staff turnover is high, especially among high-level staff. The licensing units of the various departments are understaffed, and would not be able to cope with the expected increase in the volume of registration and licensing requests. Following the adoption of the Amendments of the Law on Financial Services, a re-registration and re-licensing of NBFIs would be required, significantly stretching the FSR's capacity. An influx of new non-state pension funds may also be expected following the planned introduction of the second pillar. The supervision units of FSR departments do not have sufficient capacity to carry out systematic off-site and on-site supervision programs for more than 400 insurance

companies, 89 non-state pension funds, and 300 credit unions, nor to analyze the voluminous documentation required from regulated entities. The limited supervision that takes place is compliance-based, and FSR has developed neither the regulatory framework nor the analytical capacity to carry-out risk-based supervision of regular entities.

18. To address these issues, the authorities should consider to undertake a comprehensive reform of FSR, focusing in particular on the following actions:

- To increase the political independence and financial autonomy of FSR by transforming it into a specialized agency outside the central executive body, with a status similar to the NBU, or alternatively to integrate FSR into the NBU;

- Under the first option, to allow FSR to retain the proceeds of fees collected from market participants, and to carry over budget surpluses from one year to the next, subject to full disclosure of its budget and external audit of its accounts by recognized international auditors; to allow FSR to fix staff salary and benefits structure in accordance with a set of private sector benchmarks and adjust them accordingly; and to provide FSR staff with the same legal immunity as staff from the NBU;

- Once its independence and autonomy has been legally established, to abolish the requirement that regulations issued by FSR be approved by the State Committee on Regulatory Policy and Entrepreneurship, as in the case of the NBU;

- To develop the regulatory and methodological framework for risk-based supervision of regulated entities over the medium-term; and

- To develop the analytical capacity for risk-based supervision of regulated entities over the medium-term.

19. In parallel, FSR could consider establishing a multi-year twinning program with a financial sector regulator in a European country, with the support of multilateral and bilateral donors. This program would focus as a matter of priority on strengthening the procedures and practices of FSR in the areas of licensing, supervision and enforcement in line with international standards, and on supporting further development of the legal and regulatory framework for NBFIs in line with international standards, through information sharing, technical advice, in-house and international training programs, and IT support.

III.2 Strengthening government debt management and debt market development strategy

20. The limited development of the domestic government bond market and the absence of a government bond yield curve originate from the lack of an integrated government debt management and debt market development strategy. *First,* the current debt management strategy places excessive focus on the short-term cost of government

debt. This has resulted in a bias towards foreign currency issues with insufficient attention paid to the longer term currency and roll-over risks of foreign currency debt and has hampered the development of the domestic debt market. *Second*, debt issuance in the primary market is unpredictable and the secondary market is illiquid. Standard elements of a well-functioning government securities market are absent, including the use of large issues as market benchmarks, a regular issuance calendar, and clear rules for the conditions under which market outcomes will be accepted or rejected.

21. Beyond taking short-term measures to improve government debt management such as securitizing government debt with the NBU and smoothing the roll-over calendar through debt buy-backs and re-issues, the authorities should consider to take action on the following:

- To develop the primary market by adhering to a well-announced financing plan with specified limits for deviations. The issuance strategy would focus on 2-3 benchmark series to enhance liquidity and reduce the liquidity premium, and would be supported by moving to a one-step auction procedure, conducted at regular intervals, preferably monthly;

- To discontinue the use of private placements for debt issuance on the external market so as to avoid potential reputational risk for the Government;

- To implement a system of primary dealers (PDs). This could be accompanied by a limited standing repo facility for PDs to ensure adequate market liquidity and incentives. This would be done through close discussions with banks;

- To develop a market communication strategy. This could involve regular meetings with key market participants focusing on debt strategy and financing plans;

- To strengthen policy coordination between the Ministry of Finance (MOF) and NBU by expanding the scope of the existing committee on the positions of non residents to cover development of the PD system and repo facility. The NBU and MOF can further promote the market by shifting to government securities for the conduct of monetary policy to reduce market fragmentation;

- To establish a risk management unit within the Financial Policy and Debt Management Department of the Ministry of Finance (SDMD), responsible for the development and implementation of benchmark issues, cut-off decisions at auctions, and coordination of financing plan with the budget department); and

- To strengthen the authority of SDMD and provide it with clear authority for operationalizing the government debt management strategy.

22. To support this action plan, the authorities would benefit from establishing an inter-agency working group including the MOF, NBU, the National Security Defense

Council, the International Monetary Fund, USAID, the US Treasury and the World Bank. The implementation of the action plan action could be supported by multilateral and bilateral donors.

III.3 Developing the sub-national debt market

23. The development of the sub-national debt market is hampered by a number of critical impediments. *First*, limited fiscal autonomy of sub-national governments (SNGs), resulting from the instability in expenditure and revenue assignments for SNGs, the high share of mandated expenditures in SNG budgets, the low share of local taxes in SNG budgets, the limitations in the range of available local taxes, the limited authority of SNGs to set local tax rates within the bounds established by law, and the inability of SNGs to pledge specific own future revenue streams as debt collateral. *Second*, deficiencies in the legal and regulatory framework for SNG borrowing, including lack of clarity in the definition of public debt, deficiencies in the definition of the purposes of SNG borrowing, deficiencies in the legal provisions regulating Government and SNG guarantees and overly restrictive authorization and control requirements of SNG borrowing by the Government. *Third*, distortions in the structure of market incentives, resulting from preferential treatment of SNG debt in banks' capital adequacy calculations and interest-free Treasury loans to SNGs. *Fourth*, lack of market transparency, resulting from weakness in SNG accounting and auditing framework, deficiencies in the legal and regulatory framework for inter-SNG undertakings, and deficiencies in the legal and regulatory framework governing the relationships between SNGs and Communal Service Enterprises (CSEs). *Fifth*, absence of a SNG bankruptcy framework. And *sixth*, distortions in the framework for competition among market instruments and participants, including recourse to interest-free Treasury loans beyond the coverage of short-term cash imbalances, weak methodology to allocate State Budget grants to SNGs, and possible connected lending by banks to SNGs.

24. To address these issues, the authorities should consider undertaking a comprehensive reform of the legal and regulatory framework for the sub-national debt market, focusing on the following measures:

- To increase SNG fiscal autonomy, through aligning the state Budget with the provisions of the Budget Code regarding SNG subventions, maintaining indices of relative fiscal capacity constant for a minimum of three years as per the Budget Code, allowing for a greater proportion of taxes to be retained at the local level (for instance, greater share of the single tax or a small – not more than 0.3% - share of the Corporate Income Tax (CIT) and adopting a local property tax on buildings over the medium-term, and authorize SNGs to pledge specific own revenues streams (only local not shared taxes);

- To remove deficiencies in the legal and regulatory framework for SNG borrowing, in particular: (i) During a first phase (*Phase One*), SNGs would apply to the MOF for permission to borrow and MOF would be required to formally

notify the SNG of its decision within 15 working days of the date of submission of the dossier of registration. The MOF's decision to deny authorization should be published on the MOF website upon its communication to the SNG and the SNG should have the right to appeal this decision. Transparent procedures for appeal of the decision should be spelled out in a separate regulation, including the modalities for publication of the request for appeal and of the appeal decision on the MOF website; (ii) During a second phase (*Phase Two)*, over the medium term, MOF authorization would become automatic unless refused within the 15 day time limit; (iii) Beyond *Phase Two*, and over the long-term, there would be scope to move from ex ante to ex post control of SNG borrowing by the MOF initially with overall debt ceilings enforced on SNGs. As markets mature, the prudential framework could be revised for SNGs moving toward market regulation in selected cases, if that is accompanied by measures to increase SNG fiscal autonomy as well as enhance their accountability to local constituencies;

- To remove distortions in the structure of market incentives, phase out medium-term Treasury loans immediately and short-term liquidity support over the medium term, and, for banking sector loans to SNG, adopt variable risk-weighting ratios in function of SNG credit rating in calculating the regulatory capital of banks;

- To improve market transparency, including requiring yearly audits of SNG accounts by external auditors, amendments to the privatization law allowing privatization of CSEs, adoption of a Public-Private Partnerships (PPP) Law covering all types of PPP transactions, adoption of strategy to move to full cost recovery pricing for CSEs and reduction of non-payments to CSEs, combined with improved targeting of consumption subsidy scheme for poor households, and integration of amortization and cost of capital in calculation of full cost recovery tariff for CSEs;

- To establish a SNG bankruptcy framework; and

- To strictly monitor connected party lending between banks and SNGs.

III.4 Developing the equities market

25. The development of the equities market is hampered by narrow free float, weaknesses in the corporate governance framework, deficiencies in currency legislation, and poor price discovery. (See Section III.6 below).

26. Sound market development is undermined by serious weaknesses in the corporate governance framework and deficiencies in currency legislation, in particular (i) lack of transparency of ownership and control of traded companies; (ii) lack of protection of minority shareholders; (iii) unreliable financial reporting and valuation procedures; (iv)

weak responsibility and accountability of supervisory boards; and (v) out-of-date currency regulation system of operations with securities.

27. Current NBU regulations place cumbersome and unnecessary controls on transactions involving foreign currency transfers to securities market participants. Most significantly, the NBU requires specific application for a license to conduct individual transactions. Given the nature of securities market activity, these NBU procedures effectively prevent the timely execution of trades on behalf of foreign portfolio investors as well as Ukrainians wishing to invest abroad. Moreover, these controls will also severely impede proper investment practices by pension fund managers who will be permitted (under draft Pillar II Law) to invest a substantial share of their accumulated assets in foreign markets. While the NBU may wish to adopt a cautious approach to liberalizing capital account transactions, the current system is cumbersome and costly.

28. To address these issues, the authorities should consider to take the following measures:

- to adopt the new JSC Law without further delay and to adopt detailed regulations to implement the provisions of the new JSC Law, in particular to ensure effective disclosure of listed companies' controllers (including ultimate controllers down the chain of control), effective protection of minority shareholders, improve financial disclosure, and strengthen the role and accountability of supervisory and management boards; and

- to adopt a new Law on Currency Regulation to replace the out-of-date Decree on Currency Regulation with the aim to simplify controls on foreign currency transactions.

III.5 Developing the market for asset-backed securities

29. The development of the market for mortgage bonds is hampered by several impediments. *First,* many banks have relaxed underwriting procedures for mortgages, from 75/25 loan-to-value (LTV) ratio required under the Mortgage Bond Law to mortgages with smaller down payments of between 90/10 or even 100%. *Second,* many financial institutions have issued US dollar-denominated Eurobonds using the proceeds to make mortgages at very positive spreads but creating significant currency mismatch for borrowers.. As of July 2007, 89% of all mortgages were denominated in US dollars. And *third,* as revealed by the issuance of the first pilot mortgage bond with the support of the USAID ATCI Project in early 2007, the legal and regulatory framework for mortgage bonds is overly complex and needs to be revised less the issuance of mortgage bonds be uneconomic.

30. The development of the State Mortgage Institution (SMI) is subject to several impediments. *First,* the integrity of the governance and supervisory framework of SMI is at risk. Currently, the government exercises executive oversight of SMI through a

supervisory board, and regulatory supervision is conducted FSR. Agency agreements between SMI and banks are regulated by the NBU, and the latter has a fiduciary responsibility to ensure that SMI executes its business activity in an effective and transparent way. Announced plans to integrate SMI within the portfolio of the State Investment and Innovation Agency threaten the integrity of SMI's governance and supervisory framework and risk compromising the purpose for which SMI was established and retarding the emergence of the mortgage market. *Second*, the UAH pool of outstanding mortgages available for purchase by SMI is severely limited due to the dollarization of the mortgage market.

31. Looking forward, the development of a broad range of asset-backed securities, including housing mortgage-backed securities, securities backed by credit card receivables, car loan receivables, or leasing, is hampered by the absence of a comprehensive legal and regulatory framework for securitization. This framework should allow bank and non-bank financial institutions to structure securitization products through the establishment of Special-Purpose-Vehicles (SPVs) registered as trusts in Ukraine.

32. To address these issues, the authorities should consider to take action on the following:

- The NBU to review regulation for risk management of foreign exchange (FX) denominated mortgages and high LTV mortgages by banks;
- To adopt a revised legal and regulatory framework for mortgage bonds;
- To privatize SMI and price State guarantees to SMI bonds to market; and
- To adopt a Law on Securitization and related regulations allowing securitization of a broad range of assets through SPVs registered as trusts in Ukraine.

III.6 Strengthening securities market infrastructure

33. Market development is hampered by several deficiencies in market infrastructure.

34. *First*, with PFTS handling about 96% of on-exchange transactions on the Ukrainian market, the persistence of nine other exchanges makes no sense. Trading on the Ukrainian stock exchange is sporadic and there is little information or transparency in its operations. The other eight exchanges are almost dormant and exist primarily for the purpose of participating in State Property Fund privatizations receiving their 1% facilitation commission on the sale of State-owned shares. Market observers note that the occasional trades transacted over these trade organizations are generally done for the purpose of manipulating the price of the traded issue. Shares traded on these exchanges are subject to wide price swings with no apparent reason.

35. *Second,* the co-existence of two central depositories to serve the Ukrainian securities market is damaging to sound market development.

36. Since its establishment in 1997, MFS has performed depository and clearance and settlement functions for dematerialized securities and has earned the trust and respect of market participants. It services the accounts of over 1,100 market participants including issuers, banks and custodians. MFS operations have the necessary software and human capital trained and effectively implementing the critical depository functions for the market. The vast majority of transactions are settled free of payment (FOP). Recently, MFS has a established a delivery-vs-payment (DVP) system, However, the DVP system is not used by market participants for several reasons, including: (i) MFS is not allowed to open correspondent accounts with foreign depositories; and (ii) market participants prefer not to disclose the cash side of the transactions in order to evade taxes. This, combined with the fact that more than 90 percent of share transactions take place off-exchange, with no reporting requirement of these transactions to the exchange, contributes to poor price discovery.

37. MFS meets six of the nine standards adopted by the Group of Thirty (G30), ie T+1 confirmation and affirmation, confirmations extended to clients, delivery vs payment, irrevocable payment, T+3 settlement, and coding standards. The three remaining standards, ie, multilateral netting, central stock depository, and stock borrowing and lending procedures, cannot be met because Ukrainian legislation is not currently in compliance with international standards. In 2004, MFS was the target of a takeover attempt by two competing private groups, with one group acquiring 28% of the shares through several financial entities, raising the risk of capture and resulting loss of independence and trust.

38. Prior to the establishment of the NDU by the Government in 1999, a MOU was signed by the Government of Ukraine, the World Bank and the US Government stating that the NDU would have no commercial functions and would engage only in three functions: codification, standardization and international relations for the effective period of the MOU until 2010. In early 2006, the Government unilaterally terminated the MOU, and it granted full license for depository activity to the NDU later in the year. To date, the NDU has only registered a handful of securities and does not perform any useful function on the Ukrainian securities market.

39. *Third,* the registrar system is highly unreliable and open to abuse. Licensing requirements are minimal. In recent years there have been several instances of double registration and stealing of shares through the registrar system.

40. *Fourth,* despite significant progress in the legislative framework governing accounting and auditing in Ukraine, the laws and institutions regulating financial reporting still fall short of international standards, In addition, Ukraine suffers severe capacity shortages of qualified accountants and auditors to serve the rapidly expanding needs of the market. As a result of this capacity shortage, access to international

standards-based financial reporting is limited to a few large companies that have been able to procure the services of international accounting/auditing advisory companies. However, these international companies often audit the same information they help produce, as an audit by these firms is a often a pre-requisite for access to international financing as International Financial Reporting Standards (IFRS) compliant financial information. A recent proposed amendment to the Accounting Law will require that almost 10,000 companies use IFRS. Effective implementation of this new requirement implies a considerable effort in training and education.

41. And *fifth*, neither SSMSC nor FSR have issued regulations for the valuation of infrequently traded securities held by pension funds, insurance companies and investment funds. In addition, SSMSC has not issued regulations for the valuation of private equity transactions by venture capital funds. The asset valuation profession remains undeveloped, and no international price vendors are active on the Ukrainian market to date.

42. To address these issues, the authorities should consider to take a number of key measures:

- To strengthen PFTS and streamline stock exchanges, SSMSC should issue regulations (i) to tighten information disclosure requirements for first-tier securities on PFTS; (ii) to require all stock exchanges to establish independent compliance departments reporting to the supervisory board; (iii) to carry-out a re-licensing of all stock exchanges that do not meet a minimum level of activity; and (iv) to require that all off-exchange trades be reported to PFTS within 15 minutes of the trade, and requiring PFTS to implement the required electronic platform; and (v) to consider concentrating public offerings of state shares on the main stock exchange;

- To strengthen the clearing and settlement system, the authorities should adopt legislation to establish multilateral netting, central stock depository, and stock lending and borrowing procedures in accordance with international standards (G30). SSMSC should issue regulations (i) to require all requests for ownership registries to be converted to an electronic system and making it mandatory for registrars to use this electronic platform; (ii) to allow MFS to open correspondent accounts with foreign depositories and to incorporate all types of money settlement in the depository system in accordance with international standards, to support move to DVP settlement; (iii) to prohibit any legal entity or individual from acquiring (directly or indirectly) more than 5% of shares in any clearing and settlement company; (iv) to encourage MFS to complete the installation of the data back-up system offsite, to implement an electronic platform to handle requests for ownership registries with both custodians and registrars, and to establish a guarantee fund to support move to DVP settlement;

- To streamline the registrar and custodian system, SSMSC should issue regulations (i) to require that all share certificates to be converted into dematerialized securities held by custodians upon their next trade, (ii) to require all new share issues to be in dematerialized form, (iii) to tighten licensing requirements for registrars; and carry-out a re-licensing of all registrars in accordance with the new licensing requirements;

- To strengthen the accounting and auditing framework, the authorities should (i) reform the legal and statutory framework in line with IFRS standards; (ii) build institutional capacity and enforce financial reporting and auditing requirements; and (iii) enhance academic education, professional training and retooling of accountants, in line with the recommendations of the Accounting and Auditing Reports on the Observance of Standards and Codes (ROSC); and

- To improve securities valuation, SSMSC and FSR should issue regulations for the valuation of infrequently traded securities in accordance with European Venture Capital Association methodology, remove any barriers for the entry of internationally recognized price vendors on the Ukrainian market, and license these vendors.

III.7 Developing investment funds

43. The development of investment funds is hampered by limitations in the legal framework, deficiencies in the regulatory and supervisory framework, weaknesses in the corporate governance framework, and lack of market transparency.

44. The Law on Joint Investment Institutions (JIIs) does not allow for the possibility of establishing JIIs with compartments as provided in most advanced investment funds legislation. It does not allow JIIs to invest in securities issued by other JIIs, thereby preventing the development of funds-of-funds. And it does not allow retail investors to participate in Unit Investment Trusts (UITs), thereby severely limiting their development as personal disposable income grows over the medium-term.

45. As mentioned above, SSMSC has not issued regulations for the valuation of infrequently traded securities or private equity transactions. No investment funds active in the market have been adequately vetted by SSMSC in terms of fitness and propriety of their ultimate controllers. The supervision of investment funds is compliance-based, and the regulatory and methodological framework for risk-based supervision has not been developed.

46. As corporate investment funds are established as open JSCs under the existing JSC Law, they are subject to all the deficiencies of corporate governance under the current Law. As brokers acting as asset managers may be established in any corporate form (JSC or limited partnership by shares), they are subject to the deficiencies of

corporate governance of both forms of companies. SSMSC does not exercise oversight over corporate governance rules and practices of investment funds. In particular, neither corporate investment funds nor brokers acting as asset managers on investment funds are required to establish independent compliance departments reporting to the supervisory boards.

47. The development of investment funds is hampered by lack of market transparency. This includes deficiencies in the corporate governance of listed companies, poor price discovery, and limited liquidity on securities markets.

48. To address these issues, the authorities should consider to take action on the following;:

- To revise the Law on JIIs to allow the establishment of investment funds with compartments and funds-of-funds, and to allow retail investors to participate in UITs;

- Ensure political independence and financial autonomy of SSMSC (see Section III.1 above)

- Implement market infrastructure strengthening measures (see Section III.6 above)

- Following the adoption of the Amendments to the Law on Financial Services, SSMSC to carry out a full re-licensing of investment funds on the market, focusing in particular on tracing the ultimate controllers of investment funds and requesting complete criminal, economic and fiscal records from these controllers;

- SSMSC to exercise oversight over the corporate governance of investment funds, in particular the establishment of independent compliance departments reporting to the supervisory boards; and

- SSMSC to develop the regulatory framework and the analytical capacity for risk-based supervision of investment funds over the medium-term.

III.8 Developing private pensions

49. The development of private pensions is hampered by deficiencies in the regulatory and supervisory framework for voluntary private pensions (Pillar Three), and by shortcomings in meeting key capital market conditions that are essential for the successful introduction of mandatory private pensions (Pillar Two).

50. Key impediments to the development of voluntary private pensions include the following.

51. *First,* FSR does not have the authority to trace the ultimate controllers of non-state pension funds. As a result, the 89 NSPFs currently operating on the market have not been properly vetted by the regulator with respect to the criminal, fiscal and economic background of their ultimate controllers. In addition, the supervision of NSPFs by FSR is compliance-based, and FSR does not exercise oversight over the corporate governance rules and practices of NSPFs.

52. *Second,* FSR does not enforce limits on exposure to specific types of assets by NSPFs. As a result, some NSPFs are heavily invested in domestic equities, a high-risk strategy in light of the limited liquidity and lack of transparency of domestic equity markets and of the weakness of domestic securities market infrastructure, in particular the stealing of securities through the registrar system.

53. And *third,* as mentioned above, FSR has not issued regulations for the valuation of infrequently traded securities, resulting in huge uncertainty in the value of NSPF portfolios.

54. To remedy these issues, the authorities should consider taking action on the following:

- Ensure political independence and financial autonomy of FSR (See Section III.1 above)

- Following the adoption of the Law on Financial Services, FSR to carry out a thorough re-licensing of NSPFs currently in operation, focusing in particular on tracing ultimate controllers of NSPFs and carrying out a thorough economic, fiscal and criminal background check of these controllers;

- Implement measures to strengthen market infrastructure (See Section III.6 above)

- FSR to develop the regulatory framework and capacity for risk-based supervision of NSPFs, in particular exercising oversight over the risk management rules and practices of NSPFs;

- FSR to exercise oversight over the corporate governance of NSPFs, in particular requiring the establishment of independent compliance departments reporting to the supervisory boards; and

- FSR to issue regulations for valuation of infrequently traded securities by NSPFs.

55. As shown by the experience of other emerging markets, creating adequate capital market conditions is on the critical path for the successful introduction and development of second pillar pensions. These conditions pertain to four main areas. *First,* macro-financial stability and a balanced strategy for financing the transition cost to the second pillar. *Second,* a strong governance, regulatory and supervisory framework for second

pillar pension funds, and regulatory and supervisory framework for retirement instruments to be offered by insurance companies. *Third*, an efficient financial infrastructure including payment and securities settlement system, stock exchanges, securities depository and custodian institutions, and accounting, auditing and valuation systems and institutions. And *fourth*, a diversified supply of reliably-priced domestic securities in which the new pension funds will be able to invest, including government bonds, municipal and municipal corporations bonds, corporate bonds, asset-backed securities, and equities.

56. To meet these essential conditions, the authorities should consider to undertake a major effort focusing on the following:

- To carry out a detailed assessment of the benefits, costs and risks of alternative financing strategies of the cost of transition to the second pillar under various scenarios for the introduction of second pillar pensions. This analysis will need to examine the relative costs, benefits and risks of alternative financing strategies with the objective to derive a financing strategy that is internally consistent and compatible with the maintenance of internal and external macroeconomic equilibria and with steady improvement in the international credit rating of the sovereign;

- To strengthen the governance framework for the second pillar pension system to ensure that technical criteria prevail in the selection of asset managers and the definition of investment policies, under the supervision of FSR, and to implement the actions presented above to ensure the political and financial independence of FSR and strengthen the enforcement capacity of FSR pension fund department (See Section III.1 above);

- To implement the actions presented above to strengthen securities market infrastructure, (See Section III.6 above) in particular to consolidate exchanges and strengthening the governance of exchanges**,** to strengthen the securities clearing and settlement system, and to improve the accounting and auditing framework;

- To establish clear limitations on use of pension fund assets (including restriction to trading securities on-exchange using DVP facilities and with minimum liquidity), a clear structure of incentives to attract international asset managers, and clear regulations allowing them to operate only with banks and custodians with an acceptable international credit rating; and

- To implement a comprehensive strategy and action plan to develop government debt management and debt market development, with the objective of developing a reliable long-term government bond yield curve.

57. To support the government in meeting these essential conditions, the USAID and the World Bank propose to support the MOF, FSR and SSMSC through a Programmatic Technical Assistance Partnership (PTAP), bringing together in synergy the USAID

Capital Market Project (CMP), the USAID Access to Credit Initiative (ATCI), Commercial Law Center (CLC) the World Bank Access to Credit Project TA component, and possible support under the World Bank Financial Sector Reform and Strengthening Program (FIRST) Initiative.

III.9 Developing the insurance sector

58. The development of the insurance sector is hampered by a number of impediments.

59. *First*, the existing legal and regulatory framework suffers from major weaknesses and needs to be reformed. The Draft Law "On Amending the Law of Insurance" currently before the Cabinet of Ministers is a major improvement over the existing law and introduces many desirable reforms, including the requirement that all insurers be joint stock companies. However, the Draft Law also contains a number of technical flaws, certain items would be better left to more flexible by-laws, and licensing, reporting, reserving and asset rules could be both simplified and strengthened. In addition, the registration, training and taxation of brokers and agents need to be brought to EU standards. The current highly intrusive set of by-laws could also be significantly pruned in preparation for a more market-based approach to supervision. *Second*, as discussed above, the supervisory framework of the insurance sector suffers from major weaknesses. In particular, FSR has not traced the ultimate controllers of insurance companies nor varied out economic, fiscal and criminal background checks of these controllers as part of the licensing process. The supervision of insurance companies by FSR is compliance-based, and FSR has not developed the regulatory framework and analytical capacity to exercise risk-based supervision of insurance companies. *Third*, the taxation of non-life insurers is not in line with international standards and needs reform in order to restore the industry to a normal structure, capitalize on the entry of international insurers with modern governance standards, and set the foundation for a healthy contribution to economic growth. *Fourth*, the accounting standards for insurers are not up-to-date and leave too much scope for interpretation. *Fifth*, re-insurance policy is handled through tax rules, rather than through prudential rules, corporate governance requirements and strong supervision. *Sixth*, the Law on Non-State Pensions does not permit competition between all contractual savings institutions. *Finally*, there is a chronic lack of skills in the sector and the need to develop actuarial and basic operating skills in particular.

60. In order to address these issues, the authorities should consider to take action on the following:

- To revise the draft Law on Insurance in accordance with international standards;

- To implement the actions presented above to strengthen FSR;

- FSR to carry-out a full re-licensing of insurance companies including tracing their ultimate controllers and carrying out economic, fiscal and criminal background checks on these controllers;

- FSR to develop the regulatory framework and analytical capacity to exercise risk-based supervision of insurance companies;

- To fundamentally reform the taxation framework for non-life insurers;

- To implement the reform of the accounting and auditing framework in the insurance sector in accordance with the recommendations of the Accounting and Auditing ROSC;

- To implement a reinsurance policy based on prudential rules, corporate governance requirements and supervision;

- To revise the Law on Non-State Pensions to allow for full competition between all contractual savings institutions, subject to satisfactory safeguards, including segregation of assets covering long-term savings benefiting from tax deferral; and

- To develop actuarial and operating skills in the sector.

IV: FROM RECOMMENDATIONS TO ACTION: A POLICY REFORM ACTION PLAN

61. Addressing this policy reform agenda will require careful prioritization and sequencing of actions over the short, medium and long-term. The attached synthetic action matrix proposes a feasible road map to implement this reform agenda.

62. The USAID and the World Bank stand ready to support the Government to design and implement the proposed policy reform agenda and action plan through a broad range of instruments, including Development Policy Loans, the proposed PTAP, the AFSP (incl TA component to FSR), ongoing USAID projects including CMP, ATCI and CLC Projects, and possible additional TA grants through the FIRST Program managed by the World Bank.

ANNEX 1:Policy Reform Priorities: Synthetic Action Matrix

OBJECTIVE	SHORT-TERM	MEDIUM-TERM	LONG-TERM
Empowering regulators to trace and check ultimate controllers	Adopt revised amendments to Law on Financial Services and associated regulations		
Strengthening SSMSC	Transform SSMSC into specialized agency with same status as NBU status or integrate in the NBU		
	Agree twinning arrangement with European regulator with support of donors	Implement twinning arrangement	Implement twinning arrangement
Strengthening FSR	Transform FSR into specialize agency with same satus as NBU or integrate into the NBU		
	Agree twinning arrangement with European regulator with support of donors	Implement twinning arrangement	Implement twinning arrangement
Developing government debt market	Design government debt management and debt market development program		
	Start implementing program with multilateral and bilateral donors	Implement program	Implement program
Establishing foundations for development of sub-national debt market	Stabilize inter-governmental fiscal relationships as per Budget Code	Adopt piggy-back CIT	Adopt local property tax on buildings
	Adopt phased reform of SNG borrowing framework under Budget Code; implement Phase I	Implement Phase II	Examine scope for move to ex post controls of SNG borrowing once SNG fiscal autonomy and accountability to local constituencies increased

	Limit Treasury Loans to SNGs to short-term liquidity support only	Abolish all Treasury Loans to SNGs	
	Adopt variable risk-weights for SNG loans in capital adequacy ratio		
	Adopt SNG Bankruptcy Law		
	Require yearly audit of SNG accounts by external auditors	Adopt amendments to Privatization Law allowing full privatization of CSEs; adopt PPP Law	
		Adopt strategy to move to full cost recovery for CSEs	
Developing the equities market	Adopt regulations under JSC Law re disclosure of controllers, minority shareholders, and role of supervisory boards		
	Adopt new Law on Currency Regulation to simplify controls on FX transactions for securities markets		
Developing the market for asset-backed securities	The NBU to review regulations for risk management of FX denominated mortgages and high LTV mortgages by banks		
	Revise the legal and regulatory framework for mortgage bonds	Adopt the Law on Securitization and associated regulations	
		Privatize SMI and price government guarantees to SMI to market	

Strengthening trading systems	Require stock exchanges to establish independent compliance departments	Carry out relicensing of all stock exchanges below minimum level of activity	
	Require all off-exchange trades to be reported to PFTS & implementation of required electronic platform		
	To concentrate public offers of state shares on the main stock exchange		
Strengthening clearing and settlement systems	Adopt legislation implementing G30 standards		
	Prohibit any entity from acquiring directly or indirectly more than 5% of any clearing and settlement company		
	Allow MFS to open foreign correspondent accounts		
Strengthening custodian and registrar system	Require all requests for ownership registries to be converted to electronic trading system and require use of system by registrars		
	Tighten licensing requirements for registrars	Carry out relicensing of all registrars	
	Require all share certificates to be converted to dematerialized securities		
	Require all new share issues to be in dematerialized form		
Reforming accounting and auditing framework	Apply recommendations of Accounting and Auditing ROSC	Continue implementation	Continue implementation

Improving price discovery	Regulate valuation of infrequently traded stocks		
	License international asset price vendors		
Developing investment funds	Allow establishment of JIIs with compartments and of funds of funds, and allow retail investors to participate in UITs	Carry out relicensing of all JIIs incl tracing and checking of controllers	Develop regulatory framework and analytical capacity for risk-based supervision of JIIs
	Ensure political independence and financial autonomy of SSMSC (see above)	Require independent compliance departments in JIIs	
	Implement market infrastructure strengthening measures (see above)		
Developing voluntary private pensions (pillar 3)	Ensure political independence and financial autonomy of FSR (see above)	Carry out relicensing of all NSPFs incl tracing and checking of controllers	Develop regulatory framework and analytical capacity for risk-based supervision of NSPFs
	Strengthen enforcement capacity of FSR pension fund department	Require independent compliance departments in NSPFs	
	Implement market infrastructure strengthening measres (see above)		

Establishing the conditions essential for introduction of mandatory private pensions (Pillar 2)	Carry out scenarios for financing of transition cost and formulate financing strategy		
	Strengthen governance framework for second pillar pensions		
	Ensure political independence and financial autonomy of FSR		
	Strengthen enforcement capacity of FSR pension fund department		
	Implement market infrastructure strengthening measures (see above)		
	Implement reform of accounting and auditing framework as per ROSC		
	Start implementing government debt market development plan (see above)	Implement program (see above)	Implement program (see above)
	Agree action plan to create capital markets conditions for introduction of second pillar pensions with donors	Implement action plan	Implement action plan
Developing the insurance sector	Revise Draft Law on Insurance in accordance with international standards	Carry out full relicensing of insurance companies, incl tracing and checking of controllers	
	Revise Law on NSPFs to allow full competition between all contractual savings institutions, subject to satisfactory safeguards	Reform taxation framework for non-life insurers	
	Ensure political independence of FSR		Develop regulatory framework and analytical capacity for risk-based supervision of insurance companies

	Strengthen enforcement capacity of FSR insurance department		Develop actuarial and operating skills in the sector
	Implement reform of accounting and auditing framework as per ROSC		
	Implement reinsurance policy based on prudential rules		