The Capital Markets Working Group

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The Georgian Capital Market

Diagnostic Study and Recommendations

Discussion Draft

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ADB

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Governing for Growth in Georgia

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ACRONYMS AND ABBREVIATIONS

CPSS	Committee for Payment and Settlement Systems
CSD	NBG's Central Securities Depository
DVP	Delivery versus Payment
EU	European Union
GoG	Government of Georgia
CMWG	Capital Markets Working Group
GSCD	Georgian Securities Central Depository
GSE	Georgian Stock Exchange
IFRS	International Financial Reporting Standards
IOSCO	International Organization of Securities Commissions
ISA	International Standards on Auditing
JSC	Joint Stock Company
LAFA	Law on Accounting and Financial Audit
LIF	Law on Investment Funds
LoE	Law on Entrepreneurs
LMFO	Law on Microfinance Organizations
LNBG	Organic Law on the National Bank of Georgia
LSM	Law on Securities Market of Georgia
MoF	Ministry of Finance
NBG	National Bank of Georgia
NSCG	National Securities Commission of Georgia
OTC	Over the Counter (trading method)
RTS	Russian Trading System
SIC	Securities Information Center
SMEs	Small and Medium Size Enterprises
SRO	Self-Regulatory Organization
SSS	NBG's Securities Settlement System
STP	Straight through Processing
YE	Year-End

Acknowledgements

The Capital Markets Working Group extends it appreciation to the Asian Development Bank for leading this Study through TA 8716--Strengthening Domestic Resource Mobilization and to the Governing for Growth in Georgia Project funded by the United States Agency for International Development for providing staff assistance. In particular we would like to thank Ms. Neka Danelia, Ms. Marina Guledani and Mr. Ilia Gogichaishvili.

I. EXECUTIVE SUMMARY

1. **This Study has been prepared by the Capital Markets Working Group (CMWG or Working Group) appointed by the Government of Georgia (Government or GoG)**. The Working Group is chaired by Vice Prime Minister and Minister of Economy and Sustainable Development, Mr. George Kvirikashvili, and is assigned to: (1) study issues regarding the development of the Georgian capital market; and (2) prepare a time-bound action plan for reforms to be implemented by the GoG and the National Bank of Georgia (NBG), together with suggested actions to be taken by the private sector and requested actions from the donor community.

2. **This Study consists of three aspects**. First, it describes the current status of the Georgian securities markets, together with some recent historical context. Second, it assesses whether and to what degree the market is achieving the characteristics of successful markets. Third, it makes a series of recommendations aimed at curing or mitigating the identified deficiencies, in order to make this market more attractive for investors and to increase access for potential issuers.

<u>Core Conclusions</u>

3. The Working Group's main conclusions from this Study are:

- Georgia possesses all of the required ingredients to operate a healthy capital market; while additional functions may be advisable, it does not need to create new entities;
- In order to revive the corporate securities market, several policy missteps made in 2007 should be reversed;
- Certain aspects of the Tax Code should be adjusted to create a "level playing field" between treasury securities, bank deposits and corporate securities as investment instruments;
- The legal and regulatory system must be revised to provide a more supportive environment and also to migrate it towards EU approaches;
- There must be a strong focus on building viable content (issued securities) for the system; issuer transparency must be improved and the requirements made more proportional;
- There are steps the private sector can take to promote centrality of trading, obtain better price discovery and streamline trading; and
- There are steps the Georgian Stock Exchange (GSE), Georgian Securities Central Depository (GSCD) and NBG can take to integrate the infrastructure and link it to cross-border systems.

Below, we make 43 specific recommendations to achieve these goals, designate the parties responsible for implementation and set deadlines.

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<u>Components of the System</u>

4. **Georgia's corporate securities market possesses all of the required components for operation**. Although additional functions may be advisable, no new entities are needed. The infrastructure consists of the GSE, the GSCD and three share registrars. There are five active GSE members. Stated market capitalization as of April 2015 is 2.018 billion GEL ($903 million). Currently, there is one security on the A List level; three securities on the B List level and 128 securities on the admitted tier.

5. **The Treasury securities system operates separately from the corporate securities.** Treasuries are traded via the Bloomberg system. The NBG performs clearing, settlement and record-keeping functions for both the primary and secondary markets. The NBG's Central Securities Depository (CSD) is not a legal entity; it is a business activity operated inside the NBG. The NBG

does not charge for any of the post-trade services it provides. Because the GSCD is not linked to the central bank's system, treasuries cannot be traded on the exchange.

The Legal and Regulatory Framework

6. **The company law, the Law on Entrepreneurs (LoE), governs five forms of business enterprises.** All forms may issue corporate bonds; only the joint stock companies (JSCs) may publicly offer shares. JSCs with more than 50 shareholders are required to use an independent share registrar. Minority shareholder rights attach at the 5% and 25% levels. What is perhaps most striking is that the LoE is almost silent on State enforcement of the Law's provisions relating to shareholder rights. *Curing this regulatory gap is one of the recommendations made below.*

7. **The specialized law governing Georgia's capital markets is the Law on Securities Markets (LSM), adopted December 1998**. Given Georgia's obligations under the EU-Georgia Association Agreement, the LSM will need to be approximated to the EU approaches. This process will mean that the content of 22 Directives and Regulations must be reflected either within the LSM or the other laws described in this report. *The effort required in this regard will be substantial.*

8. **The Law on Investment Funds (LIF) was adopted July 2013**. At 6 pages in length, it is very brief compared to its counterpart laws across the region. It too will need to undergo significant expansion as part of the EU approximation process. *Again, this will require significant effort.*

9. **Georgia does not possess specialized laws on mortgage bonds or securitizations**. *This legal gap needs to be remedied.*

10. **The Law on Accounting and Financial Audit (LAFA) sets the financial reporting principles to be applied by reporting entities and the standards for audits**. It relies heavily on accepted international best practices. The remaining unresolved question is where to house the monitoring unit designed to track the activities of the auditing association and the execution of their legal responsibilities. *This open question should be addressed by the roadmap.*

11. **The capital market's legal framework is constantly shifting**. Since its enactment, the LSM has been amended 19 times, or roughly every 9 months over the last 15 years. The LoE has been amended 49 times, or roughly every 5 months over the last 20 years. Even the relatively new laws follow this same pattern. *Georgia needs to change this approach.*

The NBG as Regulator

12. **The location of the securities regulator has changed 4 times over the last 15 years**. Today, there are further discussions to move the securities regulation function out of the central bank to an independent commission. This would track other recent actions; in March 2013 the Law on Insurance was amended to provide for a new independent Insurance Supervisory Service. *Georgia needs to make a definitive decision on the location of the securities regulator soon.*

Tax Code Policies

13. **The recommendations contained in this Study are designed to create a level playing field between the various types of investment choices: treasury securities, bank deposits, corporate shares, corporate bonds and investment funds**. The Working Group is not proposing subsidies for the capital markets, only fair competition.

14. **Under the Law on Registration Fees, an issuer of securities must pay a fee of 0.1% of the total value of any offering.** However, the monies paid are retained by the MoF under the general State budget. Thus, in reality, this is a tax - perhaps the only direct tax that Georgia imposes on legal entities wishing to obtain funds by issuing securities or financial instruments. At the same time it generates almost no funds; it sends the wrong message. *The offering tax should be eliminated*.

15. **Interest and dividends paid on "freely negotiable securities", and gains from sales, are exempt from tax.** A "freely negotiable security" is defined as one that is listed on the exchange and has a 25% free float. Non-exempt interest is taxed at 5% for both income and profits tax. Gain is taxed at 20%. In February 2010, the Ministry of Finance (MoF) adopted Instruction No 75 to define how this tax exemption should be implemented. Unfortunately, the controlling tax code at that time was the 2004 version. *In order for the exemptions to be implemented, Instruction No 75 needs to be reissued under the current Tax Code.*

16. **More importantly, the definition of "freely negotiable security" does not parallel how treasury securities are traded; the playing field is not level**. *The exemption needs to be redefined to cover both admitted and listed securities on the exchange.*

17. **At the time that the LIF was adopted, there were no conforming amendments made to the Tax Code**. This is unusual. Without providing an exemption from the profits tax for qualifying investment funds, indirect investors (*i.e.,* investors in the funds) will find themselves taxed twice while direct investors (*i.e.*, those who buy securities directly for their direct accounts) will pay only once. This "non-level playing field" creates strong obstacles to developing an investment fund industry for Georgia. *This needs to be addressed within the roadmap*.

<u>Trends (2007-2014) for the Corporate Securities Market</u>

18. **By any measure, 2007-2014 were difficult years for the Georgian corporate securities markets.** Three events occurred during 2007-2008 to undercut the momentum that had been gained in building this market. The global financial crisis began in earnest in mid-2008. Then, in August 2008, Russia and Georgia engaged in a war of limited duration but lasting impact. This added further capital flight.

19. **But not all of Georgia's capital market condition can be attributed to the global financial crisis or the war**. The 'third event', occurring just prior in 2007, consisted of a radical set of amendments to the LSM. While then couched in terms of 'liberalization' the result was a drastic decrease in the transparency of the trading markets. Thus, to a large degree, the current poor state of Georgia's securities markets is "self-inflicted".

20. **The 2007 amendments removed a requirement that all transactions in securities admitted to trade on the GSE be in fact conducted on the GSE**. The problem lay not so much in the goal of the amendments but in their execution, which was severely flawed. The amendments did not adopt a best execution requirement imposed on brokers nor did they allow the exchange to require members to conduct business 'on-exchange'.

21. **The sum result of the 2007 amendments was predictable**. Trading moved dramatically away from the exchange to the off-exchange market and to the share registries themselves. As of YE 2014, 1.82% of the value of trading occurs on-exchange, 84.77% occurs off-exchange and 13.41% occurs directly at the share registries. The inescapable conclusion is that there are at least 3 corporate securities trading mechanisms operating in Georgia: the GSE, off-exchange by the brokers, and at the share registries themselves.

22. **The 2007 LSM amendments also significantly reduced the number of JSCs required to make public disclosure reports**. A component of the definition of "Reporting Company" - "any issuer with more than 100 shareholders" - was eliminated. This significantly eroded the LSM's investor protection aspects. The size test is designed to counteract the imbalance of power between a large, diverse shareholder population versus the management.

23. **As a result, the transparency of the Georgian JSC population has been regressing, not progressing**. Out of a total 2014 population of 675 active JSCs, only 258 were 'reporting

companies'. 207 of these further relied on exemptions granted under NBG rules, leaving 51 actually making annual and interim disclosure reports. This opaqueness can only discourage investors from participation.

24. **Exacerbating this impact, Georgia does not know – and under the current system cannot know – the financial make-up of the JSC population**. Unlike its neighbors Georgia does not require its JSCs to file public *summary* financial information.[1] As a result, any decisions regarding the architecture of the capital markets must be made based on best guess estimations from 8 years ago.

25. **All of the above creates several negative net impacts for the operation of the corporate securities market**.

a) **The current structure provides almost no price information for would-be buyers or sellers**. There are few quotes posted on the GSE by the brokers. Doing so is almost meaningless as the trades are negotiated outside of the system. The 'price' known to the potential buyer or seller is that which the broker discloses.

b) **Large Georgian issuers seeking to raise significant sums bypass the domestic market and apply to foreign markets**. The "value-added" missing in the local market is found instead in the foreign settings. From 2006 through 2014 Georgian issuers sold $164 *million* in securities in Georgia and $2.6 *billion* outside

c) **The fragmentation of trading creates a very challenging environment for the regulator**. The NBG cannot know when the customer was contacted or when the trade occurred. This defies normal oversight as the NBG cannot recreate facts and circumstances in a scattered and dark environment.

d) **Use of these unofficial markets results in a continuing financial deterioration for the GSCD, the one of the main pillars of the infrastructure**. Given the lower volumes of trading overall and the migration of trading to the OTC market and the share registries, the GSCD has been operationally insolvent since 2008.

e) **There is a risk of loss for investors.** One of the advantages of an organized market is the security of the settlement system. Buyers do not receive their securities until they pay and sellers do not receive their payment until they deliver. For OTC and share-registry-only trades this protection does not exist.

<u>Trends (2007-2014) for the Government Securities Market</u>

26. **Over the last 7 years the trend for the government securities market has been almost the polar opposite of the corporate market**.

a) **The amount of outstanding treasuries has been growing steadily**. This creates a deeper base for trading.

[1] In this context, "summary" means a simple statement of (1) revenues, (2) net income, (3) assets, (4) liabilities (5) shareholders' equity, and (6) number of holders of each class of securities issued and outstanding. These need not be audited figures, but the statements must be made under of penalty for false statements.

b) **The ownership make-up for the treasuries has shifted from the NBG to the banks, making them more available for trading**. Today almost all treasuries are owned by the banks. The NBG owns 4.9% and nonresidents 1.11%.

c) **The maturity structure is moving towards the longer end of the spectrum.** The GoG began issuing 2-Year notes in March 2010, 5-Year notes in June 2011, and 10-Year bonds in March 2012. This supports the secondary market and helps develop the yield curve.

d) **The pricing for issuing corporate debt and/or preferred shares is becoming more and more attractive.** Since reaching highs in August 2010, rates for treasury securities at auction have been falling, although an uptick in rates occurred late 2014. 2-year notes yield 7.43%, 5-years yield 9.91% and 10-year bonds yield 10.46%

27. **This bodes well for the issuance of corporate bonds as a financing technique**. At 10.4% (2 year treasuries + a notional 300 bps) for 2-year debt, roughly 65% of the identified potential issuers could profitably issue bonds. Perhaps even more encouraging 45% of these companies could also borrow advantageously at 12.9% for 5 years, the projected cost (5 year treasuries + 300 bps).

<u>Recent Encouraging Events (2014 - 2015)</u>

28. **The last year has seen several encouraging developments that can serve as leverage points for substantial improvements to the capital markets**.

a) **There have been 7 successful offerings of corporate securities totaling $56 million**. All were public offerings. All but one were for corporate bonds. All but one were in USD. All were sponsored by commercial banks. The maturities were between 1-3 years.

b) **There has also been a recent increase of finance activities within Georgia by the IFIs**. During 2014 and early 2015, the ADB, EBRD and IFC issued bonds totaling GEL 205 million.

c) **During March 2015, representatives of Fitch Ratings' held meetings with 15 of Georgia's leading large private companies**. Recap descriptions from these meetings are that Fitch has made a very attractive offer on fees. Obviously, bond ratings by Fitch would lend credibility to this system.

d) **Another plus for the Georgian capital markets is the advent of several private equity funds**. The largest two are the State-owned Partnership Fund and the privately-held Co-Investment Fund, with assets under management at $1.4 billion and $1.6 billion respectively. There are four other funds each with $16 to $40 million under management. These funds represent latent demand for capital market services; in 2-3 years they could tap the market as a way to sell out their positions.

e) **In September 2014, a majority of the GSE's shareholders determined to elect an entirely new Supervisory Board**. Shortly, thereafter GSE management was replaced with new personnel. New management has been assigned to devise a new business plan by June 2015. The majority shareholder group, having decided to take this action, now has a moral obligation to 'make good'.

f) **In an effort to create a more unified infrastructure for trading securities, the NBG has offered to use its system to clear and settle transactions in corporate securities, free of charge.** It also has stated it will work towards having the CSD become a financially viable entity and to share the ownership with the private sector up to 50% within that same period. The GSE and NBG need to come to a resolution on this proposal. Many other aspects of the roadmap depend on a clear decision.

g) **The NBG is in negotiations to establish a link to Clearstream.** This will enable foreign investors to settle transactions in Georgian securities.

Looking Forward

Possible Issuers and Purchasers of Securities?

29. **The most pressing question facing the reformers is how much 'content' can be expected**. Most of the challenges facing the Georgian capital markets are within the power of either the State or the private sector to fix. The question of who will want to access the capital market mechanism as an issuer or purchaser cannot be dictated.

30. **With regard to the commercial banks as possible issuers of securities, the financial statement data indicate that:**

a) There are 12 banks that may need to *generate additional liquidity*, by issuing either shares or bonds, in the amount of GEL 559 million ($322 million).

b) There are 7 banks that may wish to issue bonds to *reduce their deposit flight risk,* in the amount of GEL 341 million ($196 million).

c) There are 14 banks that have *net asset-liability mismatches* for terms greater than 1 year. These might be solved by issuing bonds in the amount of GEL 800 million ($461 million).

d) There are 5 banks that may need to *refinance their mortgage portfolios*, in the amount of GEL 127 million ($73 million).

31. **With regard to the commercial banks as possible purchasers of securities, the financial statement data indicate that:**

a) There are 9 banks with a lending-to-available-funds ratio less than 80%. *Excess available funds for these 9 banks are GEL 1.88 billion*, of which GEL 1.76 billion is in cash and balances with the NBG.

b) The 12 banks with a lending-to-available-funds ratio greater than 80% nevertheless have *excess available funds of GEL 861 million*, of which GEL 777 million is in cash and balances with the NBG.

32. **With regard to the State-owned enterprises as possible issuers of securities, the financial statement data indicate that:**

a) Twelve companies have the requisite size to issue shares, but many are either operating at a significant loss or are 'national interest' companies that likely cannot be sold.

b) The top two companies - Georgian Railway and Georgian Oil & Gas - are household names. From a business viewpoint, selling a 20% stake in the two companies based on expected price to earnings ratios should net $33 million and $73 million respectively. How could the Partnership Fund invest these monies? What would be the near term impact on jobs creation and export development?

33. **It appears the insurance companies are not likely purchasers of securities.** There is no significant life insurance industry; a potential source of long-term demand for investment securities is absent. Private pension systems are just now coming into existence. A review of casualty industry indicates they are not generating near-term profits that need investing.

34. **Two insurance companies are possible issuers.**

35. **Five of the microfinance organizations registered in Georgia are possible issuers**. But given the nature of their business, it would be unwise to allow them to sell securities to their borrowers. This said, any limitations to be imposed should be decided and the MFOs allowed to participate in the capital market.

36. **Due to their poor financial condition, the admitted companies cannot be viewed as strong potential candidates for the capital markets**.

Improving the Legal Framework

37. **Clearly, over the coming years the principal driver for revising Georgia's capital market legal framework will be the need to harmonize the legislation with EU approaches**. At the same time, as part of the conditionalities under the 2014 ADB Policy Based Loan, Georgia has committed itself to introduce a package of legislation by December 2016 to implement the strategy arising from this Study.

38. **Given this, we recommend amending the capital markets laws in two phases**. The first phase, to be introduced by December 2016, would contain (1) all of the law amendments needed to implement the roadmap that will arise out of this Study, and (2) as much of the approximation as can be achieved prudently by that time. The second phase of amendments, to be introduced by 2018 would contain the remaining approximation work.

39. **The legislative process would benefit from a comprehensive review of its compliance with (1) IOSCO's Objectives and Principles of Securities Regulation; and (2) the CPSS-10 Principles for Financial Market Infrastructures (FMI)**. However, given the uncertainty of where the securities regulator will be housed this may not be practical.

40. **During the last year there have been discussions among the Government and NBG on whether the securities function will remain within NBG or moved outside to some new entity**. There are several drivers at work that compel the Government and the NBG to come to a decision very soon.

41. **As part of repairing the gaps in the legislation, several other actions should be taken:**

- The LoE should be amended to make the securities regulator also the enforcer of the company law, as it relates to JSCs and shareholder rights;
- The monitoring unit designed to replace the Parliament's Council on Audit Activity should be placed within the securities regulation function; and
- There must be regulatory body appointed to implement the LIF.

Harmonizing the Tax Policy

42. **The Working Group is not recommending tax subsidies to aid the capital market.** Instead, the suggestions are designed to create a 'level playing field' between investment alternatives: treasury securities, bank deposits and corporate securities. In this regard we suggest:

- Eliminate the tax on offerings;
- Revise and implement the exemption for dividends / interest for listed securities;
- Revise and implement the tax treatment of gains on sales of securities; and
- Create a tax treatment for investment funds.

Improving Issuer Transparency

43. **We suggest several steps to improve issuer transparency:**

- Reinstitute the "number of shareholders test" for the definition of reporting company;
- Adopt tiered reporting requirements;
- Revise the GSE's admitted / listed concepts to (1) have the company decide whether to "list", and (2) have the GSE decide whether to "admit" securities to the lower tier;
- Devise a simplified "Going Private" process for the companies on the current admitted list; and
- Require all JSCs to report summary financial information annually.

Promoting Centrality of Trading and Improving Price Discovery

44. **We suggest several steps to promote centralized trading and obtain better price discovery:**

- Adopt a best execution rule;
- Allow the GSE to adopt an 'on-exchange' rule binding on its members;
- Eliminate brokerage operations by securities registries;
- Increase the reporting fee for OTC trades;
- Shorten the trade reporting deadline; post trade reports on the GSE system and website; and
- Create a Web-based Securities Information Center that would contain (1) real-time reports of all transactions, (2) description of all securities, (3) description of all issuers, and (4) copies of all periodic reports.

Streamlining the Trading Methodology

45. **We suggest several steps to streamline the trading methodology:**

- Finalize the GSE's reorganization;
- Invest in modern IT systems for the GSE and GSCD
- Extend trading hours
- Eliminate the pre-pay / pre-deliver requirements; and
- Lengthen the settlement cycle

Consolidating and Linking the Infrastructure

46. **We suggest three steps to consolidate and link the infrastructure**:

- Decide upon the NBG's proposal for post-trade services;
- Link the corporate securities market to Clearstream; and
- Consider a consolidated depository and registry system

Improving the Transparency of the Legal Regime and Market Operators

47. **We suggest two steps to improve the transparency of the legal regime and market operators**:

- Translate applicable regulations into English and post on the NBG's website; and
- Encourage annual and financial reporting by the infrastructure institutions in English

Increasing International Regulatory Linkages and Compliance with Standards

48. **We suggest two steps to increase international linkages and compliance with standards**:

- The securities regulator should become a member of IOSCO; and
- The securities regulator should also become a signatory to the IOSCO MMOU.

<u>*Support from the IFI Community*</u>

49. **Lastly, the Working Group requests assistance from the donor community in several aspects**.

- ADB, EBRD and IFC should all consider conducting their next local bond offerings publicly;
- In close parallel, the IFIs should consider listing their bonds on the GSE;
- The EBRD should implement donor lines of credit for bank purchases of corporate bonds;
- The donors can supply technical assistance for the legal drafting process;
- The donors can supply technical assistance for capacity building for the regulator and implementing the aspects of the roadmap under its responsibility;
- The donors can supply technical advice regarding the GSE's new IT system during the development of the specifications, the procurement process, and installation and testing;
- The donors can provide technical assistance in developing the proper legal basis for covered bonds and securitizations.

50. These recommendations are discussed in Section VIII below. The recommendations by the entity responsible for implementation are indicated in Annex 1.

51. **The Working Group is releasing this Study publicly and will be scheduling a series of events during June-July 2015 to promote public sector / private sector dialogue**. From these sessions the Working Group hopes to arrive at consensus among the stakeholders concerning the recommendations contained in this Study. This will guide the creation of a time-bound action plan and roadmap for reforms. Implementation is scheduled to begin September 2015. A notional timetable for the required actions is set out in Annex 19.

II. BACKGROUND

A. Origin of this Study

52. **This Study has been prepared by the CMWG**. The Working Group is chaired by Vice Prime Minister and Minister of Economy and Sustainable Development, Mr. George Kvirikashvili, and is assigned to: (1) study issues regarding the development of the Georgian capital market; and (2) prepare a time-bound action plan to be implemented by the GoG and the NBG, together with suggested actions to be taken by the private sector and requested actions from the donor community.[2]

B. Characteristics of Successful Capital Markets

53. **This Study compares the data collected and findings to a set of common characteristics of successful securities markets**. These are:

- ***Transparency.*** To a large degree investor participation depends on the level of openness of the system. Georgia follows a "disclosure based" model under a theory that investors should be provided full and accurate information and then allowed to make their individual decisions. Thus, the level of shareholder protection depends on the accuracy and completeness of the

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[2] The Governmental Order establishing the Group was issued 22 September 2014. The other Members of the Group are:

Mr. George Kadagidze, President of National Bank of Georgia;
Mr. Nodar Khaduri, Minister of Finance of Georgia;
Mr. George Gaxaria, Secretary of the Prime Minister's Economic Council;
Mr. Robert H. Singletary, former Chairman of the National Securities Commission of Georgia.

relevant information provided to investors during the offering process and in the secondary trading markets. The financial data needs to be presented using uniform approaches.

- ***Access to Information.*** The system must also ensure that investors have actual and meaningful access to this information. It does little good to require issuers, for example, to file annual reports with the regulator only to have these reports remain in the files unavailable to the public.
- ***Centrality.*** The capital market system also works best when it possesses "centrality". This occurs when all potential buyers and sellers of securities "meet" in one place to execute trades. This creates the best price discovery and also ensures that all participants have equal access rights. Even in situations where trading can occur in more than one 'place' an effective trade reporting system can ensure that all investors know the current 'market price'.
- ***Mitigating Systemic Risks.*** The regulatory scheme should mitigate various systemic risks. These include: (1) protecting against the insolvency of market participants handling customer monies and securities; and (2) protecting against the failure to pay or deliver securities at settlement date.
- ***Promoting Integrity within the Markets.*** Trust, confidence and participation are increased when investors believe they will be treated fairly and have equal opportunity for participation. To promote this, the legal regime should contain strict rules against insider trading, self-dealing by company officials and significant owners, market manipulation, and broker abuse of customers.
- ***Commercial Viability.*** The market infrastructure must gain enough revenues to cover operating expenses and create enough reserves for investment in upgraded IT systems, outreach to investors, promotion of the market and growth of operations and services. At the same time, the benefit to the economy is maximized when fees within the capital market systems are minimized, thus reducing "transactional friction".
- ***Conformance with Applicable International Standards.*** This has two distinct advantages. First, it installs the investor protection and market stability aspects needed to operate a successful system. Second, it makes the system more understandable (and acceptable) to foreign investors. Compliance with the international guidance supplies safety and reliability, but also generates participation.[3]

54. **This then is the 'template of values' this Study has used to examine the current status of Georgia's capital markets**. From this diagnostic, the Working Group will prepare a time-bound roadmap for agreed reforms (for the GoG and NBG) and suggested reforms (for the private sector and donor community). The recommendations by theme are contained in Section VIII. The assignment of the parties responsible (suggested) for implementing each item is contained in Annex 1. Cross-references of recommendations by theme and the responsible implementer are contained in Annex 2. A suggested timeline is contained at Annex 19.

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[3] The sources for best practice guidelines relating to capital market regulation and operations come from (1) the International Organization of Securities Commissions (IOSCO), (2) the Directives of the European Union (EU), (3) the federal securities laws of the United States, (4) the Committee on Payment and Settlement Systems (CPSS), (5) the International Accounting Standards Board, (6) the International Federation of Accountants, and (7) the Organization for European Cooperation and Development. A listing of the sources and materials is attached as Annex 3.

III. STRUCTURE OF GEORGIA'S CAPITAL MARKETS

A. Components of the Corporate Securities System

55. **Georgia's corporate securities market possesses all of the required components for operation**. Although additional functions may be advisable, no new entities are needed.

<u>Georgian Stock Exchange</u>

56. **The GSE was founded in 1999 and is the only licensed securities exchange**. It currently has 5 broker members. Stated market capitalization as of April 1, 2015 is 2.018 billion GEL ($903 million).

57. **As of YE 2014, the GSE had 409,406 GEL in shareholders' equity ($219,685)**.[4] It is owned by 19 persons total; each of the 5 GSE members has a stake.

58. **The exchange's IT system is derived from the Russian Trading System (RTS) software acquired in 2000 but has been upgraded internally several times since**. The system provides electronic linkage to all members and 'straight through processing' (STP) from pre-trade activities through clearance and settlement.

59. **The GSE operates on a 'pre-pay' and 'pre-deliver' method**. All purchase monies must be in the broker's trading account prior to entering a buy order entry. Similarly, securities must be present in the selling broker's trading account prior to entering a sell order entry.

60. **The GSE operates 2 listed tiers and an "admitted" tier** (please see Annex 5 for listing requirements). Currently, there is one security on the A Listed level (Bank of Georgia); three securities are on the B Listed level (Georgian Leasing, Liberty Bank and Teliani Valley Winery). At YE 2014, the admitted tier contained 128 securities. Two aspects of the admitted securities are worth noting.

61. **First, 118 of the 128 admitted securities (92%) arose from the mass privatization process during mid to late 1990**. As discussed below in Section VII.A., this has brought consequences for the nature and level of trading in their securities. It also raises questions concerning the proportionality of the reporting requirements imposed upon them, given their poor financial health.

62. **Second, during this early phase, the process of admitting a class of securities onto the GSE was unusual in that it could be done upon the application of any holder of that security**. A full 111 securities were admitted under this approach. After the 2008 amendments to the Law on Entrepreneurs, this action can now only be taken by the company's Supervisory Board.[5] Thus, Georgia does not follow the normal practice of companies taking the decision of whether to 'list' and the exchange taking the decision of whether to 'admit' a reporting company. This, too, has consequences for determining the proper definition of reporting company and the consequent disclosure obligations.

63. **The GSE acts as a self-regulatory organization (SRO)**. Under LSM Article 35(2)(b) the exchange is required to "ensure the observance" by its "members" of the LSM, the implementing regulations, the GSE charter and rules. The LSM also conveys inspection rights. The SRO

[4] The GSE owns 98.81% of the GSCD and 56.61% of Caucasus Registry. The GSE's historical financial results are included in Annex 5.

[5] See Matsne N5913 Amendments to the Law on Entrepreneurs dated March 14, 2008 and LoE Article 55(8)(i)).

obligations also extend to admitted or listed issuers; but the GSE's sanctions are limited to removal from listing / admission, an action that decreases transparency not increases it. The LSM is silent on the mechanisms for enforcing the imposition of money penalties.

64. **In September 2014, a majority of the GSE's shareholders elected an entirely new Supervisory Board**; shortly thereafter, GSE management was replaced with new personnel. The consequences of these changes, and the opportunities they represent, are discussed in Section VII "Looking Forward", below.

<u>Georgian Securities Central Depository</u>

65. **The GSCD is the only licensed securities depository in the country**. It is owned 98.81% by the GSE. As of YE 2014, the GSCD had 385,607 GEL in shareholders' equity ($206,915) and 5 members.[6]

66. **Unlike the GSE, the GSCD's IT system has been developed internally**. Again, several modifications have been made since, all by internal programmers.

67. **Given that the system operates on a pre-funded basis, trades are settled on a T+0 cycle, both for equities and debt**. Given that settlement risk is zero, the GSCD does not maintain a settlement guarantee fund. Nor does it operate as a central counterparty; there is no novation of trade contracts and clearing is bilateral.

68. **Clearance and settlement of off-exchange trades (OTC trades) is necessary if the purchasing and selling broker are different.** In this case, transfers between the nominee accounts are required. In cases where the member firm executes a cross trade (where the firm represents both the buy and sell sides), no settlement instructions are necessary. The member firm simply enters the details in its own records.[7] In the case of a trade recorded directly at the share registrar, the GSCD is not involved.

69. **Settlement for transactions handled by the GSCD is performed by delivery versus payment (DVP)**. The GSCD is not a member of the NBG's payment system, nor is it allowed to maintain an account at the central bank. For this reason, the cash portion of settlement is performed by one of four settlement banks.[8]

70. **The GSCD system handles all types of securities - equity, discount debt and coupon debt**. It can process trades in derivatives, but cannot calculate margin requirements and thus the GSCD cannot act as clearinghouse for derivatives.

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6 Historical financial results for the GSCD are attached as Annex 6.

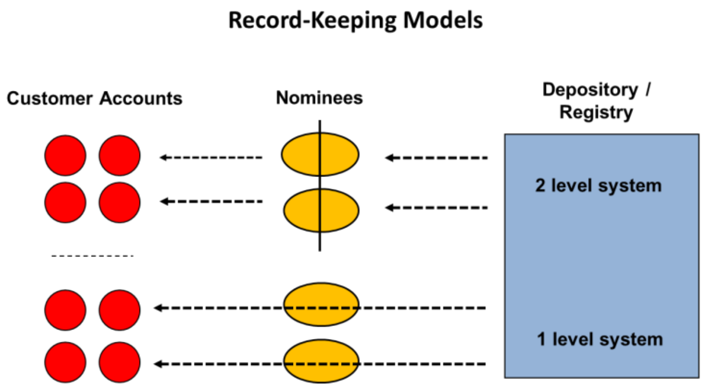
7 Even in the situation of a cross trade processed within one member firm, the trade must still be reported to the GSE under NBG Rule 20/01, Article 7 and the implementing GSE rule, described below.

8 These are: Bank of Georgia, VTB Bank, TBC Bank and Cartu Bank.

It should be noted that this arrangement – where the GSCD is not a member of the payment system nor allowed to hold an account at the central bank – is contrary to more advanced arrangements operated by both Armenia and Azerbaijan, not to mention the markets in Eastern Europe. Using settlement banks, as opposed to settling the cash portion of the trade in "central bank money" adds cost and risks to the system and in effect discriminates against non-bank investment firms. As described in Section VI.G. below, there is an opportunity to cure this defect in connection with a proposal made by the NBG's market operations unit to combine certain functionality between the GSCD and the NBG's securities settlement system (SSS).

71. **The GCSD operates on a 2-level records system**. The Depository holds separate accounts for each member, one "proprietary" for the firm's own positions and the other the "nominee" account held on behalf of customers. The nominee account is an omnibus account in that all client positions are aggregated into one account. Segregated subaccounts are possible under the system and are frequently used by the member firms, presumably for simplicity reasons. Thus, while the GSCD may "know" the individual positions of clients, it does not know their identity. All member firms maintain the accounting for their clients.

Figure 1: 1-Level vs 2-Level Recordkeeping Systems



The GSCD also acts as an SRO. The LSM grants disciplinary powers and limited inspection powers.[9] Again, the LSM is silent on the consequences of a member's failure to pay an imposed penalty.

72. **The GSCD has faced severe financial strain over the last 7 years due to a movement of trading away from the GSE's system (an electronic order matching book) towards OTC cross trades and trades handled by the share registries themselves**. The cause of this migration is discussed in Section IV.A. "Recent Trends". A quantification of the impact is discussed in Section IV.F. "Net Impacts". Proposed solutions are discussed in Section VII.E. "Promoting Centrality of Trading".

<u>Investment Firms</u>

73. **As of 2007, there were 18 licensed investment firms (securities brokers) within Georgia; as of March 31, 2015 there are 8**. Four of these are affiliated with commercial banks, either as subsidiaries or sister entities (designated by "x" in the table below). The remainder are non-bank investment firms. As can be seen, only 5 are active. The summary financial results for the currently licensed investment firms are presented in Annex 8. Market share is as follows:

9 See LSM Article 38(3)(b) and Article 38(1)(c).

Table 1: Market Share of Investment Firms

	By Value of All Brokered Trades (USD) (2014)		By Revenues (USD) (2013) [10]		By Shareholder's Equity (USD) (2013)	
	Value	%	Amount	%	Amount	%
Galt & Taggart (x)	$22,510,871	98.28%	$28,101,484	99.14%	$8,401,383	66.08%
Liberty Securities (x)	$339,933	1.48%	$37,547	0.13%	$720,648	5.67%
Caucasus Capital Group	$34,829	0.15%	$5,237	0.02%	$217,735	1.71%
Cartu Broker (x)	$11,049	0.05%	$29	0.00%	$234,742	1.85%
TBC Broker (x)	$9,225	0.04%	$33,317	0.12%	$259,319	2.04%
Abbey Asset Management	-	-	$78,966	0.28%	$317,791	2.50%
Caucasus Financial Services	-	-	$56,711	0.20%	$207,598	1.63%
STOX	-	-	$0	0.00%	$2,194,354	17.26%

74. **As the above makes clear, there is one predominant investment firm**. It is part of a complex owned by the nation's largest bank that also owns one of the three share registrars. Further, this same complex directs a new majority group for the GSE described in paragraph 64 above. The consequences of this market dominance, and more importantly, the opportunities and obligations it imposes are discussed at Section VII.F. "Streamlining the Trading Methodology" below.

Securities Registrars

75. **Today the system possesses 3 licensed registrars, down from a total of 7 in 2007**. Caucasus Registry is owned 56.61% by the GSE. United Registry is 100% owned by Galt & Taggart Holdings, the parent company of the leading investment firm. National Registry is not owned by any other market participant.

76. **As of YE 2014 approximately 13.41% of the value of all securities trades in Georgia were processed directly by the registrars, with no intermediation by the licensed investment firms**.[11] While at first glance this might imply good financial results, the fact is that these three operations had total revenues of 548,050 GEL for 2013 ($315,642) and total net income of 149,891 GEL ($86,328) all on a base of total shareholders' equity of 2,188,792 GEL ($1,260,607). This translates into an industry return on equity of 6.85%.[12] The relative market share among the three registrars is as follows:

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10 It is perhaps unfortunate that this Study is required in this part of the calendar year. It would have been more optimal for the review to take place in H2 2015 using YE 2014 data.

The Discussion Draft version of this Report will be updated as the 2014 information becomes available, any material developments will be noted. But this is not expected to impact the understanding of the relevant trends or the suggested solutions. The challenges and opportunities for the Georgian capital markets are not materially changing.

11 This percentage is down considerably from 2013, when the registrars processed 94.11% of all trade transactions, as measured by trade value.

12 The low profitability for the 3 registrars as a whole, and the recommendations in this report on how to bring more of the trading volume back onto the organized system (and as a result decreasing registry revenues), suggests a consolidated corporate securities registry, possibly combined with a consolidated depository. Because Georgia is not "writing on a blank slate" it should be emphasized that decisions in this regard may have a human impact in the nature of lost jobs. For this reason, and because this is not an immediate threat

Table 2: Market Share of Registrars

	By Revenues (2013)		By # of Issuer Clients		By Value of Trades Processed in 2014	
	Amount	%	Number	%	Value	%
United Registrar	$172,036	54.50%	383	55.03%	$2,452,510	69.63%
Caucasus Registrar	$66,490	21.06%	162	23.28%	$805,433	21.89%
National Registrar	$77,117	24.43%	151	21.70%	$317,823	8.48%

Custodial Operations

77. **Georgia's banks have linkages with three global custodial networks**. Bank of Georgia is a sub-custodian in the State Street and Citibank networks. Two other banks have accounts with Deutsche Bank. The results of interviews indicate more linkages may exist or are in negotiation but have not been made public by the banks.

B. Components of the Treasury Securities System

78. **The NBG manages and oversees both the primary and secondary markets for treasury securities**.[13] In some aspects it also acts as a market operator.

Trading

79. **Treasury securities are traded via the Bloomberg system and reported through the NBG's electronic link**. Because the post-trade system for the GSE in not linked to the central bank's system, treasuries cannot be traded on the exchange.

The NBG as Depository / Registry

80. **The NBG performs clearing, settlement and record-keeping functions for the treasuries markets, both primary and secondary**. The clearing and settlement function is referred to as the securities settlement system (SSS) and the record-keeping function (a combined depository and registry) is referred to as the CSD. In fact all functions are performed within the Montran IT system which was installed in 2010. Settlement is DVP with 'straight through processing'. The settlement cycle for auctions is T+1 and for secondary market trades is T+0, but can be longer at the parties' choice.

81. **The NBG's CSD is not a legal entity**. Instead it is a business activity operated inside the NBG. Although it is not a separate business unit, NBG states that it can keep its accounting records to track costs of operation. Seven persons on the business side and four persons on the IT side work on SSS/CSD matters, all part-time.

82. **The NBG does not charge for any of the post-trade services it provides**.

83. **Because only banks may be members of the payment system this, by extension, means that only commercial banks are members of the CSD**. This fact, again by extension, means that

to the system, the discussion of this topic in Section VII.G., below speaks in terms of mid-range realignments driven by private sector decisions.

[13] See, Organic Law on the National Bank of Georgia (LNBG) Articles 1.1, 3.3(e) and 41.1. This is also true for the NBG's Certificates of Deposit which it uses for liquidity management of the banking system. Because this Study focuses on the securities markets available to all issuers and investors the NBG CD activity is only discussed in Section V concerning trading of treasuries by banks.

only banks may directly participate in the auctions for treasuries and only banks may directly clear and settle secondary trades at the CSD. Non-bank investment firms must use a bank to participate.[14] Nor can investment firms participate through the GSCD because it too is not a member of the payment system or the CSD.[15] The NBG has made a proposal in this regard that may change this arrangement. This is described in Sections VI.G. and VII.G below.

Custodial Operations

84. Given that the custodial and clearance and settlement linkages are maintained by the banks as outlined above, this functionality exists for treasury securities as well. Foreign investors may use State Street or Citibank for holding assets in Georgia.

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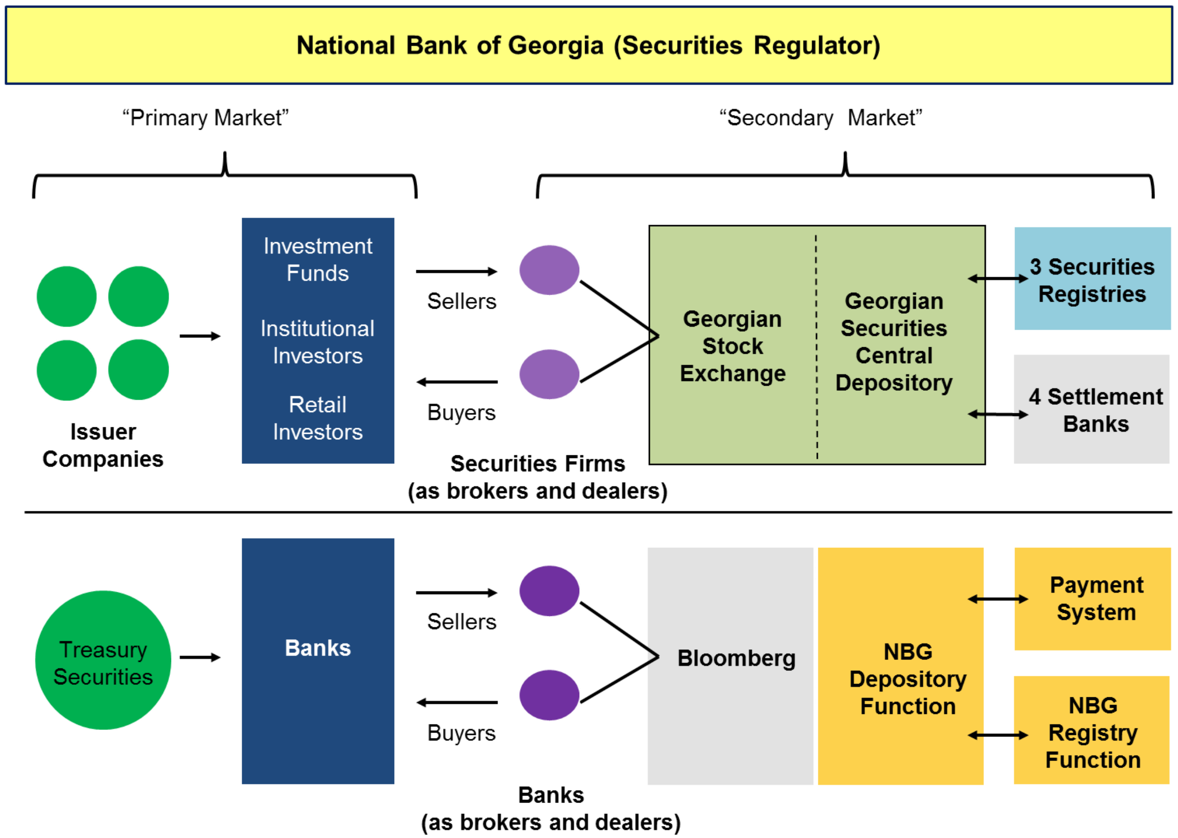
[14] This 'non-level playing field' between bank affiliated investment firms and those that are not is a theme running throughout this Study's findings. It has impact on access to finance for investors and on the ownership and operation of the capital markets infrastructure.

[15] In Armenia and Azerbaijan, the depositories are members of the payment system. All licensed investment firms may participate in the treasuries secondary market. Further, in Armenia the NASDAQ OMX's CSD is the depository for treasury securities. In Azerbaijan, the Baku Stock Exchange is the treasuries depository, soon to be relocated to the corporate securities depository (National Depository Center) now the central CSD.

Figure 2: Components of Georgia's Capital Markets

1. **Owners of domestic corporate securities:**
   ~ 300,000 persons and entities
2. **Reporting Companies:**
   258 Reporting Companies
   51 currently reporting
3. **Active Securities Firms:**
   BG Capital
   TBC Broker
   Caucasus Financial Services
   Cartu Broker
   Liberty Securities
4. **Private Investment Funds:**
   Co-Invest Fund
   Caucasus Growth Fund
   Regional Development Fund
   Liberty Consumer Fund
   Smartex
5. **Government Owned Investment Funds:**
   Partnership Fund
6. **Corporate Securities Exchange:**
   Georgian Stock Exchange
7. **Corporate Securities Central Depository:**
   Georgian Central Securities Depository
8. **Corporate Securities Registries:**
   Caucasus Registry
   United Securities Registrar of Georgia
   National Register
9. **Treasuries Trading System**
10. **Treasuries CSD**



C. The Legal and Regulatory Framework

This Section describes the laws in effect that impact the Georgian capital market.

Civil Code

85. **The foundational document governing Georgia's capital markets is the Civil Code**. Inherited from the Soviet system it does not address the concept of investment securities. Instead it speaks in language which literally translated means "valuable papers", and includes mostly payment instruments (*e.g.*, checks and bills of exchange).[16]

86. **The opinion of local legal experts is that the Civil Code should not pose an obstacle to the roadmap reforms suggested here**. If the reforms were to require amendments to the Civil Code, this process could be more cumbersome than desired. Fortunately, Article 2(2) specifies that in cases where a specialized law and the Code conflict the specialized law will prevail.

Law on Entrepreneurs

87. **The LoE governs five forms of business enterprises. All may issue corporate bonds; only JSCs may publicly offer shares.**[17] The LoE avoids many of the obstacles originally found in company laws within the region. For example, there are no statutory pre-emptive rights and companies may not require approval rights for transfers of publicly offered securities.

88. **JSCs with more than 50 shareholders are required to use an independent share registrar**.[18] This applies also to "reporting companies" under the LSM.

89. **Minority shareholder rights attach at the 5% and 25% levels**. Shareholders with 5% may (1) call for special audits, (2) call extraordinary meetings of shareholders, and (3) obtain transaction documents.[19] By virtue of several Articles, shareholders with 25% may delay or block major transactions and thus exert 'negative control'.[20]

90. **What is perhaps most striking is that the LoE is almost silent on State enforcement of the Law's provisions regarding shareholder rights.** This is especially noticeable with regards to the mandatory tender offer requirements (Article 53^2), the squeeze-out provisions (Article 53^4) and the sections on shareholder meetings (Article 54).[21] Curing this regulatory gap is discussed in Section VII.B., below.

91. **The LoE does not contain the concept of a "trust" as a legal entity**. It also does not contain the concept of a publicly-owned limited partnership or LLC that issues securities.[22] This

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16 See Articles 911-929.

17 These are: (1) general partnerships, (2) limited partnerships, (3) limited liability companies (LLCs), (4) joints stock companies, and (5) cooperatives.

18 LoE Article 51.3

19 LoE Article 53.

20 See *e.g.*, LoE Articles 14.4, 53.3^4, and 54.1^1

21 The exception to this is the NBG's right to attend shareholder meetings of reporting companies "in case of gross violations" (LSM Article 16.5). Further, the LNBG grants the right to supervise the issuance and circulation of securities (Article 52(a)). Otherwise, there is no mention in either the LoE or the LNBG of the NBG's right or authority to enforce the LoE. Any jurisdictional hook is tied to the LSM and the concept of reporting company.

22 Limited partnership interests are not included in the definition of security under the LSM. LLCs issue "negotiable shares" and there is no limit on the number of shareholders. But at the same time the opinion

means that the only form of public company currently available under the Georgian law is the JSC. This also has consequences for adopting the proper tax treatment for investment funds (please see Section VII.C. "Harmonizing the Tax Policy" below).

Law on Securities Markets

92. **The specialized law governing Georgia's capital markets is the Law on Securities Markets, adopted December 1998**. Commentators tend to describe this as being based on the US model. While that may have been true originally, given the 19 sets of amendments since then and the many subsequent changes made to the US system, this is no longer an accurate description.

93. **The LSM follows a disclosure based model**. It requires issuers to provide investors full and accurate information and then allows them to make their individual decisions. Licensing of market participants, together with financial responsibility and market conduct rules, govern the infrastructure entities.

94. **Given Georgia's obligations under the EU-Georgia Association Agreement, the LSM will need to be approximated to the EU approaches**. One of the key issues concerns whether to retain the concept of "investment contract" as part of the definition of securities. Under the current approach, informal investment arrangements are included within the securities law's registration and antifraud prohibitions. This conceivably includes two prominent activities in Georgia (1) the practice of construction companies selling "rights of occupancy" for apartment space, and (2) the practice of the pawn shops raising funds by issuing promissory notes. Thus, the issue of whether to retain "investment contracts" within the definition of securities could have broad reaching impact on investor protection and the regulator's responsibilities.

Law on Investment Funds

95. **The LIF was adopted July 2013**. At 6 pages in length (English version) it is very brief compared to its counterpart laws across the region (averaging 80 pages or so). The result of interviews at Parliament's Budget and Finance Committee indicate that the LIF was adopted to provide a legal basis for private equity fund operations that were either then underway or planned for start-up soon. This was a 'stop gap' measure.

96. **It is unclear whether the LIF has achieved this purpose**. There are sections relating to asset managers of collective investment undertakings; perhaps this is adequate for the private funds in operation (please see Section VI.D., below). But the LIF has not resulted in the formation of any publicly held investment funds. Nor have any of the 7 private equity funds operating in Georgia registered under this law. Part of this may be due to the fact that conforming amendments to the tax code were not adopted (please see Section III.E., below); the current funds have no financial incentive to elect registered status.

97. **For purposes of this report it is not necessary to itemize at length the constraints within the current law**. It will need to undergo significant expansion as part of the EU approximation process (please see Section VII.B. below).[23] The policy-makers will need to decide if this work should be included in the legislation due by December 2016, or if this will await a later date.

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of the local legal experts is that the LoE does not allow public offerings and thus the "share" is not equal to "equity share" as contained in the LSM.

[23] Simply for illustration purposes, some of the needed topics are:

- Process and pricing for issuing and redeeming units (shares)
- Calculation of net asset value

98. **However, one aspect bears note: the English translation of the LIF speaks repeatedly in terms of "trusts".** Here there is a collision between Anglo-Saxon based common law and Georgia's code-based system. As noted above, the 'trust' as a legal entity category does not exist in Georgia. Moreover it is not clear whether there is an adequate legal basis is for a "trust by contract" where the duties and powers of the trustee are contained within a legal document. This latter approach is essentially based on principal-agent law, again a common law doctrine. For these reasons the legal underpinning for operating a classic open-end mutual fund, or any fund for that matter where the assets are held as a "corpus" outside of a legal entity, may not be adequate. The drafters of the new Law on Investment Funds need to address this aspect.

Law on Covered Bonds and Securitization

99. **Georgia does not possess specialized laws on covered bonds (also known as "mortgage bonds") or securitizations**. Attempts in the past to create these types of securities have relied on the collective Georgia law relating to contracts, security interests in property, contractual trustee or bond representative functions, and nominee ownership, as well as foreign market conventions relating to these instrument. This legal gap needs to be remedied.

Law on Accounting and Financial Audit

100. **The LAFA governs the principles to be applied by entities for accounting and financial reporting and the standards to be applied for audits**. It relies heavily on accepted international best practices. First, a self-regulatory organization approach is used to be implemented by an "accredited professional organization" that is a member of International Federation of Accountants. Second, LAFA sets requirements on which entities shall use International Public Sector Accounting Standards, International Financial Reporting Standards (IFRS), IFRS for Small and Medium Enterprises and "national standards". It also requires audits to be performed in accordance with International Standards on Auditing.

101. **All securities markets professional participants are required to report using IFRS**.[24] Audits may only be conducted by firms qualified under the Register of Auditors.[25] The deadline for filing annual financial reports by these entities is March 31st of the following year.[26]

102. **The remaining unresolved question for the LAFA is how to reinvigorate the former Council on Audit Activity previously operating under the Parliament**. This was essentially a monitoring unit designed to track the activities of the accounting and auditing association and the execution of their responsibilities under the law. As of the last amendments to the LAFA the

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- Rules on advertising
- Diversification requirements for public / tax exempt funds
- Qualifications of Asset Managers (fit and proper rules)
- Obligations and powers of the Custodian
- Liquidation and reorganization of funds

[24] LAFA Article 7(4)(a).

[25] LAFA Article 6(5).

[26] Please see:

- NBG Regulation N 34/01 regarding Reporting of Brokering Companies
- NBG Regulation N 169/01 regarding Reporting of Stock Exchange
- NBG Regulation N 171/01 regarding Reporting of Central Depository
- NBG Regulation N 33/01 regarding Reporting of Securities Registrars.

Council's operations were discontinued, largely due to uncertainty of where they should be housed under the new regime. Thus this is an open question that should be addressed by the roadmap.

Frequency of Amendments

103. **The legal framework governing Georgia's capital markets is constantly shifting**. Since its enactment in late 1998 the LSM has been amended 19 times, or roughly every 9 months over the last 15 years. The LoE, enacted in 1996, has been amended 49 times, or roughly every 5 months over the last 20 years. Even the relatively new laws follow this same pattern. The LAFA, adopted June 2012, has already been amended 5 times (once every 7 months) and the LIF, adopted July 2013, has already been amended 3 times (once every 7 months).

104. **The negative impacts of this constant revision are fourfold.** First, it creates a certain disrespect for the law's constancy and authority. Second, it makes tracking the requirements of the latest version difficult, thus making compliance difficult. Third, it creates an impression of lawmakers reacting to *ad hoc* issues rather than taking a reasoned, long-term view of the strategy and policy behind the law. Fourth, it creates, especially for potential foreign investors, a sense of instability and therefore greater regulatory risk. Georgia needs to take a different approach.

Transparency of Laws and Regulations

105. **Over the past year, Georgia has made great improvements in the availability of the relevant laws in English**. All of the laws discussed here, except for the LSM and the Law on Microfinance Organizations (LMFO), are available on Matsne's English version website. Unofficial translations of the LSM and LMFO latest versions are available on the web.

106. **Unfortunately, this clarity does not extend to the sub-legislative acts adopted under these laws**. The below table lists the laws impacting the capital markets, the number of implementing regulations adopted thereunder and the number available in English. As a result, it is not possible for any potential foreign investor to understand the legal regime imposed on the Georgian capital markets below the law level (*i.e.*, down to the implementation level).

Table 3: Availability of Implementing Regulations (as of March 2015)

Law	Number of Implementing Regulations Adopted	Number Available in English
Law on Securities Market	34	1
Law on Entrepreneurs	11	0
Law on Collective Investment Undertakings	1	0
Law on Accounting and Financial Audit	13	0

D. The NBG as Regulator

107. **The location of the securities regulator has changed several times over the last 15 years**. The LSM as originally enacted in 1998 created the National Securities Commission of Georgia (NSCG).[27] The NSCG's functions were folded into the NBG in July 2007 as part of consolidating financial system regulation.[28] In March 2008 all but the banking supervision function was transferred

27 See LSM Article 46, rescinded July 11, 2007.

28 See LNBG Article 74, rescinded 26 March 2008. The function was placed inside the Financial Monitoring Service which was a separate legal person of public law the NBG.

to the newly created Financial Supervisory Agency.[29] In October 2009, the FSA's functions were transferred back to the NBG where they reside today.[30]

108. **The NBG, in its role as Georgia's securities regulator, is not a member of the International Organization of Securities Commissions (IOSCO)**. Perhaps more importantly, Georgia is not a signatory to the Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (MMOU). Both of these facts, at least from a capital markets development viewpoint, have strong negative consequences for Georgia. The compelling reasons why Georgia must join IOSCO and become a signatory to the MMOU are contained in Section VII.I., below.

109. **The results of interviews indicate that over the past year there have been discussions between the NBG and the Government as to whether the securities regulatory function should be moved out of the central bank to an independent commission**. The root driving factor for this proposal is unclear. At the same time there seems to be some movement of taking the supervision of non-bank financial institutions (NBFIs) outside of the NBG. In March 2013 the Law on Insurance was amended to provide for a new independent Insurance Supervisory Service. For the reasons discussed in Section VII.B. Georgia needs to make a definitive decision on the location of the securities regulator soon.

E. Tax Code Policies

110. **The CMWG is not proposing subsidies for the capital markets. Instead, the goal of the Working Group is to create a level playing field between the various types of investment choices**: treasury securities, bank deposits, corporate shares, corporate bonds and investment funds. This follows the concept of fair competition. Along these lines there are several aspects of the Tax Code worth noting.

<u>Taxation of Offerings</u>

111. **Pursuant to Article 7.1 of the Law on Registration Fees, an issuer of securities must pay a registration fee of 0.1% (10 basis points) of the total value of any offering**. This fee must be paid before the NBG will accept a registration application. And while the Article does not specify that it covers only registered (public) offerings this is the practical result as the NBG only reviews public offerings.

112. **Thus, the fee provides an incentive to make offerings in the private placement mode, as opposed to public offerings**. This is undesirable both for the organized market and from a regulatory transparency perspective. According to the results of interviews one reason why the recent offering of 100 million GEL of ADB bonds was done in a private placement was the desire to avoid the 100,000 GEL fee ($49,246).

113. **Given that the fee is imposed under the Law on Registration Fees, one would expect these monies would be forwarded to the NBG to defray the administrative costs of reviewing the registration application**. Not so. The monies paid under Article 7.1 are retained by the MoF under the general State budget.

114. **Thus, in reality, this is a tax - perhaps the only direct tax that Georgia imposes on legal entities wishing to obtain funds by issuing securities or financial instruments**. There is no tax

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[29] See LNBG Article 70, rescinded 12 October 2009.

[30] With regard to the NBG's authority as securities regulator please see Organic Law of Georgia on National Bank of Georgia Article 52 and LSM Article 43.

imposed on banks obtaining funds by accepting deposits. And the MoF is certainly not taxed on the monies it raises by issuing treasury securities.

Taxation of Interest and Dividends

115. Since 2009, interest from treasury securities and bank deposits have been tax exempt for both natural persons (income tax) and legal entities (profits tax).[31]

116. **The taxation of interest paid on corporate debt instruments is somewhat parallel for both income tax and profits tax.** Interest received from a “freely negotiable security” is exempt. A “freely negotiable security” is defined as: a “public or debt security admitted to stock exchange’s listing for trading, ratio of free turnover of which […], based on the information submitted by the issuer to the stock exchange, exceeds 25%”.[32] Thus the key concepts for tax exemption are that the security is listed and have a 25% free float, as certified by the issuer. Non-exempt interest is taxed at 5%.

117. **The treatment for dividends is less parallel**. All dividends received by legal entities are exempt from profits tax.[33] As for income tax, the distinction again is whether the dividend is paid on a freely negotiable security. Dividends from freely negotiable securities are exempt from tax. All others are taxed at 5%.[34]

118. **In February 2010, the MoF adopted Instruction No 75 to define how this tax exemption should be implemented**.[35] Unfortunately, the controlling tax code at that time was the 2004 version. Not seven months later (September 2010) the 2004 version was repealed and the current Tax Code adopted. Consequently, under the terms of Article 25 of the Law of Georgia on Normative Acts, Instruction No 75 became null and void.[36] Therefore, in order for the exemptions to be implemented, Instruction No 75 needs to be reissued under the current Tax Code (and perhaps reevaluated in the process).

119. **These implementation questions aside the definition of “freely negotiable security” does not parallel how treasury securities are traded**. These latter securities are not listed and in fact trade OTC. Thus, in order to create the level playing field amongst tradable securities some adjustments to the definition are recommended. Please see Section VII.C., below.[37]

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[31] See TC Article 82(1)(s) (“1.ტ” under Georgian listing) and Article 99(1)(s) (“1.ძ” under Georgian listing).

[32] The phrase “ratio of free turnover” is considered to mean “free float”, not actual turnover in the trading market.

[33] TC Article 97

[34] See TC Article 130(1).

[35] See Order of the Minister of Finance of Georgia No 75 issued February 9, 2010 on Approval of the Rules on Application of the Tax Exemptions envisaged by Articles 168(q), 172(k), 195(5) and 196(6) of the Tax Code of Georgia.

[36] Article 25 states: "A normative act which is issued based on a legislative or sub-legislative normative act which has been declared void, has no legal force, regardless of whether it has been declared legally void or not."

[37] It should also be noted that the Tax Code does not address the tax treatment of investment fund units. Presumably dividends from investment fund shares (from corporate form investment funds) would be covered under the definition of “share”.

Taxation of Capital Gains

120. **There appears to be a level playing field in terms of the taxation of capital gains derived from the sale of "freely negotiable securities" and treasury securities**.[38] All are exempt from *income tax*.[39] In parallel, gains from all are exempt from *profits tax*.[40]

121. Again, there is the issue of re-adopting Instruction No 75 to implement these provisions to parallel the dividends and interest treatment.

Taxation of Investment Funds

122. **At the time that the Law on Investment Funds was adopted, there were no conforming amendments made to the Tax Code**. This is unusual given that adopting an investment fund law requires a consideration of the tax impact on fund investors. Without providing an exemption from the profits tax for qualifying investment funds, indirect investors (investors in a fund) will find themselves taxed twice while direct investors (those buying the securities for their own accounts) will pay only once. This "non-level playing field" creates strong obstacles to developing an investment fund industry.

123. **This undesirable result is exactly where Georgia finds itself today**. All types of investment funds are subject to profits tax. The methods to remedy the distortive effect are discussed at Section VII.C., below.

IV. TRENDS (2007-2014) FOR THE CORPORATE SECURITIES MARKET

124. **By any measure, 2007-2014 were difficult years for the Georgian corporate securities markets.** Three events occurred during 2007-2008 to undercut the momentum and progress that had been made in developing this market. Two of these were external and outside the control of the markets. The global financial crisis began in earnest in mid-2008 causing a worldwide withdrawal of capital from emerging markets, Georgia included. Then, in August 2008, Russia and Georgia engaged in a war of limited duration but long-lasting impact. This added further capital flight.

125. **The net impact on secondary market activity levels was severe**. The number of transactions has decreased steadily. The value of transactions only began to recover during 2013.[41]

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38 While the terminology of the Tax Code does not speak in terms of "capital gains" it does include gains on sales of assets as both "income" for purposes of the income tax, and "corporate income" in terms of the profits tax.

Again, the treatment of investment fund units is not addressed.

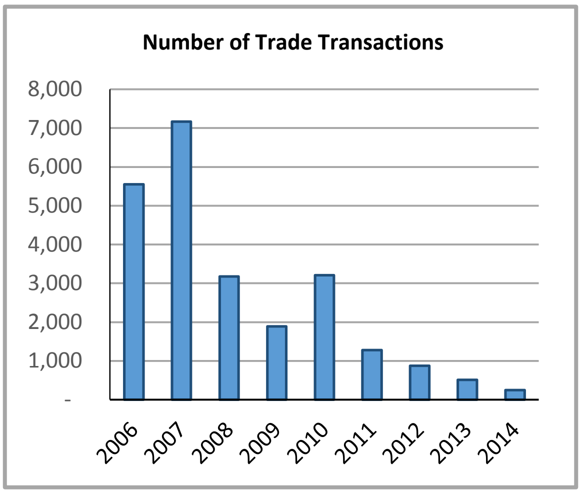
39 Please see TC Article 82.1(p) ("1.ჟ" under Georgian listing), TC Article 82.1(t) ("1.უ" under Georgian listing), and TC Article 82.1(o) ("1.პ" under Georgian listing, respectively.

40 TC Article 99.1(p) ("1.ი" under Georgian listing) and TC Article 99.1(s) ("1.მ" under Georgian listing). Whether the gain on sale of a discount bond prior to maturity is considered gain or interest is moot as both are exempt. This applies for both income tax and profits tax.

41 For purposes of these introductory graphs, the numbers of annual transactions and values are shown as composite figures for on-exchange, OTC and trades processed at the share registrars directly. The breakdowns among these categories and their significance to the future of the Georgian capital markets is discussed in Section A "Centrality and Transparency of Trading" below.

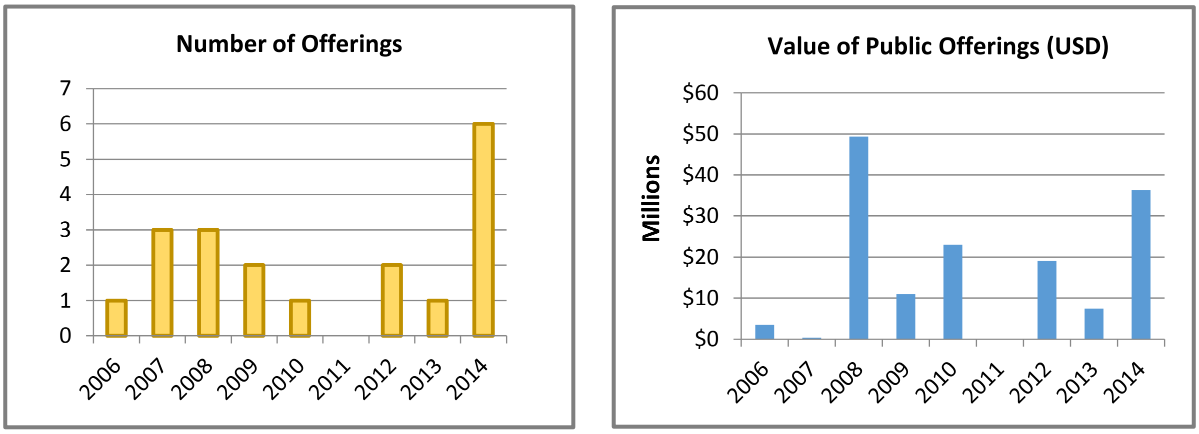
In addition, four large transactions reported as "trades" in the GSE's annual trading reports were in fact either exchanges of shares due to corporate reorganizations or reports of offerings. These have been omitted from the data as they are not secondary market transactions. These were:

Figure 3: Trade Transactions in Domestic Corporate Securities (2006-2014)



126. **Similarly, activity levels in the primary market (offerings of securities by issuers) during the period were low**. Only a handful of offerings occurred each year.[42]

Figure 4: Domestic Corporate Securities Offerings (2006-2014)



127. **These low activity levels for both the primary and secondary markets led to a shrinkage in the number of capital markets infrastructure institutions**.

Issuer	Date	Value in (GEL)	Value (USD)
UTC	15-Dec-06	89,722,692	52,013,155
GEB	26-Feb-08	157,000,000	101,355,713
UGB	28-Jun-10	38,008,734	20,660,289
GEB	29-Feb-12	718,187,660	431,706,937

42 As depicted, the number of public offerings for 2014 surged to 6 with a value of $36 million. The significance of this, plus the positive indication, is described in Section VI.A. "Recent Encouraging Events".

Table 4: Number of Participant Firms 2007 vs. 2014

Participant Firms in the Capital Markets		
	YE 2007	YE 2014
Number of GSE Members	17	5
Number of Share Registries	7	3
Number of Stock Exchanges	1	1
Number of Depositories	1	1

128. **But not all of Georgia's capital market conditions can be attributed to the global financial crisis and the war**. A 'third event', occurring just prior in 2007, consisted of a radical set of amendments to the LSM. While then couched in terms of 'liberalization' the result was a drastic reduction in the transparency of the trading markets. Thus, to a large degree, the current state of Georgia's securities markets is "self-inflicted".

A. Centrality and Transparency of Trading

129. **The 2007 LSM amendments removed a requirement that all transactions in securities admitted to trade on the GSE be in fact conducted on the GSE.** Many FSU countries included "exchange-only" rules in their first-generation securities laws. This was aimed at creating 'centrality of trading' and obtaining better price discovery. By limiting the fees that exchanges could charge, the benefits of the "exchange-only" rule were deemed to outweigh the reduction in freedom for individual investors. In later years, however, the FSU countries began eliminating this monopoly provision as the exchanges became more accepted by society and gained their operational footing.

130. **But as part of eliminating the exchange's monopoly, these countries also imposed certain investor protection rules.** The most important is the *"best execution"* rule. Under this, a broker is required to obtain the best possible price for its clients for any buy or sell order. This in turn requires the broker to "expose" the buy or sell order to the open market (the exchange's order entry system) so that the best counter-bid or counter-offer can be obtained. This requirement exists even if the broker has a matching order in hand.[43] Thus, in any trade that is 'intermediated' – that is to say, where a broker is involved - the customer's order must be presented to the open market so that the customer can obtain the best execution.

131. **Many markets eliminating the exchange-monopoly rule also adopted in its place an exchange rule that all members of the exchange must conduct their business on that exchange**. Violation of this exchange rule is not a violation of law but subjects the member to the exchange's sanctions, including fines, suspension and expulsion. For a market with a competitive investment firm environment and where no one securities firm can organize another exchange such sanctions are a serious adverse event.

132. **The combination of these actions had very positive results**:

- The monopoly position of the exchange over all trades (whether involving an intermediary or not) was eliminated;

[43] In fact, this rule is specifically designed to address the practice of "cross-trades" where the broker supplies both the buy and seller to the transaction. In this situation, it is in the broker's interest to 'cross' the trade as the broker receives both the buy and sell commission. However, this is not in the buyer's or seller's interest if there is a better bid or offer in the open market. In a cross-trade scenario where there is a better bid or offer in the open market two of the three parties benefit while the third is disadvantaged. The broker gains in all cases from the double commission; but either the buyer or seller loses as there was a better price in the open market which was not obtained.

- Private parties were free to negotiate transactions as they saw fit and process the trade at the registrar.
- Brokers involved in transactions were obligated to obtain the best execution possible for their clients, by among other things, bringing the order to the open market for the best possible bid or offer;
- The practice of crossing trades between the broker's clients was allowed only where there were no better bids or offers available in the open market; and
- Members of the exchange were obligated to conduct their brokerage and dealing business on the exchange or be subject to suspension or expulsion.

133. **Georgia's 2007 amendments eliminated the LSM's exchange-monopoly provision but did not impose a best execution rule**.[44] And, at the same time, the GSE did not adopt an internalization rule as described in paragraph 131. Benefits 1 and 2 above were achieved. Benefits 3 through 5 above were not.

134. **Instead, the LSM was revised to allow a practice of off-exchange trades called (aptly enough) "fixing"**. This allows a broker to find both the buyer and seller for any transaction, execute the cross-trade and simply report it to the GSE.[45] There is no obligation for a broker to expose any order to the open market. To add insult to injury the reporting fees charged by the GSE for on-exchange and off-exchange trades were made equal.[46] Member firms have no cost penalty for conducting fixings; leaving in fact only the benefit of the double commission. The GSE has no sanction or leverage to prevent this.

135. **The sum result of the 2007 amendments was predictable**. Trading moved dramatically away from the exchange to the off-exchange (fixing) market. Further, in many cases, the trading moved not only off-exchange but to the share registries themselves.

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[44] LSM Article 33(3) was added in 2009, but it imposes a best execution obligation only; there is no regulation specifying how this is implemented.

[45] In practice, as the trading data from 2008 through 2014 shows, almost all off-exchange or "fixed" trades were in fact in-house cross-trades.

Percentage of Trades Negotiated vs. Crossed (by Transactions Value)							
	2008	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
% of Trades Crossed	99.12%	99.30%	98.91%	97.39%	99.98%	99.70%	99.65%
% of Trades Negotiated	0.88%	0.70%	1.09%	2.61%	0.02%	0.30%	0.35%

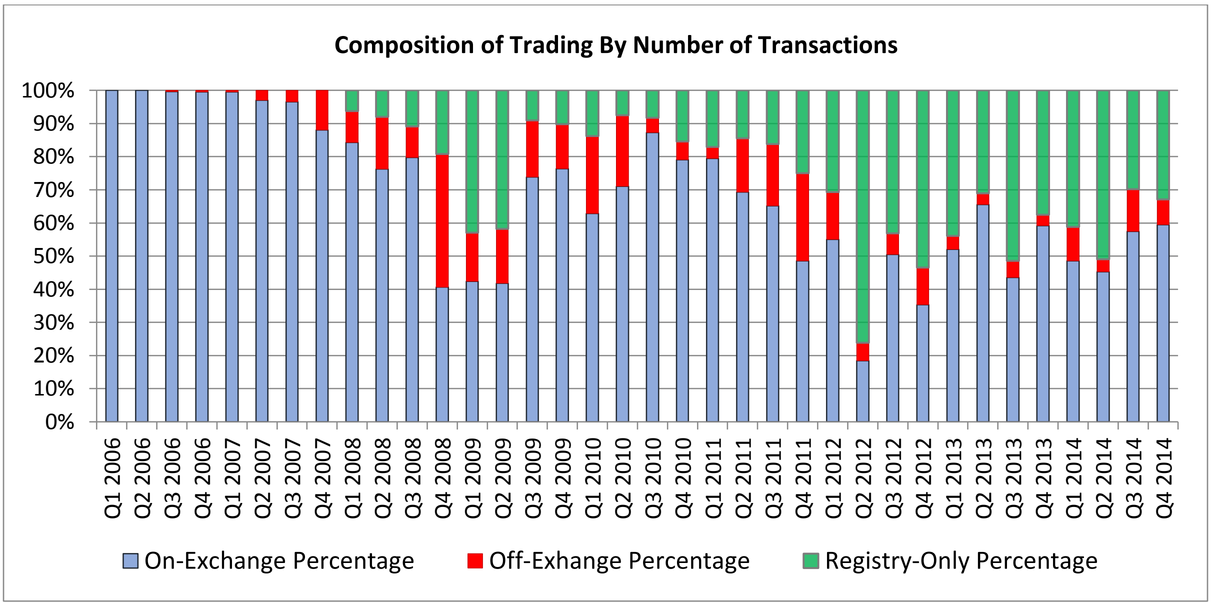
[46] LSM Article 18(6) requires that all transactions in securities, whether conducted on-exchange, off-exchange or at the registries, be reported to the GSE. NBG Rule N 20/01, Article 7 and GSE Rules provide the specifics. The mechanics of this rule, and its financial impact on the GSE and GSCD, is discussed below.

Table 5: Trends in Secondary Trading

As of	Percentage Make-Up Number of Transactions Handled			Percentage Make-Up Value of Transactions		
	GSE	Off-Exchange	Registry Only	GSE	Off-Exchange	Registry Only
Q4 2006	99.68%	0.32%	0.00%	60.05%	39.95%	0.00%
Q4 2014	53.04%	8.50%	38.46%	1.82%	84.77%	13.41%

136. The shift in the make-up of the **number** of transactions appears to have been more or less gradual during the time period.

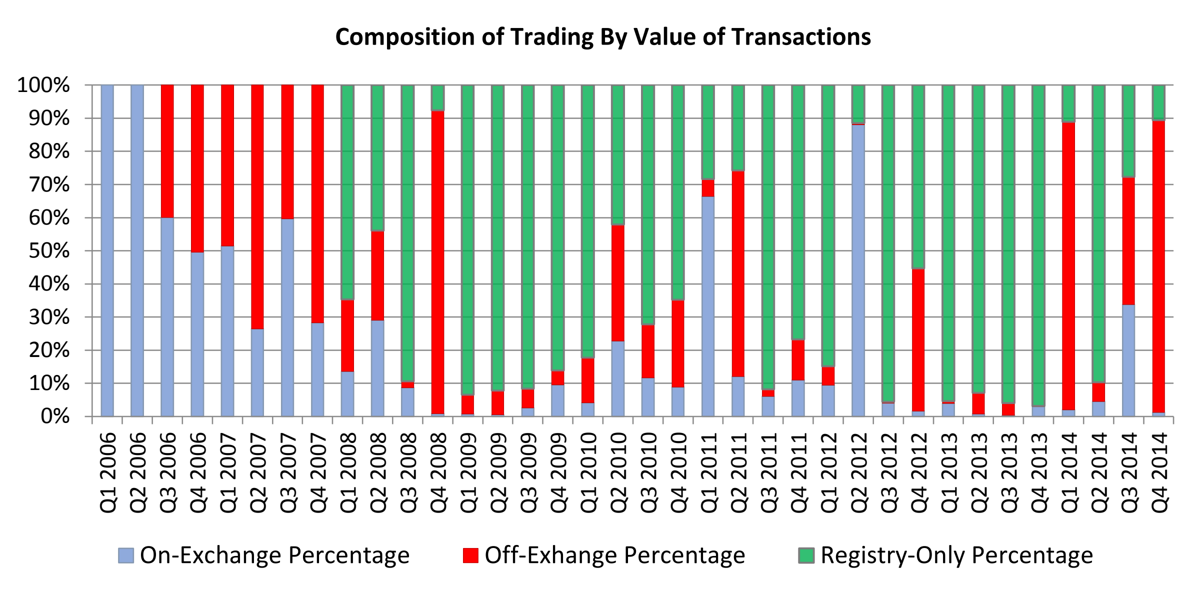
Figure 5: Secondary Market Composition – by Number of Transactions



137. However, the shift in the make-up of the **value** of transactions appears to have begun even before the effective date of the amendments.[47]

[47] The fact that there was considerable off-exchange trading just prior to the 2007 amendments gives rise to a suspicion that the changes to the LSM were driven by a desire to validate and extend an already existing practice. To a certain extent the point is moot given the elapsed time.

Figure 6: Secondary Market Composition – by Value of Transactions



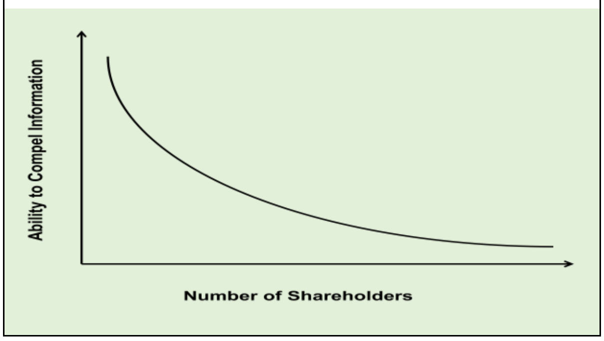
138. **The inescapable conclusion is that there are at least 3 corporate securities trading mechanisms operating in Georgia**: the GSE, off-exchange 'fixings' by the brokers, and the share registries themselves.

B. Transparency of Corporate Population

139. **The 2007 LSM amendments also significantly reduced the number of JSCs required to make public disclosure reports**. The definition of "Reporting Company" was narrowed to include only those entities that (1) have securities admitted to trade on the exchange, or (2) had made a public offering of securities. Component 3 to the prior test - "any issuer with more than 100 shareholders" - was eliminated. Companies that simply had a large number of shareholders were no longer required to file annual and semiannual reports.[48]

140. **This action eroded the LSM's investor protection aspects**. The logic underpinning a "size test" for requiring periodic public reports is that the ability of an individual shareholder to compel information from the company decreases rapidly as the individual's percentage ownership decreases. This is depicted as in Figure 7. Thus, the size test is designed to counteract the imbalance of power between a large, diverse shareholder population versus the management. Georgia's elimination of the size test reinstated this imbalance of power.

Figure 7: Rationale for "Size Test" of Reporting Company



[48] See Matsne N4520, Amendments to the Law on Securities dated March 27, 2007. In April 2012, the Article was further revised by removing the "admitted test".

141. **This change of definition did not affect the companies where management had decided to admit their securities for trading on the GSE, or to make a public offering**. Those companies that had decided to access the capital markets were still required to make annual and interim reports.

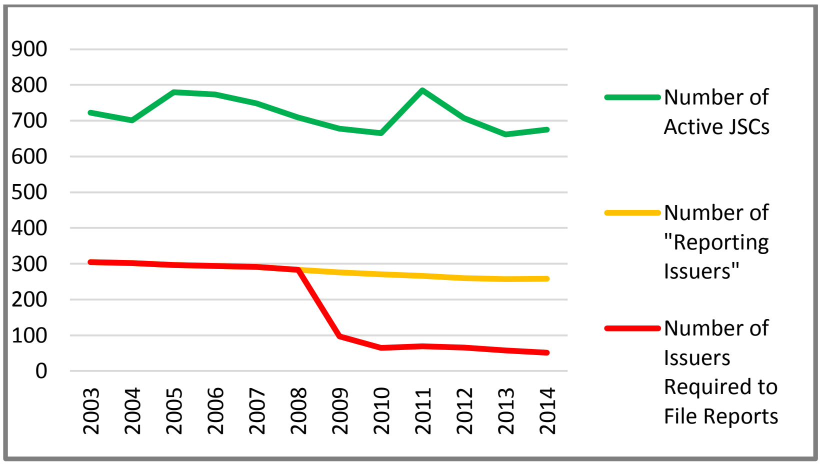
142. **But the change of definition played straight into the hands of managements of those companies that had gone through mass privatization yet had not embraced their obligations to their new owners, the so called "red directors'**. They were simply "big" as a result of privatization. Without an obligation for these issuers to make public reports, their shareholders found themselves in exactly the disadvantaged position described in paragraph 140 above. The red directors had control.

143. **Subsequent to the change in definition of 'reporting company' the securities regulator adopted further exemptions on the requirement to file disclosure reports.**[49] As a result of the changes to the LSM and the expansion of the exemptions, the number of companies filing reports for 2008 fell by almost 80%.

Table 6: Number of Reporting Companies (2003 – 2014)

Year	Number of Active JSCs	Number of "Reporting Companies"	Number of Companies Required to File Reports
2003	722	305	305
2004	701	302	302
2005	780	297	297
2006	773	294	294
2007	748	291	291
2008	709	283	283
2009	678	276	97
2010	665	271	65
2011	785	266	69
2012	707	260	66
2013	662	257	58
2014	675	258	51

Figure 8: Transparency of the Issuer Population



[49] Under exemptions to the reporting requirements adopted by the Financial Supervision Agency in 2007 and renewed by the NBG in 2009 reporting companies are not required to file periodic reports if they (1) are subject to a bankruptcy proceeding, (2) have not had their securities traded in the last 2 years, (3) have less than 50 securities-holders, and/or (4) are "inactive". This explains the difference between the stated number of reporting companies and the number actually filing reports.

144. **Thus, the transparency of the Georgian JSC population has been regressing, not progressing**. Out of a total population of 675 active JSCs for 2014 only 258 were reporting companies. 207 of these relied on exemptions, leaving 51 actually making annual and interim reports. This opaqueness can only discourage investors from participation. And, the resulting lack of investor interest can only discourage issuers from seeking capital markets financing.[50]

145. **Exacerbating this impact, Georgia does not know – and under the current system cannot know – the financial make-up of the JSC population**. Unlike its neighbors it does not require its JSCs to file public summary financial information. With 51 reporting companies at YE 2014, this means that out of 675 JSCs a full 631 file no public financial information, regardless of their size. As a result, any decisions regarding the architecture of the capital markets – at least as it may impact the issuer community – must be made based on best guesses or snapshots taken of the reporting company population as of 8 years ago.

C. Quality of Reporting

146. **Although the issuers' reports are filed with the NBG, they are not posted on the regulator's website**. Instead, these reports are available from the NBG "upon application". Reporting companies that are also admitted onto the GSE system are required to send copies to the exchange which posts them on its website.[51]

147. **The NBG reports that it engages in aggressive enforcement of the reporting requirements and that it requires the issuers to file 'cured' reports with them**. This appears especially so during 2013 as reflected in the number of "deficiency letters" issued by NBG supervision staff to the reporting companies.

Table 7: NBG Actions

Year	Number of Deficiency Letters Issued
2009	7
2010	12
2011	11
2012	47
2013	185
2014	31

148. **Today, some of the problems in prior periods regarding the quality of issuer reporting appeared to have been addressed**. This should be further promoted by the requirements of Article 7(4)(a) of the LAFA which requires reporting companies to have their financial statements audited by a company listed on the Register of Auditors (currently 11 firms). This is effective as of the FY 2014. The deadline is May 15th.[52]

D. Transparency of the Infrastructure Institutions

149. **The financial statements and annual reports of the infrastructure institutions exist in Georgian only**. It is almost

[50] To be fair, part of the dilemma here is the fact that many of the companies with large numbers of shareholders arose out of the privatization process and have not "gained traction" afterwards. And, as depicted in Section VII.A. and Annex 11, most of these are financially weak.

This raises questions of the "proportionality" of requiring these companies to file periodic reports versus their financial ability to do so, leaving aside for the moment the need to ensure that minority owners are protected.

Perhaps the answer is to devise a streamlined way for these companies to buy-out their numerous and fragmented shareholders while maintaining fairness. In this way the weak, but widely-held, companies can go private and exit the reporting company population. Please see the suggestions at Section VII.D.

[51] LSM Article 11(6). This system is not optimal in that the reporting companies that are not admitted onto the GSE do not have their reports published by the exchange. These remain at NBG only. Further, there is a chance that the reports posted on the GSE's site but may not match the reports on file with the NBG.

[52] LSM Article 11.

impossible for any potential foreign investor to obtain financial information in English concerning the GSE, GCSD, securities registries or the investment firms.

E. Market Dominance

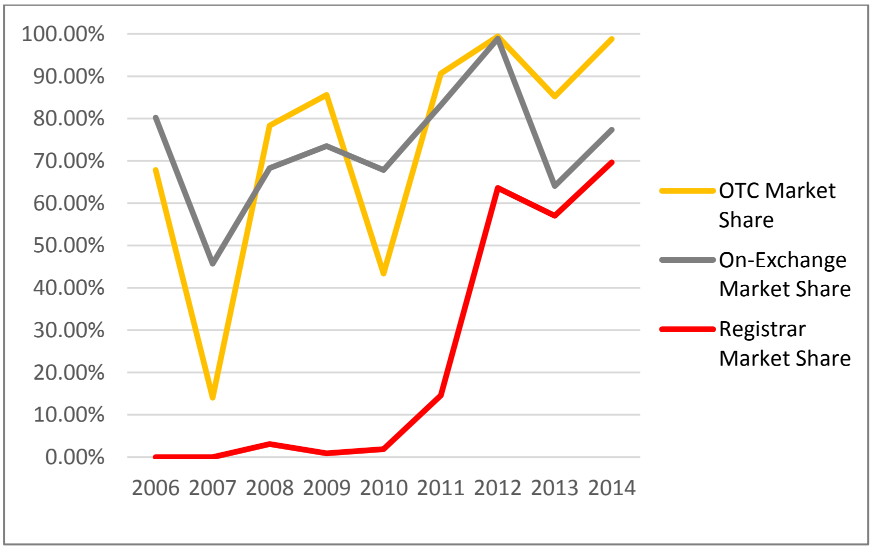
150. **One last aspect of the corporate securities markets bears noting here**: it is the fact that one bank / investment firm / share registry complex dominates the market.

Table 8: Bank of Georgia Complex Market Shares

Market Segment (as of 2014)	Bank of Georgia Complex	All Others
Ownership of GSE[53]	44.00%	56.00%
On-Exchange Market Share	77.39%	22.61%
Off-Exchange Market Share	98.79%	1.21%
Share-Registry-Only Market Share	69.63%	30.37%

151. **Nor is today's status quo a recent event**. This has been a growing trend as various other investment firms and share registries entered and exited this market.

Figure 9: BoG Complex Market Share 2006 – 2014



F. Net Impacts

152. **All of the above creates several net impacts upon the operation of this market**. The first, and perhaps the most important, is that the current structure provides almost no price discovery for would-be buyers or sellers. There are few quotes posted on the GSE by the brokers. Doing so is almost meaningless as the trades are negotiated outside of the system. The 'price' known to the potential buyer or seller is that which the broker discloses. Transactions are posted very late after the fact. Under the GSE rule, trades must be reported by close of business of the following business day. This means that a trade executed at 10:00 on a Friday need not be reported until 17:00 Monday.

53 Bank of Georgia owns 32% as beneficial owner and a further 12% as nominee for undisclosed persons.

153. **This can only be viewed as a disincentive to participate in the secondary market.** The inability to understand, prior to the trade and in an open and honest manner, the prices for securities does not lead to trust.

154. **The second net impact is that the large Georgian issuers seeking to raise significant sums bypass the domestic market and apply to foreign markets**. The "value-added" missing in the local market is found instead in the foreign settings. While this may be a valid and necessary business decision for the issuers, it means that Georgian citizens and enterprises are disenfranchised from investment opportunities in Georgia's bluest chip companies.[54]

Table 9: Offerings by Georgian Issuers (2006-2014)

OFFERINGS BY GEORGIAN ISSUERS						
	Georgian Capital Market			Euromarket		
Year	**Company (issuer)**	**Type**	**Value (USD)**	**Company (issuer)**	**Type**	**Value (USD)**
2006	Galt & Taggart Capital	Common	**$3,450,664**			
2007	Teliani Valley JSC	Common	**$17,804**	Bank of Geo 9.00% 02/12	Bond	**$200,000,000**
	Elit Electronics LTD	Bond	**$206,000**			
	Elit Electronics LTD	Bond	**$106,000**			
2008	Caucasus Energy & Infrastructure JSC	Common	**$45,997,990**	Geo Sovereign 7.5% 4/13	Bond	**$500,000,000**
	Energokavshiri JSC	Common	**$3,013,453**			
	Auto Finance JSC	Bond	**$371,200**			
2009	VTB Bank Georgia JSC	Common	**$9,515,665**			
	VTB Bank Georgia JSC	Common	**$1,450,065**			
	Georgian Railway	Bond	**$14,939,644**			
2010	VTB Bank Georgia JSC	Common	**$23,056,130**	Geo Railway 9.875% 7/15	Bond	**$250,000,000**
2011				Geo Sovereign 6.875 4/21	Bond	**$500,000,000**
2012	Telasi JSC	Common	**$19,085,743**	Bank of Geo 7.75% 07/17	Bond	**$400,000,000**
				Geo Oil & Gas 6.875% 5/17	Bond	**$250,000,000**
				Geo Railway 7.75% 07/22	Bond	**$500,000,000**
2013	VTB Bank Georgia JSC	Common	**$7,406,288**			
2014	VTB Bank Georgia JSC	Common	**$6,350,673**			
	M2 Real Estate	Bond	**$5,000,000**			
	M2 Real Estate	Bond	**$10,000,000**			
	TBC Credit LLC	Bond	**$2,500,000**			
	TBC Credit LLC	Bond	**$2,500,000**			
	Georgia Leasing LLC	Bond	**$10,000,000**			
	Totals		**$164,967,318**			**$2,600,000,000**

155. **The third net impact is that the fragmentation of trading creates a very challenging environment for the regulator**. It is difficult to police the execution of trades when the order tickets are not time-stamped, as is the standard practice for exchange operations. The NBG cannot know

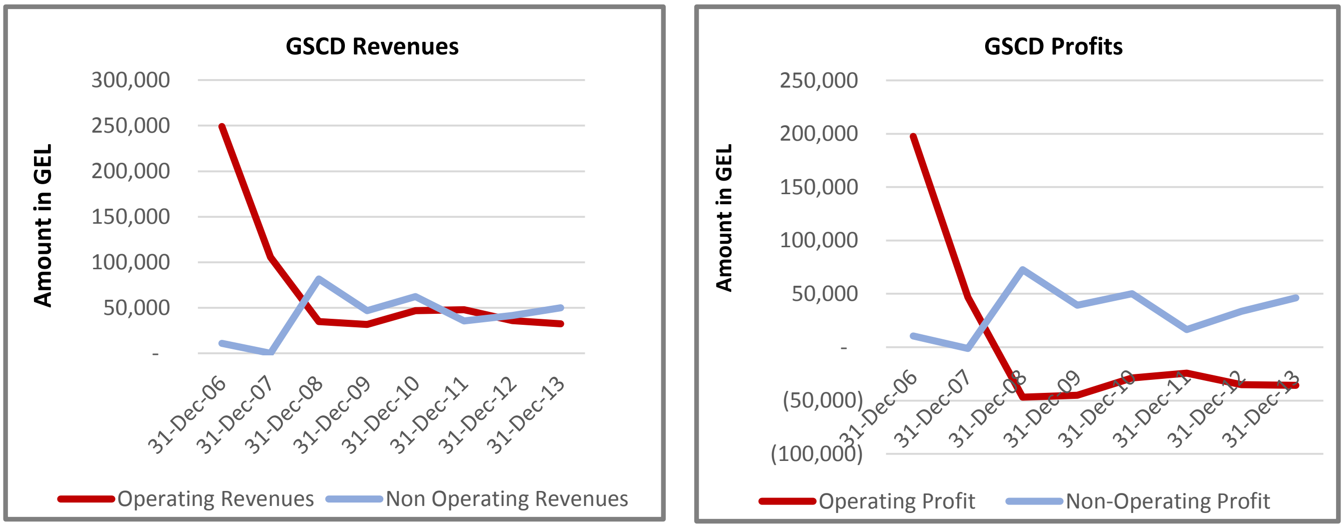
[54] To be fair, even in a perfect environment it is doubtful that the Georgian capital market would possess the economies of scale to place $500 million offerings. With a population of roughly 5 million and a GDP of $15.7 billion (est. 2014) there is an inherent limit to the amount of capital that can be raised internally. This points to a need to combine the various capital markets activities (corporate bonds and shares, treasuries, NBG CDs and currency) into one platform and to seek linkages to other markets.

when the customer was contacted and when the 'trade' occurred. Nor can the NBG know the actual market price (the best bid and offer) of the securities spread among 3 'trading markets'. In sum, the method of executing these trades defies normal oversight as it attempts to recreate facts and circumstances in a scattered and dark environment.

156. **The fourth net impact is that the use of these unregulated / unofficial markets means a continuing financial deterioration of the one of the main pillars of the infrastructure**. The depository is privately-owned, for-profit entity and should be expected to earn its continuing existence by providing value-added. At the same time, it creates a public good by providing the transactional security for the markets. The system needs this function. While Georgia may not need the GSCD *per se*, the country needs a depository. The dilemma facing the GSCD would apply to any replacement entity.[55]

157. **This has been a pressing question for the GSCD**. Given the lower volumes of trading overall and the migration of trading to the OTC market it has been operationally insolvent since 2008. It remains in business only due to the retained profits pre-2008 which were placed in bank time deposits and generate interest income for the GSE complex.

Figure 10: GSCD Revenues and Profits (GEL) (2006-2013)



158. **The fifth net impact is a risk of loss for investors**. One of the advantages of an organized market, in addition to good price discovery, is the security of the settlement system. On-exchange trades are processed using the DVP principle. Buyers do not receive their securities until they pay and sellers do not receive their payment until they deliver. This is one of the bedrocks of the investor protection scheme.

159. **For OTC and share-registry-only trades this protection does not exist.** For off-exchange trades the settlement is handled by the broker.[56] DVP may be employed or not through its system. For share registry only trades, the payment flow is completely separate from the re-recordation of ownership (so called Free of Payment). One entity does not handle both payment and securities

[55] To some degree this question might also be asked regarding the GSE. But it already receives fees from the reporting of the OTC and registry-only trades. Thus, paradoxically, the financial impact of shifting the trading back to the GSE would not be as great.

[56] Please see footnote 46 above regarding the percentage of OTC trades that are crossed in-house.

transfer. Thus there is a risk of loss for investors who engage in off-exchange and share-registry-only transfers. The extent of the settlement failure risk cannot be known.

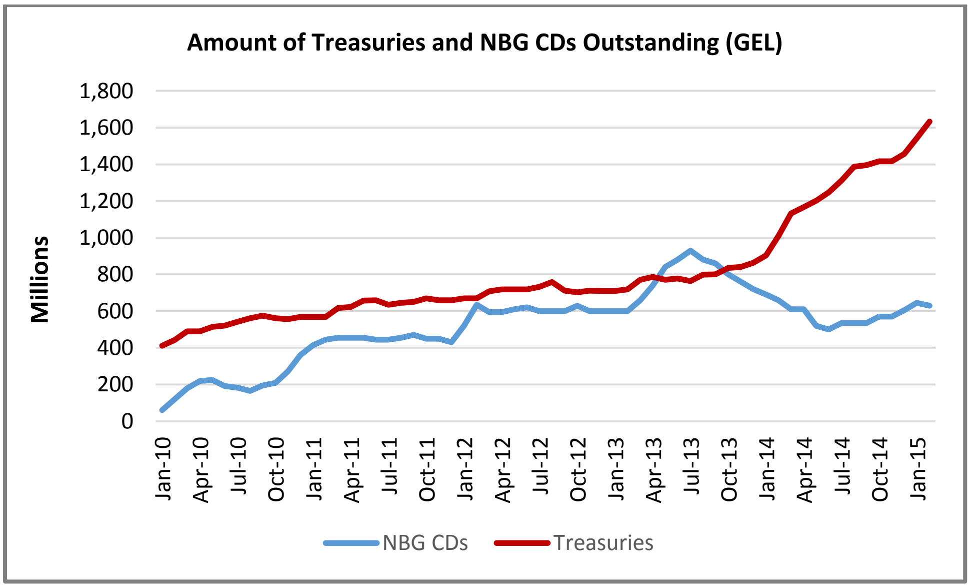
V. TRENDS (2007-2014) FOR THE GOVERNMENT SECURITIES MARKET

160. **Over the last 7 years the trend for the government securities market has been almost the polar opposite of the corporate market**. The trading is centralized, the IT system modern, price discovery good and the amount of outstanding securities growing.

A. Issuance Patterns

161. **The amount of outstanding treasuries has been growing steadily**. This creates a deeper base for trading.

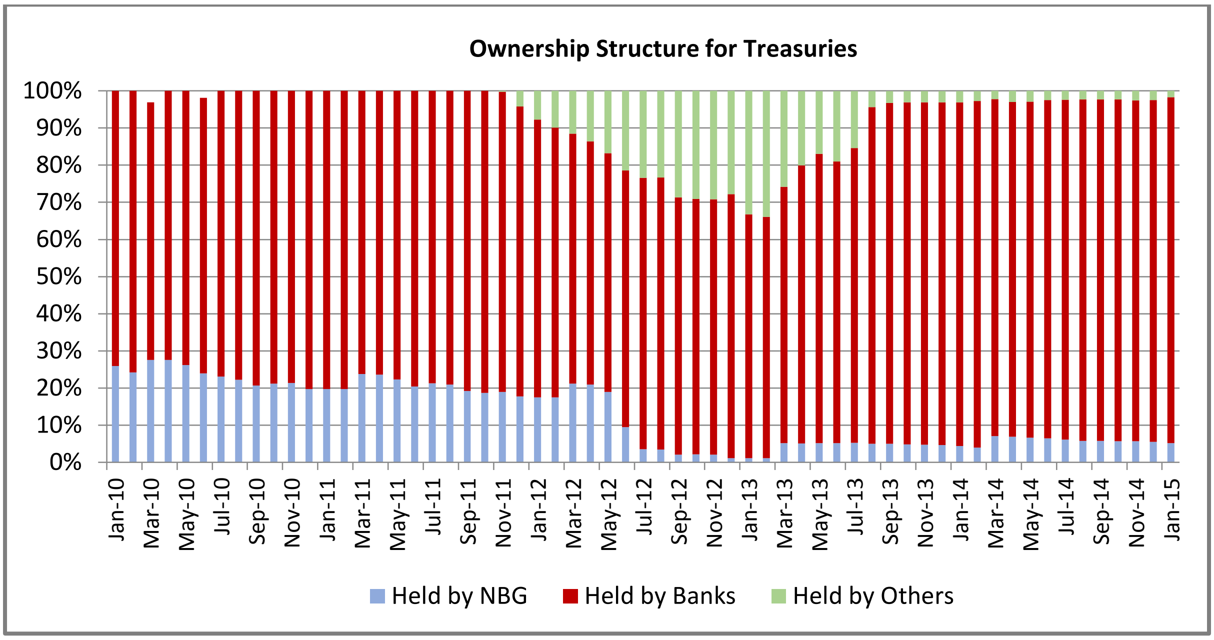
Figure 11: Amount of Treasuries and NBG CDs Outstanding (2010 – 2015 YTD)



B. Ownership Patterns

162. **The ownership make-up for the treasuries has shifted from the NBG to the banks, making them more available for trading**. Today almost all of the treasuries are held by the banks. The NBG owns 4.9% and nonresidents 1.11%. Residents own .01% and are excluded from the graph.

Figure 12: Ownership Structure for Treasuries (2010 – 2015 YTD)

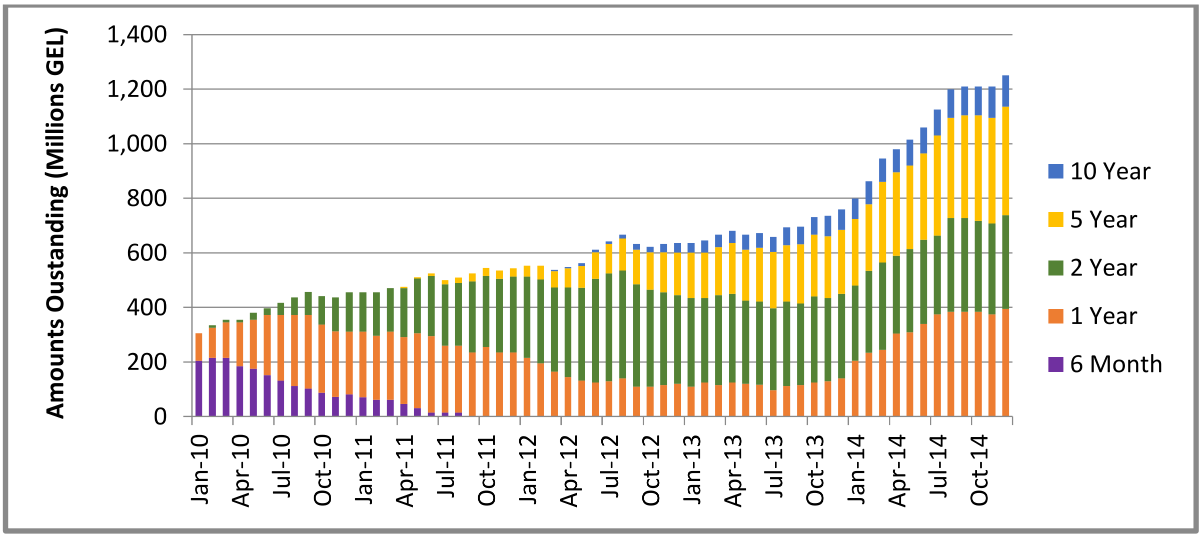


C. Maturity Structure

163. **The maturity structure is moving towards the longer end of the spectrum.** The GoG began issuing 2 Year notes in March 2010, 5 Year notes in June 2011, and 10 Year bonds in March 2012. The result is a shift away from the 180 day and 365 day treasury bills to these longer terms. This aids the creation of the secondary market because longer term maturities tend to trade more often than short-term "buy and die" maturities.

164. **A second benefit of longer and more varied maturities is that it helps develop the yield curve and provides a better starting point for pricing mid to long-term corporates**.

Figure 13: Maturity Structures for Treasuries (2010 – 2014)



D. Secondary Trading Levels

165. **From 2010 through 2013, the cumulative impact of these trends was a more active secondary trading market**. Beginning 2014, however, trading in treasuries declined sharply, perhaps due to high liquidity in the banking system and more active use of the repo market. This is

somewhat confirmed by a parallel fall-off in NBG CD trading, although it should be emphasized that the CDs are now 6 month and 3 month in duration.

Figure 14: Monthly Trading in Treasuries (USD) (2011 – 2015 YTD)

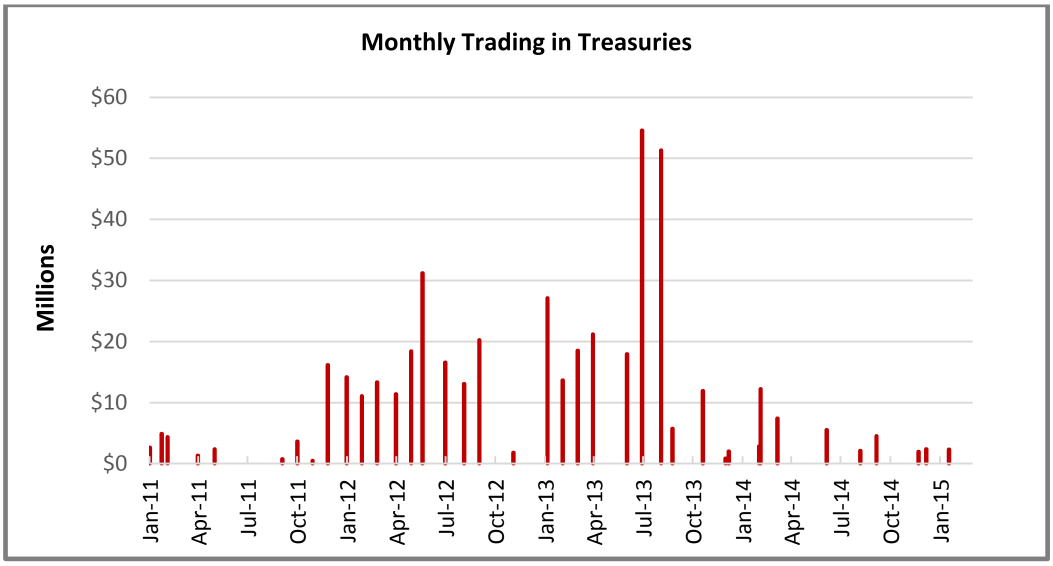
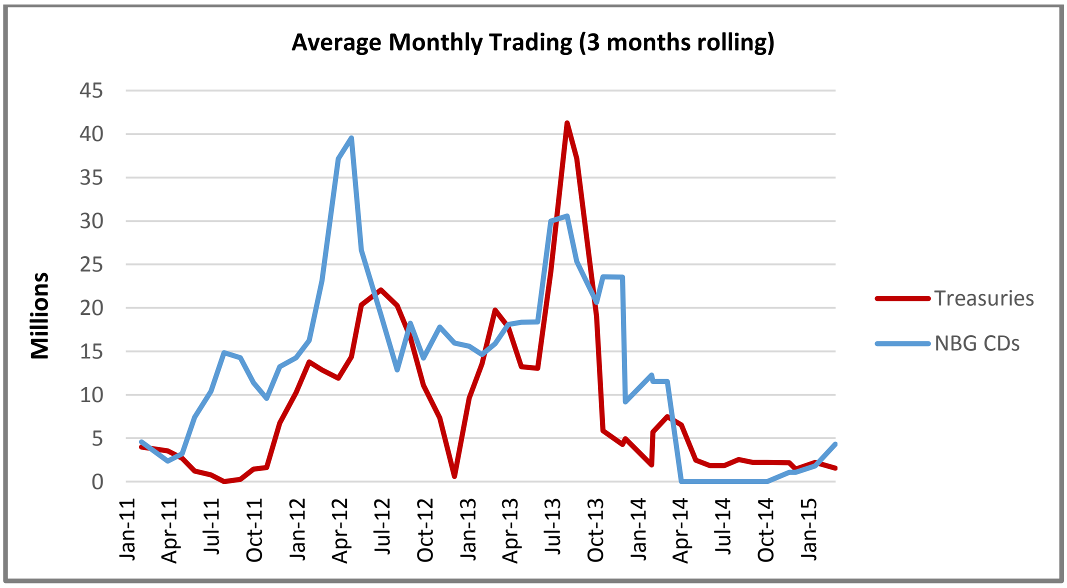


Figure 15: Average Monthly Trading in Treasuries and NBG CDs (USD) (2011 – 2015 YTD)



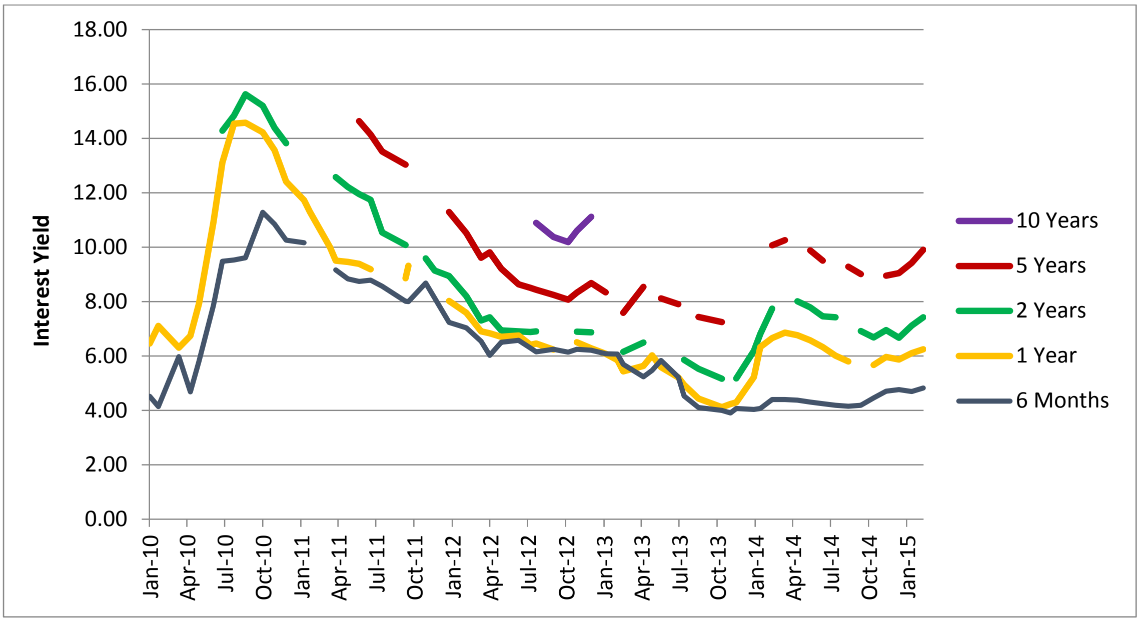
166. **One consequence of the currently lower trading is that the yield curve can only be constructed from the auction rates**.

E. Interest Rate Trends

167. **The pricing for issuing corporate debt and/or preferred shares is becoming more and more attractive.** Since reaching highs in August 2010, rates for treasury securities at auction have been falling, although an uptick in rates occurred late 2014. Data for August 2009 through January

2015 is attached as Annex 13.[57] 2-year notes yield 7.43%, 5-years yield 9.91 and 10-year bonds yield 10.46%

Figure 16: Treasury Yields at Auction (2010 – 2015 YTD)



F. Net Impacts

168. **These rate trends bode well for the issuance of corporate bonds as a financing technique**. At 10.4% (2 year treasuries + a notional 300 bps) for 2-year debt, this cost of debt funds would appear attractive. Roughly 65% of the companies considered eligible issuers possess net profit margins greater than this figure. These Georgian companies could borrow at this rate and term, and generate enough profit to service the debt. Perhaps even more encouraging 45% of these companies could also borrow advantageously at 12.9% for 5 years, the projected cost (5 year treasuries + 300 bps).

169. **In sum, not only has the treasury market experienced healthy growth over the last 7 years, it is also beginning to support the development of the corporate bond market**. Indeed, as discussed immediately below, 2014-2015 has seen a marked increase in offerings.

VI. RECENT ENCOURAGING EVENTS (2014 - 2015)

170. **The last year has seen several encouraging developments that can serve as the leverage point for substantial improvements to the capital markets**. Private sector activity has picked up. There is renewed interest in developing the market infrastructure. The NBG is moving forward with supporting actions and has made an interesting proposal to the private sector. Georgia has signed the EU Georgia Association Agreement, committing itself to increased linkages. These developments by themselves cannot guarantee the creation of a broad and deep securities market, but they are necessary and welcome ingredients. The challenge for developing and executing the roadmap is to capitalize and build on this momentum.

[57] Beginning in April 2011, the MoF moved away from issuing 180 day bills. These were replaced by NBG CDs for liquidity management purposes. Thus, the 6 month rates below are NBG rates past April 2011.

A. *Corporate Bond Offerings*

171. **From January 1, 2014 through March 31, 2015, there have been 7 successful offerings of corporate securities totaling $56 million**.

Table 10: Corporate Bond Offerings (2014-2015 YTD)

Date Completed	Issuer	Type	Amount of Offering	Term	Interest Rate
20-Mar-14	VTB Bank Georgia JSC	CS	$6,350,673[58]	--	---
22-Apr-14	M2 Real Estate	Bond	$5,000,000	1 years	9.50%
10-Jun-14	M2 Real Estate	Bond	$10,000,000	1 years	8.42%
26-Jun-14	TBC Kredit LLC	Bond	$2,500,000	2 years	9.00%
11-Oct -14	TBC Kredit LLC	Bond	$2,500,000	2 years	9.00%
22-Sep-14	Georgia Leasing LLC	Bond	$10,000,000	3 years	8.75%
15-Mar-15	M2 Real Estate	Bond	$20,000,000	2 years	9.50%

172. **These offerings carry several important messages**:

- All were public offerings. These were not transactions between institutional investors but the result of sales to retail investors.
- All but one offering were for corporate bonds, reinforcing the views of many of the professional participants that corporate bonds hold the best potential for further capital markets development
- All but one offering were in USD. This perhaps shows the relative preference of retail investors for foreign currency bonds versus GEL bonds.
- All were sponsored by the commercial banks. This demonstrates the potential for even what critics call a bank-centric system to generate positive corporate finance results.[59]
- The maturities were between 1-3 years. The ability to offer bonds greater than 1 year maturity is increasing.

One of the bonds offered, Georgian Leasing Company, was listed on the B List in October 2014 and has traded 1.477 million GEL to date ($786,517). Thus, as of 2015, Georgia has a growing, if still limited, experience with publicly offering securities and then having them traded on the GSE.

B. *IFI Bond Offerings*

173. **There has also been a recent increase in finance activities within Georgia by the IFIs**. During 2014 and early 2015, the ADB, EBRD and IFC issued bonds denominated in GEL.

Table 11: IFI Bond Offerings (2014 – 2015 YTD)

Issue Date	Issuer	Term (Months)	Interest Rate	Amount Sold (GEL)	Amount Sold (USD)
13-Mar-14	EBRD	24	3-month-GEL-CD-NBG	50,000,000	$28,798,526
13-Feb-15	EBRD	36	3-month-GEL-CD-NBG	25,000,000	$11,125,946
17-Feb-15	IFC	24	6.924%	30,000,000	$14,625,585
19-Feb-15	ADB	36	3-month-GEL-CD-NBG	100,000,000	$47,986,948

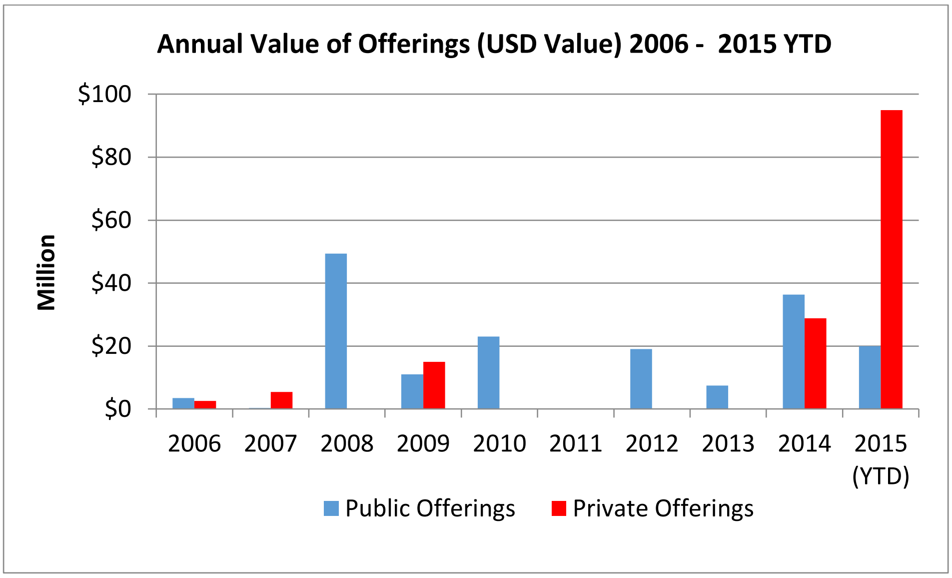
58 The VTB shares were offered for 11,000,000 GEL; this entry is converted into USD at that day's exchange rate.

59 Admittedly, the issuers of these bonds were affiliates of the banks that sponsored the underwritings.

174. **Each of the offerings was done via private placement and thus did not represent public retail offerings or result in admission or listing on the GSE**. Still several aspects of the offerings are encouraging: (1) the amounts sold are relatively high compared to parallel activity in Armenia[60], (2) the denomination of the bonds was in GEL, (3) the maturities are relatively long, and (4) the bonds carry a floating interest rate, an aspect not seen in the corporate bonds offered to date and thus a further "maturing" of the future possibilities in the debt world.

175. **The offerings by the private sector and the IFIs, taken together, are changing the trend**.

Figure 17: Total Offerings (2006 - 2015 YTD)



C. Involvement by Fitch Ratings.

176. **During March 2015, at the invitation of the GSE, representatives of Fitch Ratings' visited Tbilisi and held meetings with 15 of Georgia's leading large private companies**. The subject was the possible issuance of corporate bonds and Fitch's role within that activity in terms of rating corporate bonds.

177. **Recap descriptions from these meetings are that the companies were enthusiastic about the idea of issuing local bonds and that Fitch has made a very attractive offer**. They have agreed to lower their fee for assigning ratings for a certain time period, and further, to charge an even lower fee for the first few customers. While it would be inappropriate to quote actual figures, it is fair to say that the rates being discussed would hardly be an impediment to the issuer's decision mathematics.

60 Offerings in Armenia have been as follows:

Armenia IFI Offerings					
Issue Date	Issuer	Term (Months)	Interest Rate	Amount Sold (AMD)	Amount Sold (USD)
23-Dec-13	IFC	36	9.7	2,000,000,000	$4,939,491
31-Jan-14	EBRD	12	6-month-AMD-T-Bill-CBA	2,000,000,000	$4,890,095
30-Jan-15	EBRD	6	17%	2,000,000,000	$4,211,236
11-Feb-15	EBRD	6	14.50%	2,000,000,000	$4,177,109

None of the IFIs report bond offerings in Azerbaijan.

178. **Obviously, a rating by Fitch would lend credibility to an offering**. But it would also help solve two decisions facing the NBG (in its role as banking regulator) when banks are purchasers of the corporate bonds. First, should the corporate bonds be eligible as collateral in repo transactions for liquidity management purposes, and if so at what haircut? Second, what should the capital reserve requirement be for banks holding the bonds as assets?

179. **Answering these questions for unrated bonds will place the NBG is a position of a 'quasi-rater'**. True, the NBG's decision may not take the form of assigning a grade (AAA, AA, and so forth) but the decision on eligibility, haircut and reserve requirement necessarily requires analysis and assessment. Nor can the NBG's decision be kept private. Thus there is reputational risk for the NBG.[61] A rating by Fitch (or S&P or Moody's) will benefit the issuer, the commercial bank purchasers and the central bank.

D. Emergence of Private Equity Funds

180. **Another plus for the Georgian capital markets is the advent of several private equity funds**. These tend to divide between two tiers, both filling a significant need.

181. **In the upper tier is the State-owned Partnership Fund and the privately-held Co-Investment Fund**. Both of these funds have considerable assets under management ($1.4 billion and $1.6 billion respectively) and they are complementary to each other. The Partnership Fund focuses on early stage start-ups with current projects ranging from $10 to $688 million. The Co-Investment Fund invests a minimum of $5 million up to $3 billion. In addition, the Black Sea Trade and Development Bank has $601 million under management and has been investing in Georgia in the form of debt. Thus, these three funds can play a major role in both real sector and infrastructure funding.

182. **In the lower tier there are four private equity funds with $16 to $40 million under management.** These operations focus on SMEs and early growth stage companies. All have successful track records. Summary information for these funds is included at Annex 14.

Table 12: Private Equity Funds Operating in Georgia

Name	Assets under Management	Types of Investment	Stage of Investment
Georgian Co-Investment Fund	$1.6 billion	Equity (25% - 75%)	Greenfield and Brownfield and distressed companies
Partnership Fund	$1.4 billion	Equity to 50%; mezzanine debt	Early stage growth
Black Sea Trade & Development Bank	€ 601 million	Debt, Equity and Guarantees	Green field investments; modernization of technology; expansion of capacity.
SEAF Caucasus Growth Fund	$40 million	Equity and debt	Growth stage
SEAF Georgia Regional Development Fund	$15 million	Equity and debt	SMEs in early stage and mid-venture
JSC Liberty Consumer	$16 million	Equity	Not specified
Smartex	Not specified	Equity	Seed financing, Early-stage financing, Growth-stage financing

[61] There is also a potential conflict of interest. Many securities regulation regimes are regulating the securities ratings industry. With the NBG as the securities regulator it may find itself once again as market operator and market regulator.

183. **These funds are having a clear, positive benefit for the economy; a review of their portfolios reflects a large number of successful projects**. In addition it appears that even today the demand for private equity funding outstrips the supply. The Co-Invest Fund indicates they have declined 250 proposals since fund inception mainly because they were below the stated minimums. Thus, the niche of $2-5 million seems underserved.

184. **Perhaps more relevant to this Study, the existence of these funds represents latent demand for capital market services**. Although these funds have not reached the point in their portfolio lifecycle where they need to exit, that phase will be arriving in 2-3 years. At that point the funds could tap the market as a way to sell out their positions.[62] This latent demand appears to be $15-20 million in positions.[63]

185. **It is also hoped that the private equity fund operations are promoting the concept of the outside investor within the business culture**. To the extent that Georgian business views taking on investors from outside the core ownership group as a normal 'next stage' event, the possibility that they will tap the markets for capital increases.

E. GSE Reorganization

186. **As noted above, in September 2014, a majority of the GSE's shareholders determined to elect an entirely new Supervisory Board**. Shortly, thereafter GSE management was replaced with new personnel. New management has been assigned to devise a new business plan by June 2015.

187. **While there are certain issues that must be resolved to make this a positive development (please see Section VII.F.), the current situation represents a chance to decide on a positive, proactive future for the exchange**. To a certain degree, the majority shareholder group, having decided to take this action, now has a moral obligation to 'make good'. The recommendations contained in this Study require a capable, strong exchange as part of the capital market system in order to succeed.

F. EU-Georgia Association Agreement

188. **In November 2013, in a historic undertaking, Georgia and the European Union initialed the EU-Georgia Association Agreement**. As part of this agreement, Georgia agreed to approximate its securities legislation with 22 EU Directives over a 5-7 year period (see Annex XV-A of the Agreement).[64] On its face, then, the Association Agreement would seem to provide the direction and

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[62] In the recent past where the funds wished to exit, the investee company has repurchased the shares or repaid the mezzanine debt, either from the company's own funds or from bank borrowings. There have been roughly 10 such cases since 2010.

This however either reduces capital or substitutes debt for debt. It would be much more preferable for the investee company if the fund sold its position to other investors (perhaps through the market) rather than having to deplete its own capital.

[63] On another note, it is unfortunate that the Georgia Regional Development Fund must close by April 2016. Under the terms set out by the founder Millennium Challenge, the fund shall be liquidated and the proceeds transferred to the Ministry of Finance for the State Budget. With a little imagination by MoF, GRDF's portfolio could be sold today to a fund manager with two positive results: (1) the MoF would still receive its funds and (2) the existing portfolio could stay in business with the chance to grow. Taking this action, however, would require prompt action by the MoF as GRDF now stands at $15 million in assets, and declining.

[64] A listing of the subject Directives and Regulations as they relate to the capital markets is attached as Appendix 11.

timing of regulatory changes relating to this securities market. Out of all of the international guidelines and models, the EU Directives are now the most compelling.

189. **Fortunately, as noted, the Association Agreement does not require transposition of these Directives in whole immediately**. Georgia has some 'breathing room' which is much needed. The EU model has been created for highly developed and deep securities markets. The regulation regime is far too complex for the Georgian *status quo*. By initialing the Association Agreement, Georgia has *de facto* given itself 5 years to have this securities market advanced to a stage where it can support the application of the EU Directives.

190. **But the overall message is that Georgia has a requirement to review its entire legal framework as it impacts the capital market**. This provides a holistic opportunity to construct a sound plan for revisions and improvements, fixing along the way the deficiencies identified above.

G. NBG's Proposal for Post-Trade Services for Corporate Securities

191. **In an effort to create a more unified infrastructure for trading in financial instruments, the NBG has proposed that the GSCD become a member of the SSS, so that corporate securities and government securities clear and settle within one system**. It remains unclear how the cash leg will be handled, whether: (1) GSCD will use a settlement bank(s), or (2) monies will be settled using the payment system.[65]

192. **It is also unclear what type of records transparency will exist between the CSD and the GSCD**. If the NBG requires a 1 level system then this means the NBG will be able to look into the accounts of the GSCD's members. For the NBG "wearing its regulator hat" this is beneficial and reduces regulatory risk. Records held at the NBG could be used to recreate records if the GSCD and/or one of its member firms fails. For the NBG "wearing its market operator hat" this is undesirable. It is not industry practice for a depository / registry to be able to look through its nominee holders to know the beneficial holder. Thus this question needs attention.

193. **These remaining issues aside, the NBG has offered to provide these services without charge to the GSCD or its members**. It also has stated it will work towards having the CSD become a financially viable entity and to share the ownership with the private sector up to 50% within that same period. The NBG's keeping the remaining 50% is reasonable given that the system handles treasuries and the NBG is the fiscal agent and also given the system handles NBG's CDs.

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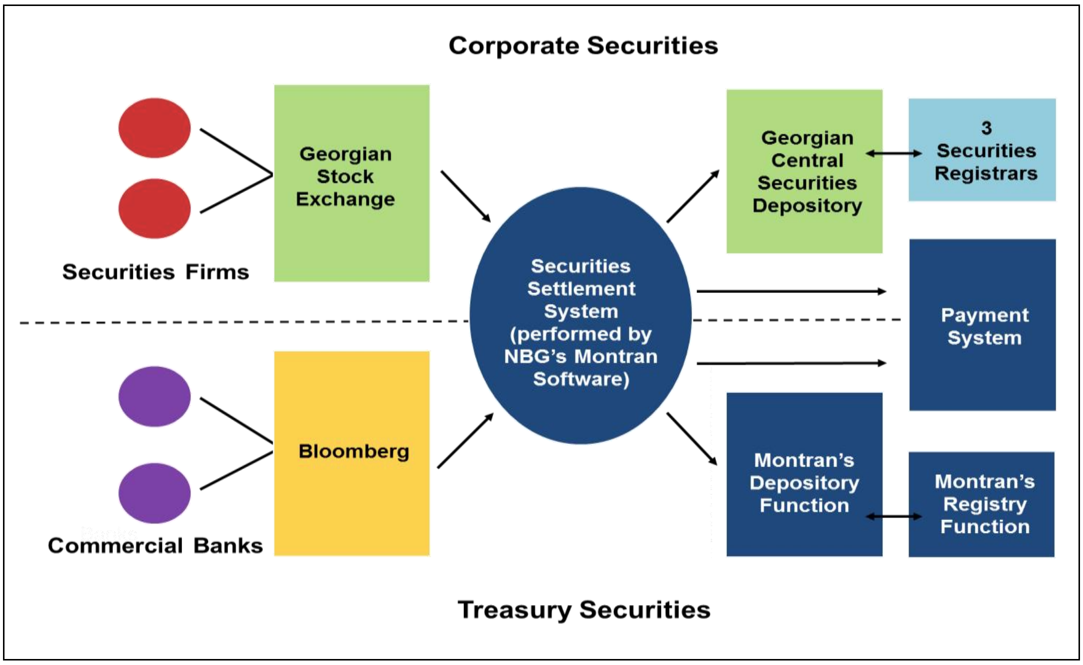
[65] This latter approach where the settlement agent transfers monies using the payment system among accounts held at the central bank is known as using "central bank monies" and is the current best practice trend.

Figure 18: NBG Proposed Post-Trade Arrangement



194. ***If* the GSCD is allowed to become a member of the payment systems and *if* the GSCD is allowed to maintain a nominee account directly with the central bank for monies, this arrangement would present several significant improvements for the GSCD and its members**. First, GSCD members could abandon the use of settlement banks and therefore cut costs. Second, use of central bank monies for the cash leg is more efficient and less prone to errors. Third, it means reduced costs for members given that the NBG will not charge for this service for a minimum of 5 years. Fourth, it opens the door to direct trading in treasury securities by GSE members, both bank affiliated and non-bank affiliated; thus it would help level the playing field for the treasuries secondary market. Fifth, it creates an environment where the two operations could be merged into one entity.

195. **At the same time the arrangement could have two drawbacks for the GSE / GSCD complex**. First, it means a loss of the revenue currently obtained for the clearing and settlement service. Second, it opens the door for OTC trading of corporate securities, and a loss of market share for the GSE.[66]

196. **As discussed in Section VII.F., below, the NBG and GSE need to come to a resolution on this proposal**. Given the many other issues under consideration and the fact that other interrelated decisions will be made in the coming months, this question cannot be postponed, at the risk of becoming moot or otherwise overtaken by events.[67]

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[66] It is hard to hold out this last point as a "deal-breaker" for the idea, given the make-up of current trading in corporate securities in Georgia. Even if the trading moved to OTC via Bloomberg these trades still need to be reported under the current regime, and the GSE charges a fee for that.

[67] There are two other related issues in this regard. First, if the NBG's system becomes involved in clearing and settlement, does it become a regulated entity? Second, in this case does the NBG's proposal violate LSM Article 1(8)?

H. Enhanced Linkages to International Infrastructure

197. **The NBG is in negotiations to establish a link to Clearstream.**[68] This will enable foreign investors to settle transactions in Georgian securities and hold them through an internationally recognized depository. There are two aspects to this (1) the "cash leg", which enables transfers of monies, and (2) the "securities leg" which enables the transfer of securities.

VII. LOOKING FORWARD

A. Possible Issuers of Securities

The question of generating more 'content' for the capital markets is the most pressing question facing the reformers.[69] Most of the identified challenges to the development of the Georgian capital markets are within the power of either the State or the private sector to fix. The question of who will want to access the capital market mechanism as an issuer cannot be dictated. Thus, it is highly important to understand which types of companies may wish to enter this system and in what roles, as purchaser or issuer.

<u>Commercial Banks</u>

198. **In order to estimate the roles of Georgia's commercial banks in the capital markets the Working Group reviewed the 2013 audited financial statements of 21 commercial banks**. The full results are attached as Annex 15.

199. **The Banks as Issuers?** The main business drivers for the banks issuing securities are:

a) to generate liquidity;
b) protect against deposit flight risk;
c) fix asset – liability mismatches;
d) refinance assets;
e) leverage the balance sheet
f) replace bank borrowings;
g) deleverage the balance sheet

200. **Do the Banks Face Overall Liquidity Constraints?** Liquidity was measured using the "lending to available funds" ratio. For this, two parameters were used: (1) a "narrow" scope, which includes lending to customers compared to available funds, and (2) a "broad" scope which includes lending to both customers and banks compared to available funds. In general, the Study considered a banks with lending to available funds greater than 80% as approaching liquidity constraints.

201. **Using this metric, there are 12 banks within the liquidity constraint range**. They need additional funds of GEL 559 million ($322 million) to reset their liquidity to 80%. Since their D/E ratios are not high, these banks can either issue debt or equity securities (common or preferred shares).

202. **Do the Banks Need to Protect Against Deposit Flight Risk?** Issuing bonds helps build a "floor" of source funds that cannot be extracted from the bank on demand, thus building in a

[68] Clearstream is a leading European supplier of post-trading services. It provides monies and cash transfers as part of cross border clearance and settlement. It can also act as a depository and/or custodian. It has linkages with over 110 countries and 54 European markets and settles more than 250,000 transactions daily.

[69] The content question can be stated differently: how do we bring more attractive investment securities to be offered to investors and subsequently traded?

component of permanent-source financing. This is a technique to protect against deposit flight as a result of a shock to a particular bank or the system overall. In order to determine if the banks need to follow this strategy we examined the make-up of the deposit base.

203. **The data indicate that there are 7 banks with demand deposits in excess of 50% of the total base.** The amount of debt securities needed to bring the demand deposit component to 50% of total base is GEL 341 million ($196 million).[70]

204. **Do the Banks Need to Fix Asset-Liability Mismatches?** Issuing corporate bonds allows the bank to match the time period of the source funds exactly to the time period of the loans extended. The amount (interest rate) to be earned on the loan is fixed and known. Similarly, the amount of interest to be paid on the bonds is also fixed and known. But the price for this "insurance" (the amount of interest to be paid on the bonds) is usually higher than the costs of deposits. Thus, issuing bonds addresses the classic asset-liability mismatch faced by banks, but at a cost.

205. **While it is not feasible to attach here the asset-liability matching tables for each individual bank, the following is the net position for each bank for the maturities greater than 1 year**.

Table 13: Net Asset Liability Position for > 1 Year

Bank Code	Net Positions	
	> 1 Year (GEL)	> 1 Year (USD)
8	226,631,000	$130,525,255
17	166,251,000	$95,750,158
2	114,501,000	$65,945,401
1	100,215,000	$57,717,560
14	61,619,000	$35,488,683
13	55,790,000	$32,131,544
5	33,178,000	$19,108,449
15	14,972,000	$8,622,934
6	9,397,000	$5,412,083
7	6,956,000	$4,006,220
4	5,456,626	$3,142,675
12	2,308,000	$1,329,263
10	2,270,950	$1,307,925
20	1,248,854	$719,262
9	(8,673,000)	($4,995,105)
18	(15,042,000)	($8,663,249)
11	(22,792,000)	($13,126,764)
19	(29,555,671)	($17,022,214)
16	(73,262,000)	($42,194,321)
21	(202,489,000)	($116,620,976)
3	(1,340,531,000)	($772,061,856)

206. **Thus, the data indicate that several banks have a need to better match their assets to liabilities possibly by issuing bonds with maturities that match the longer end asset classes**. Full

70 The 50% demand deposit level is used for illustration purposes only. In addition, the definition of 'time deposit' is any deposit greater than 1 month. The data is taken from the notes to the financials statements of each bank (on liquidity risk) which provides greater differentiation of time periods.

optimization would require GEL 800 million ($461 million). However it should be noted that these bonds would carry a higher cost than shorter maturity borrowings and thus the business decisions on using bonds to match durations must take this into account.

207. **Do the Banks Need to Refinance their Assets?** Banks usually issue covered bonds when they have reached their liquidity limits but not their leverage limits. Further, banks use securitization when they have reached both their liquidity and leverage limits.

208. **The data indicate that there are 5 banks where mortgage loans constitute 20% or more of their total lending to customers.** The amount of refinancing that would be needed to bring this percentage to 15% (a notional threshold only) is GEL 127 million. Thus, while the total amount of needed refinancing is not a precise sum, it does provide a sense of the scale of possible financing through the securities markets.

Table 14: Summary of the Banks' Need to Issue Securities

Business Goal of Issuance	Number of Banks Needing Access	Amount Required (GEL million)	Amount Required (USD million)
Generate Needed Liquidity	12	559	$322
Reduce Demand Deposits to 50% of Overall Base	7	341	$196
Reduce Net Asset-Liability Mismatches	14	800	$461
Refinance Portfolio	5	127	$73
Line Item Totals[71]		**1,827**	**$1,052**

209. **The Banks as Purchasers?** In order to gauge the banks' appetite for liquidity-driven purchases it is necessary to explore whether in fact the banks have excess cash on hand. Low levels of lending to available funds tend to correlate to the need to invest the excess liquidity.

210. **The data indicate that there are 9 banks with a lending to available funds ratio less than 80%.** Excess available funds for these 9 banks are GEL 1.88 billion, which is comprised of GEL 1.76 billion in cash and balances with the NBG. Weighted average portfolio yield for these 9 banks is high, but banks have lower levels of lending to available funds, which imply that banks either cannot or do not wish to lend more to their customers. Therefore, the banks should have a degree of interest in suitable investments, with a large portion of it in making long term investment driven purchases, given that the weighted cost of funds for these 9 banks is low and comprises to 5.97%.

211. **The data also indicate that there are 12 banks with a lending to available funds ratio more than 80%.** However**,** these still have excess available funds in the amount of GEL 861 million, which comprises of GEL 777 million in cash and balances with the NBG. These funds can be used for liquidity rather than investment driven purchases for short term money market instruments.

71 Because some transactions serve more than one business goal the cumulative total needed may be less than the line item totals.

Table 15: Summary of the Banks' Need to Purchase Securities

Liquidity Category	Number of Banks Needing Access	Excess Available Funds (GEL million)	Cash and Balances at NBG (non-reserved) (GEL million)
Highly Liquid Banks (LAF <80%)	9	1,880	1,760
Liquid Banks (LAF >80%)	12	861	777
Line Item Totals		**2,741**	**2,537**

212. **In Summary**:

a) There are 4 categories of business drivers applicable in Georgia that would appear to guide banks towards being issuers of securities.

b) Out of 21 banks analyzed 20 banks have a need to issue securities in at least one of the categories of business drivers.

c) The cumulative amount of securities that could be issued to satisfy these business needs is as much as GEL 1.8 billion, or over USD 1 billion. By any measure this is a significant sum for a capital market system.

d) At the same time, Georgian banks have excess funds of GEL 2.7 billion that could be used to purchase securities. This could be used for corporate bonds.[72]

e) The implied interest by these banks in investments is should be high given that they are not able or willing lend more and may be looking for other outlets for their attracted funds, especially when their cost of funds are low.

<u>Georgia's State-Owned Enterprises</u>

213. **As part of this Study, the Working Group compiled an inventory of the State-owned enterprises, together with summary financial data**. This was in an effort to understand whether the companies have the need and potential to issue either shares or corporate bonds within the Georgian capital markets. The full inventory is attached as Annexes 16 (GEL) and 17 (US$).

214. **There are 89 active SoEs**. 12 have revenues greater than $5 million.

72 As noted above, the NBG can provide specificity and guidance in 3 distinct ways as banks consider purchasing corporate bonds. First, the NBG should set the eligibility criteria for corporate bonds to be used as collateral in repo transactions (along with stated required haircuts) according to the bond's rating. Second, the NBG should determine the capital reserve requirements for bonds, again according to their ratings. Third, the NBG should establish criteria for these same two questions for unrated corporate bonds.

Table 16: State-Owned Enterprise Candidates for Securities Issuances (2013)

	Company Name	Revenues (USD)	Net Income (USD)	Shareholders' Equity (USD)	Return on Equity	Profit Margin
1	Georgian Railway JSC	$285,260,612	$37,568,393	$903,718,827	4.16%	13.17%
2	Georgian Oil and Gas Corporation JSC	$187,617,923	$54,306,859	$327,663,998	16.57%	28.95%
3	Telasi JSC	$150,753,326	($21,818,234)	$49,915,913	-43.71%	-14.47%
4	Electricity System Commercial Operator JSC	$67,300,663	$539,369	$3,255,677	16.57%	0.80%
5	TBILAVIAMSHENI LLC	$47,595,658	$6,338,030	$56,202,676	11.28%	13.32%
6	Georgian State Electrosystem JSC	$43,433,162	($36,304,210)	$126,594,483	-28.68%	-83.59%
7	SAKAERONAVIGATSIA LLC	$31,946,495	$8,320,880	$53,745,896	15.48%	26.05%
8	United Water Supply Company of Georgia LLC	$27,108,219	($6,859,414)	$169,931,463	-4.04%	-25.30%
9	State Construction Company LLC	$14,580,740	($2,545,303)	$23,731,343	-10.73%	-17.46%
10	Georgian Airports Union LLC	$8,827,609	($581,811)	$96,062,316	-0.61%	-6.59%
11	Nikoloz Kipshidze Central University Clinic LLC	$8,296,417	$309,781	$10,370,061	2.99%	3.73%
12	Center for Mental Health and Addiction Prevention LLC	$5,174,165	$73,920	$5,366,152	1.38%	1.43%

215. **As can be seen, this is a "mixed bag" of results.** While some of the companies are quite large, they are either operating at a significant loss or are national interest companies that likely cannot be sold. That said, the top two companies - Georgian Railway and Georgian Oil & Gas - are household names. If the government chose to sell a minority position in these companies into the Georgian capital market system a strong interest might be expected.

216. **Does selling 20% of Georgian Railway or Georgian Oil and Gas make sense as a business proposition for the Government?** This of course depends on the expected sales price versus the reduction in the future dividend stream.[73] The 'plus' to the GoG – the amount of monies it would receive from the sale - is one variable. The 'negative' to the GoG, the present value of the reduction in dividends depends on the discount rate applied. This is the second variable.

217. **If the 20% stake was sold at "book value" – the value of 20% of shareholders' equity – the proceeds could be substantial**. 20% of Georgian Railway would equal $180 million. 20% of GOGC would be $65 million. The problem is, at least in the case of Railway, low profit margins and return on equity. Book value may not be the proper metric.

218. **Valuing Railway and GOGC with a view to their earnings streams may be more appropriate**. Under this method the sales proceeds would be geared to a multiple of the earnings stream. The net realized gain would be the sales proceeds minus the present value of the amount of dividends that will be foregone over the next 20 years.

[73] It should be noted that the GoG uses the dividend stream from these two SOEs to fund the Partnership Fund's private equity projects.

Table 17: Net Sales Proceeds from Selling 20% Stake: Georgian Railway (US$ million)

			Present Value of Foregone Dividends @ x discount rate (US$ million)						
			13	12	11	10	9	8	7
			$22.03	$23.43	$24.97	$26.70	$28.63	$30.79	$33.23
P/E Ratio	Value of 20% Stake		Net Realized Gain in US$ million						
10	$75.14	Net Realized Gain in US$ million	$53.11	$51.71	$50.16	$48.44	$46.51	$44.35	$41.91
9	$67.62		$45.59	$44.20	$42.65	$40.92	$38.99	$36.83	$34.40
8	$60.11		$38.08	$36.68	$35.13	$33.41	$31.48	$29.32	$26.88
7	$52.60		$30.56	$29.17	$27.62	$25.90	$23.97	$21.80	$19.37
6	$45.08		$23.05	$21.66	$20.11	$18.38	$16.45	$14.29	$11.86

Table 18: Net Sales Proceeds from Selling 20% Stake: Georgian Oil & Gas (US$ million)

			Present Value of Foregone Dividends @ x discount rate (US$ million)						
			13	12	11	10	9	8	7
			$11.74	$12.49	$13.31	$14.23	$15.26	$16.41	$17.71
P/E Ratio	Value of 20% Stake		Net Realized Gain in US$ million						
10	$108.61	Net Realized Gain in US$ million	$96.87	$96.13	$95.30	$94.38	$93.35	$92.20	$90.90
9	$97.75		$86.01	$85.26	$84.44	$83.52	$82.49	$81.34	$80.04
8	$86.89		$75.15	$74.40	$73.58	$72.66	$71.63	$70.48	$69.18
7	$76.03		$64.29	$63.54	$62.72	$61.80	$60.77	$59.62	$58.32
6	$65.17		$53.42	$52.68	$51.86	$50.94	$49.91	$48.75	$47.46

219. **In order to take this analysis down to the next level, it is necessary to understand the GoG's strategy on how it sees Georgian Railway and GOGC developing**. Are there significant growth and productivity gains that can be achieved near-term? If so, this would militate towards waiting to achieve these gains and then selling a partial stake. On the other hand, how could Partnership Fund invest a gain of $33 million (notionally in the case of Railway) or $72 million (notionally in the case of GOGC) into its private equity operation today? As noted in Section VI.D., the Co-Invest Fund has turned away 250 proposals, many because they are simply below $5 million. Could not $50 million in fresh funds injected into Partnership Fund be put to good use? What would be the near term impact on jobs creation and export development?

<u>Insurance Companies</u>

220. **As in the case of the commercial banks, insurance companies should be analyzed as both potential buyers and potential issuers of securities**. The summary financial results for the insurance industry are included as Annex 18.

221. **Possible Buyers?** By their nature, insurance companies take in monies today, for contingent liabilities to be paid tomorrow. Between the pay-in and pay-out dates these monies must be invested. The business drivers for insurance companies acting as purchasers arises in two scenarios. First, in the case of life insurance activities, the pay-in and pay-out dates span years. This creates a pool of

"patient money" that should be invested in medium to long-term assets.[74] Second, even casualty insurers generate pools of monies that need investing.

222. **Unfortunately for Georgia there is no meaningful life insurance industry.** This means that a potential source of demand for investment securities is absent from the system. Private pension systems are growing; some estimates put the value under management at $17 million. Thus these two sources of purchase monies mat not be material today but bear watching. A review of the financial results for the industry casts doubt on the idea that the casualty insurers are generating profits that need investing. Please see Table 19.

223. **Possible Issuers?** The question then turns to whether the insurance companies need to issue securities. Again the data is instructive; please see Table 19. It is clear that with the exception of one firm (perhaps two), the insurance industry is thinly capitalized and in need of broadening its financial base. The question then becomes whether the insurance companies needing to raise funds have the profitability and performance metrics to come to the capital market successfully. This is both a question of the financial position of these companies and a question of their business plans and model. Thus it cannot be answered wholesale; but it would seem unlikely in the Georgian setting to sell shares in a loss-making enterprise.

Table 19: Insurance Industry Financial Data (YE 2013)

#	Company Name	Revenues (USD)	Net Income (USD)	Shareholders' Equity (USD)
1	JSC Aldagi	$117,233,773	$13,747,624	$68,098,255
2	JSC GPI Holding	$45,238,150	$3,664,113	$16,307,666
3	IC Group LLC	$28,819,328	($224,616)	$1,311,409
4	LTD Irao	$25,622,300	($882,336)	$2,901,572
5	LTD Alpha	$14,319,888	($779,084)	$2,847,491
6	LTD PSP	$8,564,028	($32,583)	$3,267,197
7	LTD Ardi	$7,811,252	$116,910	$1,540,366
8	LTD Cartu Insurance	$6,835,831	($1,069,688)	$1,489,483
9	LTD Tao	$4,152,511	($48,640)	$2,062,458
10	LTD Unison	$2,687,314	$62,036	$1,503,767
11	JSC Standard Insurance Georgia	$2,499,042	($10,558)	$1,127,210

224. **What appears clear is that there are one or two insurance companies that have the performance metrics to be able to issue securities to broaden their financial base**. It is also clear that neither of the two are limited between debt and equity. Both have debt to equity ratios below 2, although, it may be more advisable to issue equity securities (common or preferred shares) for regulatory ratio purposes.

[74] In this regard, life insurance companies have the same investment profile as pension funds.

Table 20: Performance Metrics for Select Insurance Companies (YE 2013)

#	Company Name	Profit Margin	Return on Assets	Return on Equity	Debt to Equity Ratio
1	JSC Aldagi	11.73%	6.93%	20.19%	1.91
2	JSC GPI Holding	8.10%	7.57%	22.47%	1.97

<u>MicroFinance Organizations</u>

225. **There are 70 microfinance organizations registered in Georgia**. A summary look at the industry by assets would seem to indicate that 5 MFOs have the requisite size to be a realistic issuer.[75]

Table 21: MFO by Assets (YE 2013)

	Microfinance Organization (in a descending order)	Total Assets Range (GEL)	Cumulative Total Assets within the Range (GEL)
1	MFO "Credo "	>20M	540,049,257
2	MFO "Rico Express "		
3	MFO "Cristal"		
4	MFO "Lazika Capital"		
5	MFO "Intel Express Georgia"		
6	MFO "Credit Plus Georgia"	10M-20M	123,677,301
7	MFO "B.I.G"		
8	MFO "Creditservice+ "		
9	MFO "Swiss Capital"		
10	MFO "Georgian Credit"		
11	MFO "Easy Credit Georgia"		
12	MFO "Microcredit"		

226. **The MFO Law speaks specifically as to how MFOs can raise debt funds**. First, MFOs may not accept deposits.[76] Presumably, the main risk is deposit flight, which coupled with the small size these institutions, make this a danger. But raising monies through loans (credits) is allowed.[77] And issuing corporate bonds is separately and specifically authorized.[78] Presumably, raising capital through equity offerings is governed by the LoE and LSM.

227. **But given the nature of the MFO business a few limitations may be in order**. It would seem unwise to allow MFOs to sell their securities to their borrowers. First, given the nature of the MFOs' clientele, there is a question of the ability to understand the investment risk. Second, selling securities to the borrowers raises the prospect of "tying". This is an abusive practice engaged in by lenders who make obtaining loans conditional on buying the lender's securities. Investment risk aside, this practice multiplies the effective interest significantly.

228. **During the interviews some persons suggested imposing an even wider limitation**. On the theory that a MFO's securities are not suited for any retail investor the suggestion is to require a

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75 Summary financial results for these 12 MFOs are attached in Annex 19.

76 MFO Law Article 4(3).

77 MFO Law Article 4(1)(f)

78 MFO Law Article 4(1)(h)

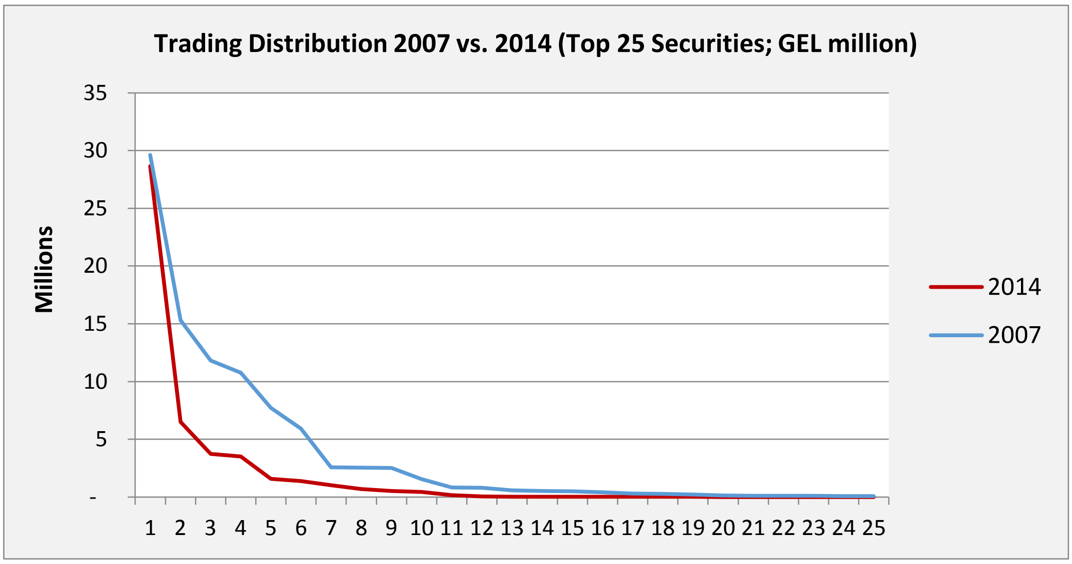
high minimum unit value (*e.g.*, 10,000 GEL) so that effectively only institutional investors could buy the securities.[79]

229. **These concerns were amplified during the research for this Study**. Despite a requirement to publish their annual financial statements we found a number of the largest MFOs opaque. Some had no website; some refused to send their financial data, despite official request letters. In general the impression was of an industry that did not practice the habit of transparency essential to offering securities publicly and thereafter consistently making the required disclosure reports.

230. **That said, during the interviews the MFOs indicated an active interest in selling corporate bonds as a way of raising funds but also their profiles with the public**. Thus, there seems to be a disconnect between the desire to raise funds from selling securities publicly and an understanding of the need for transparency.

Current Reporting Companies

231. **The financial statements of the admitted companies indicate that this group cannot be viewed as strong potential candidates for the capital markets**. Of the 125 non-financial companies on this list, only 1 has shareholders' equity greater than $10 million and net income greater than $3 million (Sarajsihvili: ENIS). An analysis of the trading patterns for the top 25 securities confirms that investor interest is shrinking for the smaller companies. Since 2007 the trading distribution has 'sat down'; investors are focused only on the larger companies.



232. **This is a category where the policy-makers should be looking for ways to excuse these companies from the capital market**.

79 The NBG has already addressed the question of how MFOs that raise significant funds from the public should be treated for prudential purposes. It has established the concept of Qualified Credit Institution which is any lending organization (other than a bank) that has raised funds from more than more than 400 individuals or has attracted funds from individuals exceeding GEL 5 million (US$ 2.68 million). These requirements are in addition to any disclosure rules applicable to reporting companies under the LSM. There is currently one institution, Rico Credit, registered in this category.

Conclusions and Analysis

- There are 4 categories of business drivers applicable in Georgia that would appear to guide banks towards being issuers of securities. The total amount of possible funds is GEL 1.8 billion, or over USD 1 billion.
- At the same time, Georgian banks have excess funds of GEL 2.7 billion that could be used to purchase securities (most likely bonds).
- There are at least two SoEs that would be attractive candidates for issuing securities. A sale of a 20% stake might be expected to yield net proceeds of $33 and $72 million.
- There are one or two insurance companies that might wish to issue securities in this market in order to broaden their financial base. They seem to have a choice between equity or debt securities. The life insurance segment, and the operators of private pension schemes, should be watched as potential purchasers.
- There are perhaps 5 MFOs that have the requisite size to be an effective issuer of securities. These should be allowed to come to market; the NBG, in its roles as the MFO regulator and the securities regulator, should decide on any limitations to be imposed.
- The current admitted companies do not present any significant development opportunities for the capital market.
- The ability of the large, privately owned companies to come to the market cannot be quantified definitively as their financial statements are not public, but the anecdotal evidence is that there is demonstrated interest.

B. Improving the Legal Framework

233. **It is clear that over the coming years the principal driver for revising Georgia's capital markets legal framework is the need to harmonize the legislation with the EU approaches**. As noted above, the deadlines for achieving this range between 2018 and 2020 for each of the 22 relevant Directives and Regulations.[80]

234. **At the same time, as part of the conditionalities under the 2014 ADB Policy Based Loan, Georgia has committed itself to introduce a package of legislation by December 2016 to implement the strategy arising from this Study**. This then provides a closer deadline for devising amendments to the capital markets legal regime.

235. **The question becomes what should Georgia attempt to achieve and under what timeframes?** It is both impossible and inadvisable to create all of the approximating amendments into the package to be introduced by December 2016. The legal work required for the EU approximation effort will be very substantial.[81] Also, as noted above, the EU regime is simply too heavy to be applied to the Georgian market as it exists today. Even it were possible to achieve approximation by December 2016 doing so would likely suffocate the current activity.

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[80] Two interrelated items within the Banking section have deadlines of 2017.

[81] It should be noted that since the signing of the Association Agreement some of the stated Directives and Regulations have been repealed and replaced, and some new relevant items enacted. An itemization of these changes is set out in Annex 10. Thus, some of Georgia's stated obligations have been overcome by events. In this regard it will be necessary to determine exactly what Georgia's approximation obligations are.

Approach the EU Approximation Process in a Phased Manner

236. **Given this, the Working Group recommends that the amendments to the capital markets laws be undertaken in two phases**. The first phase, to be introduced by December 2016, would contain (1) all of the law amendments needed to implement the roadmap that will arise out of this Study, and (2) as much of the approximation as can be achieved prudently by that time. The second phase of amendments, to be introduced by 2018 would contain the remaining approximation work. This phased approach will achieve what can be reasonably done under all of Georgia's obligations, yet impose the new regime in a manner that supports the health and growth of the capital market.

237. **Given that the goal of the Working Group is to complete the public / private consultation and to have an agreed roadmap by July 31st, this means the implementation work can begin September 2015**. This then means 5 calendar quarters of time before the package must be submitted. In light of this the Working Group has already conducted a high-level comparison of the applicable EU Directives and Regulations and the current Georgia laws. There is much work to be done.

Conduct a Review of Compliance with IOSCO and CPSS-10 Principles

238. **The legislative process would benefit from a comprehensive review of its compliance with two sets of highly relevant international standards**.

- The last Report on Observance of Standards and Codes relating to IOSCO's Objectives and Principles of Securities Regulation was conducted in 2006.
- There has been no assessment conducted concerning compliance with the CPSS-10 Principles for Financial Market Infrastructures adopted in April 2012.[82]

239. **However, given the uncertainty of where the securities regulator will be housed (see immediately below), this may not be practical**. If the securities regulation function remains within the NBG, then assessing the current regulatory practices becomes desirable. Assessments and recommendations can be formed with the understanding that they will apply on a going-forward basis and should be incorporated, as needed into the legislative amendments. If, however, the securities regulation function comes out of the NBG then an assessment and recommendations become less meaningful.

Decide on the Location of the Securities Regulator

240. **During the last year there have been discussions among the Government and NBG on whether the securities function will remain within NBG or moved outside to some new entity**. There are several drivers at work that compel the Government and the NBG to come to a decision very soon:

1) Article 10^1 of the LIF appointing the NBG as the supervising authority expires 1 June 2015. This Article needs to be made permanent or a new regulator appointed.
2) It is still undetermined under the LAFA where the monitoring unit designed to replace the former Council on Audit Activity will be housed.

[82] Over the last decade there have been a number of reviews and reports concerning Georgia's capital market. These are listed in Annex 4. None of them contains a detailed assessment as required by IOSCO or CPSS-10.

3) As discussed prior, the supervisory authority over the Law on Entrepreneurs should be consolidated and strengthened.
4) A reformed pension system is under consideration for Georgia. Part of the regulation required for the new scheme will be overseeing pension fund managers.
5) As the NBG takes on certain functions with the corporate securities market (supplying clearance and settlement services for the GSCD) it becomes a "market operator" while at the same time serving as the market regulator.[83]

241. **The central questions in this regard are where should the securities regulator be housed, and in what configuration?** There are several models to choose from; Georgia has tried most of them over the last 15 years. But what is the correct choice for this financial system today, and for looking forward?

242. **There are strong arguments for keeping the function within the NBG**. It has significant financial resources. It is also the bank regulator. Keeping the NBFI regulation function within the NBG would recognize the interrelated nature and operations of the financial markets and allow for a parallel approach of comprehensive, integrated regulation. It would also encourage bank participation in the capital markets.

243. **Advocates for a separate regulator argue that the NBG is either too focused on the banks, or not focused enough on the securities market**. They cite a bank-centric attitude for development of the financial system. They also cite the NBG's conflict of interest if it provides post-trade services for corporate securities.

244. **If indeed the securities regulatory function is taken out of the NBG it should be placed in a consolidated NBFI regulator, together with jurisdiction over insurance, auditing, pensions, the company law and the investment fund law**. A series of small, poorly funded commissions each assigned their small jurisdictions, challenged by capacity development and unable to act in an integrated manner should be avoided.

245. **Making this decision is also necessary to implement the capital markets development roadmap that will result from this report**. It makes little sense conduct this effort without having the involvement of the regulator.

Make the Securities Regulator Also the Enforcer of the Law on Entrepreneurs

246. **As part of repairing the gaps in the issuer transparency area, the LoE should be amended to make the securities regulator also the enforcer of the company law, as it relates to JSCs and shareholder rights**. In the current configuration this would be assigned to the NBG. If a separate securities regulator is established the corporations regulator function would travel with the securities regulator function.

Place the LAFA Monitoring Unit in the Securities Regulator

247. **The monitoring unit designed to replace the Parliament's Council on Audit Activity should be placed within the securities regulation function**. This will provide more seamless oversight of the financial reporting process by the reporting companies and the licensed entities.

[83] This conflict of interest, by itself, does not require the regulatory function to come out of the NBG. Securities regulators in the region engage in 'market operator / regulated functions' far more extensive than the minor role under consideration for the NBG. Still, if it is decided to keep the regulatory function inside the NBG certain firewalls should be created.

<u>Update the LIF to Designate the Regulator after June 2015</u>

248. **There must be regulatory body appointed to implement the LIF**. Without this, no investment funds can be registered and no enforcement for unlicensed fund activity is possible.

C. Harmonizing the Tax Policy

249. **The idea behind the suggestions below is to create a 'level playing field' between investment alternatives: treasury securities, bank deposits and corporate securities**. By creating a 'tax neutral' stance among investment alternatives, the State allows each to compete on equal footing for capital.

<u>Eliminate the Tax on Offerings</u>

250. **A discussed above, the "registration fee" imposed on securities offerings is not designed or used to defray the administrative costs of processing prospectus registrations**. It is a tax, with the funds sent to the State budget. Georgia does not tax any other entity for seeking to raise capital; it should abolish this one case. Based on 2014 data (with the highest amount of public offerings in years) the lost revenues from eliminating the fee on offerings would have been $36,350. This tax is meaningless; the message it sends the market is wrong.

<u>Revise and Implement the Exemption for Dividends / Interest for Listed Securities</u>

251. **In order to align the concept of tradable corporate security to the tradable treasuries, the definition of "freely negotiable" should be adjusted**. In theory there are several ways to denote this: (1) securities from all reporting companies (OTC tradable); (2) the securities tradable on the admitted tier, and (3) securities that are listed. Again, these are the numbers of companies in each category:

Table 22: Companies by Trading Category

Trading Category	# in Group
Reporting Companies (OTC tradable)	258
Admitted Companies	128
Listed Companies	4

252. **While it is true that the total number of "freely negotiable securities" derives from the 258 reporting companies, setting the boundaries this broadly may not be appropriate**. First of all, only 52 make public disclosures necessary to protect investors. Secondly, if in fact part of the policy decision is to push trading onto the organized and transparent market then including the OTC market would be counterproductive. Thus the decision could be to define the eligible securities as being those that are admitted or listed to trade on the GSE. The free-float requirement would remain.

253. In this way, and if the recommendation to revise the admitted / listed concepts is accepted, then the set of securities eligible for the tax exemption would be: (1) admitted or listed to trade, (2) with 25% or more free-float, and (3) current on all required disclosure reports. Investor protection is preserved and trading is encouraged onto the organized market.[84]

254. **The MoF's Instruction No 75 should be reviewed, modified and reissued**.

[84] Under the suggested approach to admitting and listing securities for trading, the GSE would have the obligation to delist (or remove from the admitted tier) any company in violation of the periodic reporting requirements. In the event of a company's failure to file, the GSE would refer the matter to the NBG for enforcement via orders and penalties. If after a predetermined time the issuer is still in violation then the security would be removed from the system. It should be emphasized that this is undesirable in terms of investor protection and trading transparency and should be the last resort.

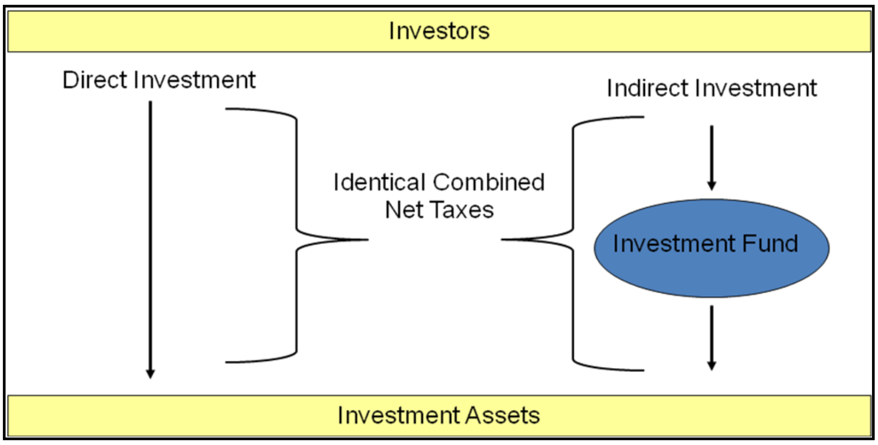
Revise and Implement the Tax Treatment of Gains on Sales of Securities

255. The above points relating to the definition of freely negotiable securities and the need to reissue Instruction No 75 apply to the capital gains issue as well.

Treatment of Investment Funds

256. **In order to expect the investment fund industry to develop in Georgia, some changes to the tax legislation will be required**. Without these there will be a disincentive to use investment funds as they will be more expensive from a tax perspective than direct investment in securities.[85] To achieve this "level playing field" the investment funds must be treated as "tax transparent".

Figure 19: Optimal Taxation of Direct vs. Indirect Investments



257. **Essentially, tax transparency means that the fund does not pay profits tax on its income (in the form of interest and/or dividends received) or on gains from sales of securities**. Instead the shareholders in the fund pay tax when they receive distributions from the fund and/or sell their shares. Without this tax transparency an investment fund shareholder pays tax twice – once at the fund level and then again upon receipt of distributions. In contrast the direct investor (who buys the security directly for his/her own account) pays tax only once.

258. **Georgia already has some progress in curing this defect**. Dividends paid to a legal entity are not taxed. And, there are tax exemptions for interest from freely-negotiable securities, and gains on sales. Still double taxation will exist for gains and interest resulting from securities falling outside the definition of freely-negotiable (the former at 20% and the latter at 5%). This can be avoided by providing a tax exemption in the Tax Code for investment funds organized in a form that would normally pay profits tax.[86]

259. **The question then becomes what circumstances and limitations should be applied in this regard.** In other markets, the most frequent limitation imposed for tax exemption does not refer to whether the fund is publicly or privately held but instead the nature of the portfolio. Stated another way, in order to qualify for the exemption the investment fund's portfolio must be widely diversified

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85 This disincentive extends not only to domestic investors but also to foreign investors who have a high expectation that their returns will not be taxed at the fund level.

86 These are the JSCs. It should also be noted that if Georgia adopts the contractual plan form of fund (as contemplated by approximating the investment fund law with the UCITS Directive) then the tax exemption should apply to this type of entity also.

and the fund itself should not participate in management of the portfolio companies. Some examples for consideration include:

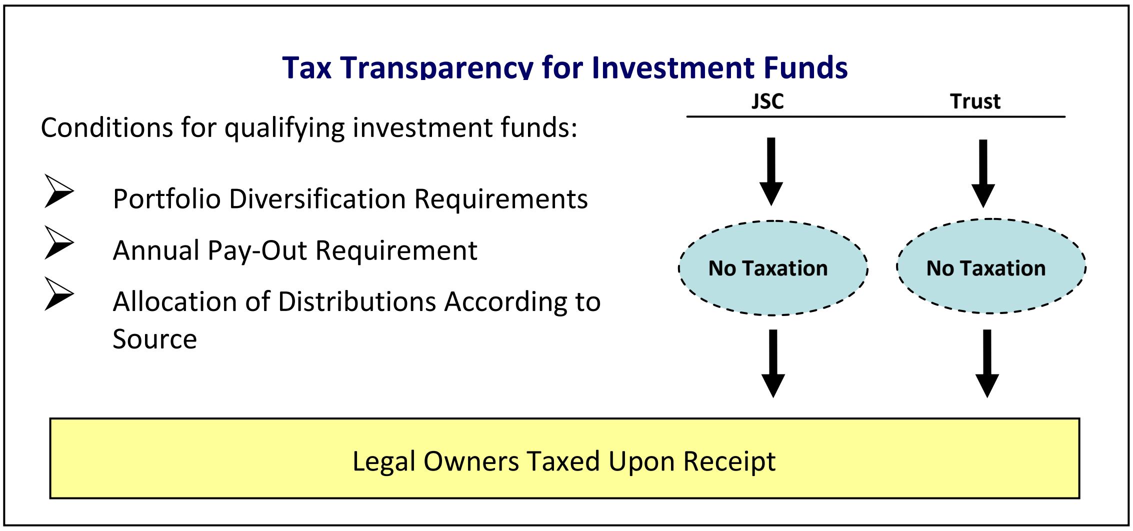
- The fund shall not hold more than 10% of any class of security;
- The fund shall not invest more than 5% of its assets in any one security; and
- The fund shall not hold more than 10% of its assets in securities issued by any one issuer

260. **While most persons understand the diversification rules to be an investor protection mechanism (and they are) the rules were originally introduced to protect the tax base**. Were the diversification rules not in place any real sector company could convert to holding company form, claim 'investment fund' status and then claim the exemption. Not only would this pervert the concept of investment funds it would erode the taxable base. Thus limiting the tax exemption to diversified funds (which due to this limitation cannot control their portfolio companies) helps ensure that tax transparency is properly applied.[87]

261. **Another requirement for the tax exemption is that the fund shall pay out its investment income at least annually**. This is designed to match the accrual of taxable income to the payment of taxes on such. Otherwise taxable income could accrue within the fund, be retained and no taxes paid upon it, to the disadvantage of the tax base.

262. **A third common requirement is that distributions be classified by their source origin**. The reason is that there are several types of tax liabilities depending on the nature of the passive income. And this will remain true for Georgia even if it adopts the other recommendations to the tax policy. Interest and dividends from OTC securities will still be taxed.

Figure 20: Conditions for Tax Exemption for Investment Funds



263. The Tax Code should be amended to provide an exemption from the profits tax for investment funds (both privately and publicly held) if they: (a) meet defined diversification rules, (b) make payouts at least annually, and (c) categorize the payments as to source origin.

87 An example of the diversification rules are at the U.S. Tax Code, Subchapter M appearing at Title 26 United States Code §861 *et. seq.* A user friendly site for Tax Code sections is http://vlex.com/source/us-code-internal-revenue-code-1025/toc/01.01.13

D. Improving Issuer Transparency

264. **The challenge facing Georgia with regard to issuer transparency is how to define and capture those companies that need to issue pubic reports in order to protect their security holders, and which companies should be allowed to exit the reporting system**. Part of the problem in this regard is that the LSM rules and the GSE rules both impact who must disclose what. To succeed in creating a streamlined and fair system a few steps should be taken.

Reinstitute the "Number of Shareholders Test" for the Definition of Reporting Company

265. **The 'number of shareholders' aspect to the definition of reporting company should be reinstated.** As discussed in paragraph 140, the reason for including the 100 shareholder test in the pre-2008 version of the LSM was to counteract the imbalance of power between a large, diverse shareholder population versus the management (and significant shareholders) who possess the information concerning company operations.

266. **If the number of shareholders test is included in the definition, the language of the LSM might read as follows**:

> "Reporting Company" means an issuer that meets any of the following criteria:
>
> a) an issuer that has sold its securities via a public offer within the last 3 years;
>
> b) an issuer that has sold its securities in a transaction that relied on an exempt transaction provision, but in fact did not qualify;
>
> c) an issuer whose securities are admitted to be traded, pursuant to the issuer's request or consent, on an exchange;[88]
>
> d) an issuer that has 100 holders or more of any class of securities issued and outstanding by that issuer; or[89]
>
> e) an issuer voluntarily electing reporting company status.

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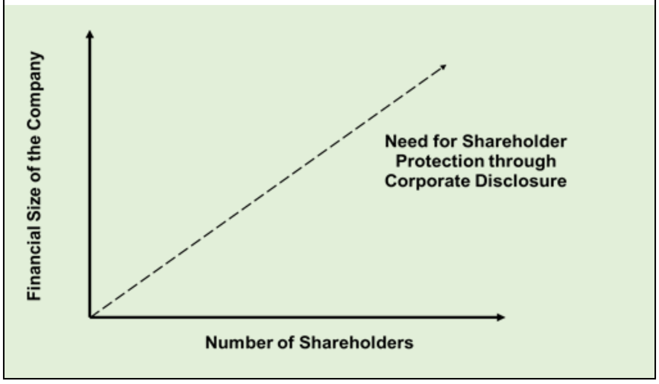
[88] This would reinstate this test, removed in April 2012.

[89] The inclusion of "3 years" and "100 holders" are notional figures. The exact numbers are open to discussion. This formulation also parallels the content of LoE Article 55.1 which governs the make-up of a Supervisory Board.

Adopt Tiered Reporting Requirements

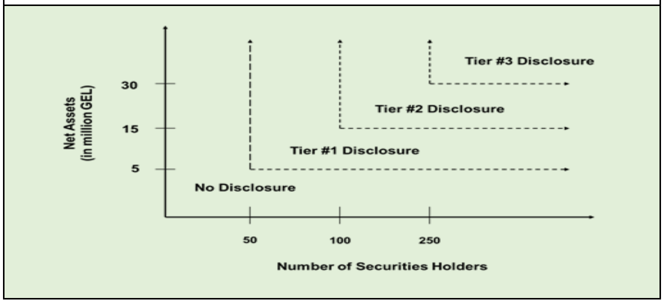
267. **Not all reporting companies are created equal.** The obligation to file periodic reports imposes a financial cost on a company. And, the ability to bear this cost and time burden varies widely by size of the companies. Because the need for disclosure (shareholder protection) varies according to the size of the company it is also fair to scale the level of required reporting according to size. This is known as "tiered disclosure" where the frequency and detail for the required reports increases as the size of the issuer grows.[90]

Figure 21: Rationale for "Size Test" of Reporting Company



268. **A tiered disclosure regime for Georgia is already enabled under the LSM**. Article 9(3) gives the NBG the power to adopt exemptions "based upon the company's own capital […], the number of securities holders, and a determination that the cost to such companies of providing such reports outweighs the public interest". This is exactly the concept described above.

Figure 22: Notional Concept of Tiered Disclosure



Revise the GSE's Admitted / Listed Concepts

269. **In order to align the new reporting company definition to the tradability of securities, the GSE's rules on how companies are admitted should be changed**. Essentially the approach should be thus: (1) the decision to list a security shall rest only with that issuer, and (2) the decision to place a security onto the admitted tier shall belong to the GSE, with the proviso that only securities issued by reporting companies are eligible.[91] In this way a company's decision to list makes it a reporting company; a GSE decision to admit a security does not. Moreover, becoming an admitted security cannot result in more reporting obligations for the company because the GSE can only admit securities that are already reporting companies.

270. **Adopting this approach will help streamline the definition of reporting company and simplify those actually required to file**:

- Companies that were admitted onto the GSE without management decision (and that have less than 100 security holders and who have not made a public offering) would no longer be reporting companies and must be removed from the admitted tier.

[90] The financial parameter for the size test can be expressed in terms of **assets** instead of **equity**. These two points bear some discussion as Georgia considers the proposed amendments.

[91] It is understood that the language of LoE Article 55(8)(i) would need to be revised to achieve this distinction.

- Companies that were admitted at the choice of management would remain as reporting companies, unless management elected to remove the company (as long as they have less than 100 security holders or have not made a public offering).
- Much of the content of the current reporting exemptions as issued by the NBG would no longer be necessary.

Devise a Simplified “Going Private” Process

271. **As a practical further step to the above the regulator should be empowered to devise a simplified “going private” process applicable only to the companies that came out of the privatization process**. As noted above, a number of these companies are required to file disclosure reports simply because they have a large number of shareholders. But they have little financial resources. The shareholders need the protection of the disclosures; the companies can ill-afford that cost.[92]

272. **The challenge then is to devise a process where the company can buy out existing shareholders in a method that gives a practical price and affords equal opportunity**. Further, since the companies may not have large resources to achieve this all at once this process may need to occur over time.

273. **It is beyond the scope of this Study to determine the exact parameters of such a simplified “going private” process**. This does, however, require the combined effort of the regulator and the private sector, perhaps to include the GSE.

Institute JSC Reporting of Summary Financial Information

274. **In order to police compliance with the new reporting requirements the regulator must know the make-up of the corporate population**. To achieve this Georgia should instate a requirement that JSCs file annual summary financial data.[93] This should be distinguished from a requirement to file annual audited financial statements. Filing this information might be conducted in conjunction with the electronic tax filing system in order to make compliance easier.

275. **If the securities regulator knows the number of security holders possessed by each JSC, and the company’s assets (or shareholders’ equity) then the regulator can know which JSCs are reporting companies and which are not**. Once this is known the GSE can determine which securities are eligible for placement on the admitted tier and which are not.[94] In this way the decision by the GSE to place a security onto the admitted tier does not result in that company becoming a reporting company because it took no affirmative action in this regard. Because the GSE can admit only companies that are already reporting companies no additional regulatory burden for the issuers can result.

E. Promoting Centrality of Trading and Improving Price Discovery

276. **As discussed above, the Working Group believes the 2007 amendments were proper in one important aspect: it gave private citizens the liberty to conduct transactions in securities as they wished** – via the impersonal market (exchange) or directly between known buyers and sellers

[92] As noted above these costs are expected to rise for 2014 as the reporting companies are required to use auditors on the Register of Auditors. See LAFA Article 7(4)(a).

[93] For example, revenues, net income, assets, liabilities and shareholders’ equity. Also number of holders of each class of security issued and outstanding

[94] Again it should be emphasized that the decision to list is at the option of the company.

(and recorded at the share registries). Nothing in this report should be read as an attempt to cut back on that freedom.

277. **When it comes to the brokerage community, however, these recommendation take a different slant.** Georgia's market participants need to decide if in fact they wish to have an organized market that protects investors. Price transparency must be vastly improved.

278. **This Study does not recommend returning to a legally imposed monopoly for the GSE**. This would ignore the fact that the GSE must "earn its way" by creating value-added for investors and the market intermediaries. It also would be contrary to the spirit of the Markets in Financial Instruments Directive.

279. **At the same time we recommend a series of changes to the way that intermediated trades (*i.e.*, trades involving a broker) are handled**. These impose strong incentives to bring buy and sell orders "into the sunshine" and create a market where all buyers and sellers have equal and fair access.

<u>Adopt a Best Execution Rule</u>

280. **The first step in this regard is to impose a "best execution" rule under LSM Article 33(3) that specifies how brokers shall obtain the best possible price for their clients for any buy or sell order**. This in turn will require the broker to "expose" the buy or sell order to the open market (the exchange's order entry system) so that the best counter-bid or counter-offer can be obtained. The end impact will be two-fold: (1) the customer will receive the best possible price, and (2) there will be a central market where all orders are exposed and the order prices recorded.

<u>Allow the GSE to Adopt an On-Exchange Rule Binding on Members</u>

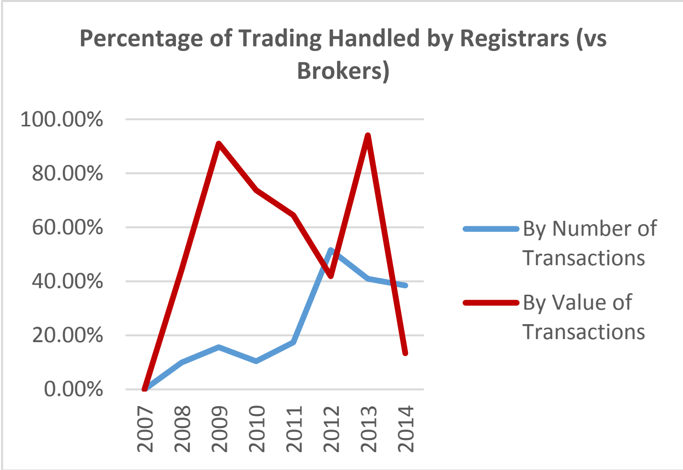
281. **As a corollary to a best execution rule, the GSE should be allowed to adopt an "exchange-only" rule applicable to its members for routing orders**. This rule would apply slightly differently between the admitted and listed securities. For admitted securities, all members would be required to bring all orders to the exchange and post them for execution. If a broker has arranged both the buyer and seller for a trade – and there are no better limit orders outstanding for the security either on the buy or sell side – then the trade can be executed as arranged. However, if there is a better bid or offer for the trade then this must be honored. For listed securities the members would be prohibited from executing trades OTC. All trades would be required to take place on-exchange.

<u>Eliminate Brokerage Operations by Securities Registries</u>

282. **Preserving a citizen's freedom to engage in direct transactions with others does not mean that the securities registrars should be allowed to act as unregistered exchanges**. Situations where the buyer and seller come unsolicited to the registrar to record a trade are proper. Situations where the registrar is actively finding buyers and sellers for others are not. This is an investment firm function. Yet, the historical data suggests that this has been happening. The securities regulator needs to take a watchful stance on this question.

Figure 23: Registrar Only Transactions Market Share

Year	% By Number of Transactions	% By Value of Transactions
2007	n/a	n/a
2008	9.88%	44.24%
2009	15.58%	91.07%
2010	10.36%	73.69%
2011	17.36%	64.51%
2012	51.60%	41.88%
2013	40.94%	94.11%
2014	38.46%	13.41%



<u>Increase the Reporting Fee for OTC Trades</u>

283. **In order to encourage trading onto the organized market, the fees charged for reporting OTC trades should be made higher than the costs of on-exchange trades**. The current system of equal costing, along with no need for pre-deposit, were cited during the interviews as why the investment firms prefer OTC trading. The OTC fee compared to on-exchange trades can be decided by the policy-makers but it would appear that a multiple over 2x would be inappropriate.

284. **In order not to threaten the freedom of individuals to process trades (non-intermediated) at the share registrars, the current fee structure should remain**.

<u>Shorten the Trade Reporting Deadline; Post Trade Reports on the GSE System and Website</u>

285. **Transaction reporting will become more credible if it becomes more prompt**. The current deadline of the close of the next business day only reinforces a sense that this market does not prioritize information flow. The GSE has recently adopted a practice of accepting trade reports scanned and emailed to the exchange. These are then posted to the GSE website, usually by close of that day.

286. **This can be improved in two ways**. First, the deadline for trade reporting can be shortened to 15 minutes. Secondly the GSE can post trade reports immediately to the website. Both of these measures can be considered temporary pending the GSE's decision on new IT systems.

<u>Create a Web-based Securities Information Center</u>

287. **The fragmentation of information can also be cured by creating a web-based "securities information center"**. This would contain (1) real-time reports of all transactions, (2) description of all securities, (3) description of all issuers, and (4) copies of all periodic reports. This operation should cover all securities offered and traded in Georgia: treasuries, NBG CDs, corporate bonds, corporate equities and IFI bonds. As a further option it could contain (1) prospectuses relating to public offerings and (2) copies of all relevant laws and regulations. In this one step, then, Georgia could cure many of the transparency concerns cited in this Study.

288. **The question remains where this function should be housed**. Georgia does not need a new capital markets entity; the choices for housing the function are the NBG or the GSE complex. It can be handled as a business unit with a separate website. The GSE has indicated its willingness to take on this role.

F. Streamlining the Trading Methodology

289. **In addition to taking steps to push the trading onto the organized and open market, the GSE needs to take steps to pull it in that direction also**. Stated differently, although there are strong reasons why the government and the regulator would like to see the trading in a centralized, transparent place, at the end of the day the capital markets are a private sector activity. The GSE needs to earn its place as the preferred trading location by adding clear value.

Finalize the GSE's Reorganization

290. **The first step in that direction is for the GSE to 'get its house in order'**. As noted above, in September 2014 an entire new supervisory board was elected, and in November new management installed. However, in terms of making fundamental changes to the GSE's operational structure, it still is within a "frozen conflict".[95]

291. **In terms of devising and executing the time-bound roadmap this is unacceptable**. Many of the recommendations made here depend on the GSE for implementation. And many of those depend on the GSE having the financial resources, IT systems and personnel to make that happen. In short, the continuing nature of that dispute threatens the success of this effort. The two shareholder groups need to come to agreement or close and liquidate the GSE, with each party going its separate way to devise new trading mechanism(s).

292. **GSE management hopes to submit a new business plan by June 2015**. The contents will be timely as part of the public / private dialogue, and a decision on steps to be taken inside the time-bound strategy.

293. **As the GSE seeks to devise a solution, the Working Group encourages it to include three aspects.** First, it would be advisable for the ownership to be more widespread. In other words, it may be beneficial to move away from one investment firm having dominant control. This is more than optics; it may help broaden interest by the other investment firms in building the exchange as an institution. Second, the new operating regime should not discriminate against non-bank affiliated investment firms. Creating an operating environment where only bank affiliated firms participate leads Georgia back towards a bank-centric financial system. Third, it would be advisable for the member firms that are not affiliated with banks to have adequate representation on the GSE's Supervisory Board. If Georgia indeed wishes to have a more diversified financial system it must provide equal opportunity to the institutions that are not affiliated with banks. This is the concept of the level playing field.

Invest in Modern IT Systems for the GSE and GSCD

294. **Of course the major issue facing the exchange is the question of raising capital**. This is needed generally to make the exchange stronger as an institution, but chiefly to enable an upgrade of the GSE's and GSCD's software. This Study did not include an IT audit or other evaluation of the current systems but the general impression during the interviews is that the current IT is not sufficient for the kinds of operations under consideration. More specifically it is unclear if the system can

[95] The majority group consists of the 4 bank-affiliated investment firms and other shareholders who are not market operators. The estimates during the interviews were that the majority controls roughly 58% of the shares while the minority group, consisting of the non-bank affiliated investment firm and others, controls 42%. Although, the GSE declined to make its shareholder registry available for this Study, the exact percentages are not important. The main point is that one group controls enough shares to make decisions on the make-up of the Board and management but does not possess enough control (75%) to decide on critical issues such as raising capital.

achieve the linkage with the NBG's CSD under consideration. It cannot support automated trade reporting for OTC trades or at the registrars.

295. **It is clear from the interviews that the GSE management is in active talks with several IT vendors.** It is outside the scope of this Study to make any recommendations. This is a GSE business decision. But clearly any new system must be able to support the recommendations agreed under this process.

Extend Trading Hours

296. **During the interviews one of the justifications made for the use of OTC trades is that the GSE sessions are only 2 hours long**. The GSE has taken the step of moving to trading on all business days, a solid step in the positive direction. It would appear that also lengthening the time period of the sessions would require little or no additional resources. This would remove this excuse for OTC style.[96]

Eliminate the Pre-Pay / Pre-Deliver Requirements; Lengthen the Settlement Cycle

297. **Another reason for the OTC style, as expressed during the interviews, is that GSE requires "pre-deposit" while OTC does not**. This argument has merit.

298. **If a system chooses pre-pay / pre-deliver then the settlement default risk is reduced to virtually zero**. While this is a positive, it can have negative effects on building the breadth and depth of trading. Advanced markets use "will-pay" and "will-deliver". Foreign investors, particularly institutional investors, are used to this flexibility. For these reasons, markets that begin with pre-pay / pre-deliver tend to move to will-pay / will- deliver over time.[97]

299. **Migrating to will-pay is easier than migrating to will-deliver**. This is simply because money is fungible. If the purchaser fails to pay, monies can be deposited by the investment firm executing the trade. This is not so for failures to deliver. In cases where the security is thinly-traded it may be difficult for the executing investment firm to go into the market, purchase the needed securities and then present them to honor the seller's settlement obligation.[98]

300. In light of the above the Working Group recommends that the GSE:

- Adopt will-pay for all transactions;
- Adopt will-deliver for listed securities
- Adopt will-deliver for admitted securities that the GSE determines have sufficient liquidity

These actions should remove all valid operational incentives to conduct trading on listed securities via OTC, and help justify the proposed "on-exchange rule" on a business basis.

[96] In fact, as discussed at footnote 46, the main motivation for the OTC style is that it overwhelmingly consists of in-house cross trades. Still eliminating the 'short hours' rationale cannot harm the overall effort.

[97] In October 2011, the Partners for Financial Stability project sponsored by USAID conducted a survey of 10 countries throughout Southeast Europe and the Caucasus concerning their pre-order trading arrangements. Most of these countries started their capital market development programs in the early 2000's, the same time as Georgia. Six countries reported requiring pre-payment, while four countries allowed will-pay. Nine countries reported requiring pre-delivery, while only one country allowed will-deliver. Thus, some countries have moved away from pre-pay, but almost all retained pre-deliver.

[98] This process is known as "buy-in". The selling customer who defaults is liable for any difference between the original trade sell price and the price paid by the firm to buy in the securities.

301. **If the GSE adopts this change in trading it will also need to lengthen the settlement cycle**. For equities the GSE can move to T+3, the accepted norm. It can choose the optimal settlement cycle for corporate bonds.

G. Consolidating and Linking the Infrastructure

Given Georgia's market size, it is important for the long-term health of the system to seek economies of scale wherever possible and to encourage the participation of foreign investors. There are several potentialities in this regard.

<u>Decide upon the NBG's Proposal for Post-Trade Services</u>

302. **The GSE and the NBG need to explore the NBG's proposal to provide clearance and settlement services for corporate securities**. In this regard there appear to be several unresolved but critical operational questions:

- Will the GSCD become a member of the payment system?
- Will the GSCD be allowed to maintain an account directly with the central bank for monies (in the form of an omnibus nominee account for the benefit of members)?
- Will the GSCD be required to hold its account at the NBG's CSD in a 1 level or 2 level format?

303. **There are also a few legal issues to be resolved**.

- LSM Article 1(8) prohibits "government bodies and agencies" from owning "financial institutions". Presumably the NBG as a "State body" falls within the definition of "government body or agency". Depositories are included in the definition of financial institutions. LSM Article 1(54). The definition of depository includes providing clearance and settlement. LSM Article 1(50). Thus the NBG providing clearance and settlement services for corporate securities would appear to be a violation of the current LSM (which can of course be revised in the redrafting process mentioned above).
- Accepting the NBG's offer to provide clearing and settlement services would seem to require that it do so for all securities. LSM Article 41(2) states that the GSE cannot receive clearing and settlement services from more than one depository (again subject to possible revision).
- If corporate securities are offered through the Bloomberg system there is a question of whether this would make it an "exchange' under the LSM. Please see Article 1(29).

304. **All of these operational and legal issues need to be resolved within the nearest future as other parts of the time-bound strategy are dependent upon it**.

<u>Link the Corporate Securities Market to Clearstream</u>

305. **The possible linkage to Clearstream is a significant positive for the system**. As this situation develops the NBG needs to ensure that the functionality benefits (access to foreign investors) extend not only to the treasuries market but also the corporate securities markets. In other words, the NBG should focus on the securities leg also being available for corporate securities.

<u>Consider a Consolidated Depository and Registry System</u>

306. **Over the longer term, the private sector should consider whether it wishes to move towards a central depository and registrar**. This is not the Government's decision, nor the regulator's. When considering this question, it is important to distinguish between the functions of depositories versus those of the registry.

307. **Securities registrars provide services to the issuers of securities and the securities' owners**. A share registrar does not have "members", only client issuers, and the persons and entities owning those securities.

308. **Depositories provide services to investment firms in connection with clearing and settling trades**. While historically depositories were formed by these intermediaries (and thus were member-owned services organizations) this ownership structure is not required in order for the depository to function properly. The investment firms must be "members" but not necessarily "owners". Depositories do not interact with the general public.

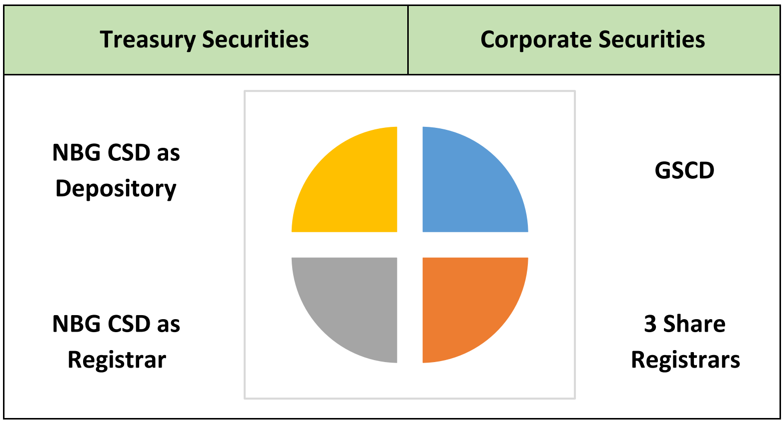
309. Depositories organize their records first by owner-of-record, then by listing the securities owned by that person or entity. Shares registrars organize their records first by class of security, then by listing the persons or entities owning that security.

Figure 24: Comparison of Registrar and Depository Functionality

	Organize their Records:	Interact with:
Depositories	First by owner name, then by securities owned	Exchange Brokers
Share Registrars	First by class of security, then by persons owning them	Owners of Securities Issuers of those Securities

310. **For the purposes of the private sector's future decisions, it is critical to note that in the modern IT world, one system can drive both types of entities**. With the proper IT capacity and a 1- level accounting system (which is discussed above) a single entity can perform the services of both a centralized depository and centralized registry for all types of securities on a highly efficient basis, reducing overall costs to the market system. As can be seen in the diagram below the choices involve which types of securities to be handled and which types of services to be provided by any one entity.

Figure 25: Depository and Registry Functions



311. **All this said, it is important to note that moving towards a centralized configuration will have an impact on staff employment**. If the regulator believes that the current operations do not present systemic risk then this matter can be left to the medium-term. The share registrars do not represent significant transactional friction.

H. Improving the Transparency of the Legal Regime and Market Operators

<u>Translate Applicable Regulations into English and Post on the NBG Website</u>

312. **A valuable step towards making the system more accessible and understandable to foreign investors would be to have the applicable regulations translated into English**. This includes the rules under the LSM, LoE, LAFA and LIF. The next step in this regard is to post these documents in an easily accessible place. If the recommendation to set up a securities information

center is accepted this becomes the logical repository. In the meantime placing them on the websites of the NBG and Ministry of Economy is recommended.

Encourage Annual and Financial Reporting by the Infrastructure Institutions in English

313. **The infrastructure institutions should be encouraged to file their quarterly, semiannual and annual reports with the NBG also in English**. Again the documents – in both English and Georgian - should be posted on the NBG website. The site already has a place-marker for this information. If the SIC is established the reports should be placed their also.

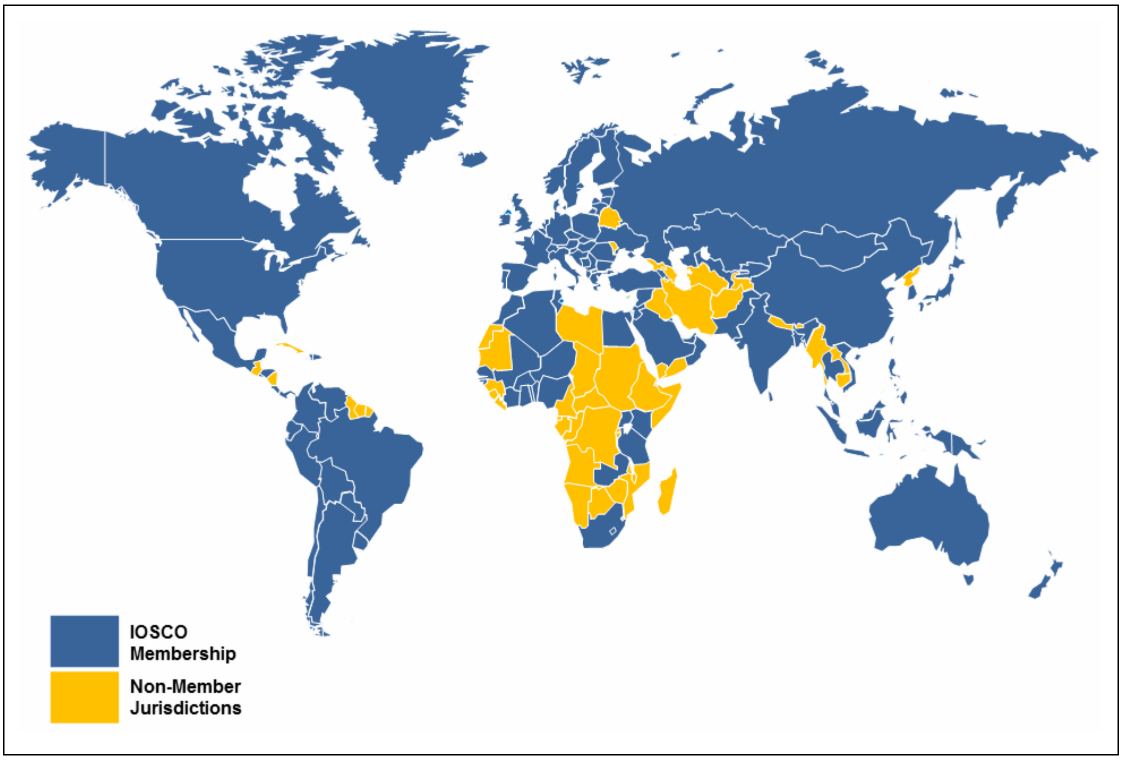
I. Increasing International Regulatory Linkages and Compliance with Standards

Become a Member of IOSCO

314. **Georgia's securities regulator should become a member of IOSCO**. The current failure to do so presents a few negative consequences for Georgia:

- At least within the capital markets world, it detracts from Georgia's reputation (a factor which is, in fairness, difficult to quantify);
- It also means that the NBG staff is not able to access IOSCO's considerable resources for capacity development and knowledge building;[99]
- It further means that Georgia's infrastructure institutions, such as the GSE and GSCD, are not eligible for associate membership, again denying them reputational and capacity building benefits.

Figure 26: IOSCO Membership Map



[99] Numerous training opportunities are available under the IOSCO's auspices. These aside, simply participating in the numerous committees such as the Emerging Markets Committee and the Technical Committee would bring significant knowledge base to the NBG.

<u>Become a Signatory to the IOSCO MMOU</u>

315. **Georgia's securities regulator should also become a signatory to the IOSCO MMOU**. In this regard, especially in terms of achieving this, it is important to note that the MMOU is not a treaty. It is working arrangement among members governing how information will be requested, shared and protected.[100] The legal basis is not the MMOU itself but the controlling laws of the signatories.[101]

316. **Becoming a signatory to the MMOU is important to Georgia for two reasons**. First, as the approximation process proceeds under the EU-Georgia Association Agreement there will be a growing demand to allow 'passport privileges' for EU licensed investment firms. At the same time Georgia will not be a member of the various EU treaties that allow and require exchange of information between EU securities regulators. It is inconceivable that Georgia should allow foreign investment firms to do business in this country without a Georgian license yet not have the ability to obtain data about them from their home jurisdiction regulator. Becoming a MMOU signatory will help bridge that gap. Second, Georgia cannot become a member of IOSCO without becoming a signatory to the MMOU.[102]

J. Support from the IFI Community

317. There are a number of areas where the IFI community can contribute to the capital markets development process, both on their 'business sides' and their 'donor sides'.

<u>Offer Donor Bonds Publicly</u>

318. **All of the offerings done recently in Georgia were private placements**. This may have been driven by business concerns rather than development policy. But the fact remains that the offerings did little to support the capital markets.

319. **ADB, EBRD and IFC should all consider conducting their next offerings publicly**. This includes setting unit values that can be purchased retail. The Georgian side must take all action to remove unnecessary cost obstacles (such as the offering tax). But the donors should support the development of the capital markets with more than policy advice.

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[100] The MMoU sets out a common understanding among the signatories regarding how they should exchange information for the purpose of supervision of the securities markets. It sets out the specific requirements for:

- what information can be exchanged and how;
- the legal capacity to compel information;
- the legal capacity for sharing information; and
- the permissible use of information.

The MMOU also sets out specific requirements regarding the confidentiality of the information exchanged, and ensures that no domestic banking secrecy, blocking laws or regulations will prevent securities regulators from sharing this information with their counterparts in other jurisdictions.

[101] Experience in the region for countries seeking to become MMOU signatories indicates that the most frequent pitfalls encountered are the ability to obtain information from sister domestic financial regulators and the ability to guarantee confidentiality of information obtained from outside. The questionnaire used by IOSCO teams to assess a candidate country's ability to join the MMOU will be highly instructive as Georgia moves towards applying for signatory status.

[102] In the past, existing members were given a grace period to sign the MMOU. No longer. Beginning in 2009 IOSCO's policy is that new members must also be MMOU signatories.

List Donor Bonds on the GSE

320. **In close parallel, the IFIs should consider listing their bonds on the GSE**. The exchange may consider waiving some fees. But the donors should provide some symbolic and reputational support for the exchange.

Implement Donor Lines of Credit for Bank Purchases of Corporate Bonds

321. **The EBRD has had in its pipeline for some time the development of a program that is essentially a line of credit to the banks to be used for purchasing corporate bonds**. This would be highly similar to existing lines of credit for onward lending. This effort may be on temporary hold given the recent GEL devaluation, but its development and approval processes within EBRD should move forward. The program should be ready to become operational when the business drivers arise again.

Technical Assistance for Approximation Effort

322. **As noted above, the level of effort required to achieve the approximation process will be significant**. A well-organized team will need to be appointed to carry this matter through not only for the first package due December 2016, but also for the package due 2018.

323. **The donors can be especially helpful in this regard by supplying technical assistance in the form of expat specialists and capacity building for local professionals**. Thus the Working Group requests that the donors – as soon as possible – explore the possibility and funding for supplying this valuable TA.

Technical Assistance for Capacity Building for the Regulator

324. **Even if the regulatory function remains inside the NBG, the regulator will need significant assistance to implement the recommendations made in this Study**. This will be magnified many fold if a new regulator is created by twin challenges: building a completely new institution, as well as implementing the roadmap. Again significant TA will be needed in the very near future and the donors are asked to explore this possibility.

Technical Assistance for Assessing Vendor Proposals for GSE / GSCD Software

325. **Yet another area of need is assistance in achieving the IT linkages and streamlining necessary to implement the roadmap**. In this regard the Working Group is not requesting financial assistance to purchase systems. This is a private sector obligation. However, technical advice during the development of the required specifications, advice during the procurement process, and assistance for oversight during installation and testing is greatly needed. This is yet a third area where the Working Group is requesting assistance.

Development of Specialized Legislation for Covered Bonds and Securitizations

326. **Although the analysis of the banking sector shows that liquidity constraints do not exist currently, the legal framework should be ready for when this becomes an operational issue**. In this regard Georgia should have the proper legal basis for the creation and sale of covered bonds (used mostly in the mortgage area) and securitizations. The specialized knowledge and assistance of the German donors would be especially helpful in this regard.

VIII. RECOMMENDATIONS

A. Recommendations by Theme

327. **Taken together, the proposed reforms to address the deficiencies and opportunities cited above can be aggregated according to the theme**.

Table 23: Recommendations Arranged by Theme

Topics and Recommendations	
Improving The Legal Framework	
1.	Approach EU Approximation Amendments to the LSM and related Laws in a Phased Manner
2.	Benchmark Georgia's Compliance with IOSCO and CPSS-10 Principles
3.	Decide on the Location and Jurisdiction of the Securities Regulator
4.	Provide for Expanded Enforcement of the Law on Entrepreneurs
5.	Place the Implementation of the Accounting and Financial Audit in the Securities Regulator
6.	Specify the Regulatory Authority of the Law on Investment Funds in the Securities Regulator
7.	Adopt Specialized Laws for Covered Bonds and Securitizations
Harmonizing the Tax Policy	
8.	Eliminate the Offering Fee
9.	Revise and Implement the Tax Exemption for Dividends and Interest from Listed Companies
10.	Revise and Extend the Exemption to Capital Gains
11.	Adopt Tax Transparency Regime for Investment Funds
Increasing the Supply of Attractive Securities	
12.	GoG offers a Minority Percentage of Shares in State-Owned Enterprises
13.	NBG Determines Criteria for Corporate Bonds as Repo Collateral and Haircuts
14.	NBG Determines Criteria for Capital Treatment for Corporate Bonds
15.	Donors offer their local currency bonds in public offerings
16.	Donors list their local currency bonds on the GSE
17.	EBRD implements lines of credit for bank purchases of corporate bonds
18.	NBG to Determine Any Limitation to MFOs Issuing Securities
Improving Issuer Transparency	
19.	Reinstitute the "Number of Shareholders Test" for the Definition of Reporting Company
20.	Adopt Tiered Reporting Requirements
21.	Revise the GSE's Admitted / Listed Concepts
22.	Devise a Simplified "Going Private" Process
23.	Institute Requirement for JSCs to Report Summary Financial Information
Promoting Centrality of Trading and Improving Price Discovery	
24.	Adopt a Best Execution Rule
25.	Allow the GSE to Adopt an On-Exchange Rule Binding on Members
26.	Increase Reporting Fees for OTC Trades by Investment Firms
27.	Develop Centralized Information Center for Trades, Issuers and Securities
Streamlining the Trading Methodology	
28.	Finalize the GSE's Reorganization
29.	Invest in Modern IT Systems for GSE and GSCD
30.	Extend Trading Session Hours
31.	Eliminate the Pre-Pay Rule and Pre-Deliver Rule for Listed Securities
32.	Shorten the Trade Reporting Deadline and Post in Real-time
Updating, Consolidating and Linking the Infrastructure	
33.	Link the GCSD with the NBG's SSS

34.	Establish both Monies and Securities "Legs" with Clearstream for Corporate Securities
35.	Consider Consolidating the Depository and Registry Functions into one CSDR
Improving the Transparency of the Legal Regime and Infrastructure	
36.	Have the Applicable Regulations Translated into English; Post on NBG's Site
37.	Encourage Financial Reporting by the Infrastructure Institutions in English; Post on NBG Site
Increasing International Regulatory Linkages and Compliance with Standards	
38.	Become a Signatory to IOSCO's Multilateral Memorandum of Understanding on Enforcement
39.	Become a Member of IOSCO
Obtaining Support from the Donor Community	
40.	Donors provide technical assistance for approximation effort
41.	Donors provide technical assistance for capacity building for the regulator
42.	Donors provide technical assistance for adoption of proper IT systems
43.	Donors provide technical assistance for drafting Laws on Covered Bonds and Securitization

B. Recommendations by Responsible Parties

328. **Achieving all of the recommended actions above will require a cohesive, proactive campaign by several sets of actors**: (1) the Government and Parliament, (2) the NBG, (3) the private sector (primarily the GSE and GSCD), and (4) the donor community. Indeed, in order to create an effective, time-bound roadmap for actual capital market development, these various parties should be assigned responsibility for competing the tasks within their purview. The Table in Annex 1 allocates the recommended actions according to the responsible parties.

329. **A table that cross-references the actions by theme and the responsible parties for implementation is set out in Annex 2**.

C. Implementation Deadlines

330. **Lastly, in order for the roadmap to be effective, these tasks must be completed within a certain sequence and within certain deadlines**. These are indicated in Annex 19.

IX. ANNEXES

Annex 1: Table of Recommendations by Responsible Implementer

Recommendations by Assignment of Responsibility for Completion (Recommendation #'s tied to Table 23)	
Needed Actions by the Government and Parliament	
1.	Conduct the Approximation Amendments to the LSM and related Laws in a Phased Manner
3.	Decide on the Location and Jurisdiction of the Securities Regulator
4.	Provide for Expanded Enforcement of the LoE
5.	Place the Implementation of the Accounting and Auditing Law in the Securities Regulator
6.	Specify the Regulatory Authority of the Law on Investment Funds in the Securities Regulator
7.	Adopt Specialized Laws for Covered Bonds and Securitizations
8.	Eliminate the Offering Fee
9.	Revise and Implement the Tax Exemption for Dividends and Interest from Listed Companies
10.	Revise and Extend the Exemption to Capital Gains
11.	Adopt the Proper Tax Regime for Investment Funds
19.	Reinstitute the "Number of Shareholders Test" for the Definition of Reporting Company
20.	Adopt Tiered Reporting Requirements
23.	Institute Requirement for JSCs to Report Summary Financial Information
21.	Revise the Admitted / Listed Concepts in LoE
12.	GoG offers a Minority Percentage of Shares in State-Owned Enterprises
Needed Actions by the NBG as Regulator	
13.	NBG Determines Criteria for Rated Corporate Bonds as Repo Collateral and Haircuts
14.	NBG Determines Criteria for Rated Corporate Bonds for Capital Treatment
24.	Adopt a Best Execution Rule
18.	Determine Limitations on MFOs Issuing Securities
22.	Devise a Simplified Going Private Rule
36.	Have the Regulations Translated Officially into English and Post to NBG Website
37.	Encourage Reporting by the Infrastructure Institutions in English and Post to NBG Website
38.	Become a Signatory to IOSCO's Multilateral Memorandum of Understanding on Enforcement
39.	Become a Member of IOSCO
2.	Benchmark Georgia's Compliance with Applicable International Standards
Needed Actions by the NBG as Market Operator	
34.	Establish both Monies and Securities "Legs" with Clearstream
33.	Link the GCSD with the NBG's SSS
35.	Consider a Consolidated Depository and Registry
Needed Actions by the GSE and GSCD	
28.	Finalize the GSE Reorganization
29.	Invest in Modern IT Systems for the GSE and GSCD
26.	Increase Reporting Fees for OTC Trades by Investment Firms
25.	Adopt an 'On-Exchange Rule' Binding on Members
30.	Extend Trading Session Hours
31.	Eliminate the Pre-Pay / Pre-Deliver Rule and Lengthen the Settlement Cycle
32.	Shorten the Trade Reporting Deadline and Post in Real-time
27.	Develop a Centralized Information Center for Trades, Issuers and Securities
33.	Link the GCSD with the NBG's SSS
35.	Consider a Consolidated Depository and Registry

Needed Actions by the Donor Community	
15.	Donors offer their local currency bonds in public offerings
16.	Donors list their local currency bonds on the GSE
17.	EBRD implements lines of credit for bank purchases of corporate bonds
40.	Donors provide technical assistance for approximation effort
41.	Donors provide technical assistance for capacity building for the regulator
42.	Donors provide technical assistance for adoption of Proper IT systems
43.	Donors provide technical assistance for drafting Laws on Covered Bonds and Securitization

Annex 2: Cross-Reference of Recommendations by Theme and Responsible Implementer

[Recommendation #'s tied to Table 23.]

	Needed Actions by the Government and Parliament	*Needed Actions by the NBG as Regulator*	*Needed Actions by the NBG as Market Operator*	*Needed Actions by the GSE and GSCD*	*Needed Actions by the Donor Community*
Improving The Legal Framework	#1. Approach EU approximation amendments to the LSM and related laws in a phased manner. #3. Decide on the location and jurisdiction of the securities regulator. #4. Provide for expanded enforcement of the LoE #5. Place the implementation of the LAFA in the securities regulator #6. Specify the regulatory authority of the LIF in the securities regulator. #7. Adopt specialized laws for covered bonds and securitizations				#40. Donors provide technical assistance for approximation effort. #41. Donors provide technical assistance for capacity building for the regulator #2. Benchmark Georgia's compliance with IOSCO and CPSS-10 Principles #43. Donors provide technical assistance for drafting Laws on covered bonds and securitization
Harmonizing the Tax Policy	#8. Eliminate the offering tax #9. Revise and implement the tax exemption for dividends and interest from listed companies #10. Revise and extend the exemption to capital gains #11. Adopt tax transparency regime for investment funds				
Increasing the Supply of Attractive Securities	#12. GoG offers a minority percentage of shares in state-owned enterprises	#13. NBG determines criteria for corporate bonds as repo collateral and haircuts #14. NBG Determines Criteria for Capital Treatment for Corporate Bonds #18. NBG to determine any limitation to MFOs issuing			#15. Donors offer their local currency bonds in public offerings #16. Donors list their local currency bonds on the GSE #17. EBRD implements lines of credit for bank purchases of corporate bonds

	Needed Actions by the Government and Parliament	*Needed Actions by the NBG as Regulator*	*Needed Actions by the NBG as Market Operator*	*Needed Actions by the GSE and GSCD*	*Needed Actions by the Donor Community*
		securities			
Improving Issuer Transparency	#19. Reinstitute the "Number of Shareholders Test" for the definition of reporting company #23. Institute requirement for JSCs to report summary financial information	#22. Devise a simplified "going private" process #20. Adopt tiered reporting requirements		#21. Revise the GSE's admitted / listed concepts	
Promoting Centrality of Trading and Improving Price Discovery		#24. Adopt a best execution rule #25. Allow the GSE to adopt an on-exchange rule binding on members #26. Increase reporting fees for OTC Trades by investment firms #27. Develop centralized information center for trades, issuers and securities		#25. Adopt an on-exchange rule binding on members #27. Develop centralized information center for trades, issuers and securities	
Streamlining the Trading Methodology				#28. Finalize the GSE's reorganization #29. Invest in modern IT systems for GSE and GSCD #30. Extend trading session hours #31. Eliminate the pre-pay rule and pre-deliver rule for listed securities #32. Shorten the trade reporting deadline and post in real-time	#42. Donors provide technical assistance for adoption of proper IT systems
Updating, Consolidating and Linking the Infrastructure			#33. Link the GCSD with the NBG's SSS #34. Establish both monies and securities "legs" with Clearstream for corporate securities #35. Consider consolidating the depository and registry functions into one CSDR	#33. Link the GCSD with the NBG's SSS #35. Consider consolidating the depository and registry functions into one CSDR	

	Needed Actions by the Government and Parliament	***Needed Actions by the NBG as Regulator***	***Needed Actions by the NBG as Market Operator***	***Needed Actions by the GSE and GSCD***	***Needed Actions by the Donor Community***
Improving the Transparency of the Legal Regime and Infrastructure		#36. Have the applicable regulations translated into English; post on NBG's Site #37. Encourage financial reporting by the infrastructure institutions in English; post on NBG Site		#37. Encourage financial reporting by the infrastructure institutions in English; post on NBG Site	
Increasing International Regulatory Linkages and Compliance with Standards		#38. Become a signatory to IOSCO's Multilateral Memorandum of Understanding on Enforcement #39. Become a Member of IOSCO			

Annex 3: Guiding Literature

SELECTED SOURCES OF GUIDELINES AND BEST PRACTICES FOR SECURITIES MARKET REGULATION AND INFRASTRUCTURE
International Organization of Securities Commissions
Objectives and Principles of Securities Regulation (June 2010)
Methodology for Assessing Implementation of the Objectives and Principles of Securities Regulation (August 2013)
Committee on Payment and Settlement Systems
Principles for Financial Market Infrastructures) (April 2012)
Disclosure Framework and Assessment Methodology for PFMI (August 2012)
International Accounting Standards Board
International Financial Reporting Standards
International Federation of Accountants
International Standards on Auditing
Organization for European Cooperation And Development
Principles of Corporate Governance (2004)
Guidelines on Corporate Governance for State-Owned Enterprises (2005)
Directives of the European Union
Transparency Directive (14 December 2004)
Prospectus Directive (4 November 2003)
Markets in Financial Instruments Directive (11 March 2008)
Market Abuse Directive (29 April 2004)
Settlement Finality Directive (19 May 1998) (6 May 2009)
Financial Collateral Arrangements Directive (6 June 2002) (6 May 2009)
Federal Securities Laws of the United States
Securities Act of 1933
Securities Exchange Act of 1934

Annex 4: List of Related Reports

#	Organization	Type	Date	Title	Doc Number	Source
1	IMF-WB	FSSA	Jan-15	FSAP -Stress Testing the Banking Sector		https://www.imf.org
2	IMF-WB	FSAP	Jan-15	FSAP-Safety Nets, Bank Resolution and Crisis Preparedness		https://www.imf.org
3	IMF-WB	Tech Note	Jan-15	FSAP-Macro prudential Policy Framework		https://www.imf.org
4	IMF-WB	Tech Note	Jan-15	FSAP / ROSC: Assessment of Observance of the Basel Core Principles		https://www.imf.org
5	IMF-WB	FSSA	Jan-15	Georgia: Financial System Stability Assessment		https://www.imf.org
6	IMF	Report	Dec-14	Financial System Stability Assessment	N14/355	https://www.imf.org
7	USAID	Report	Sep-14	Regulatory Impact Assessment. Georgian Law on Securities Market		http://www.eprc.ge
8	BG Capital	Article	Jul-14	Georgian CM: Development, concepts and opportunities		https://nasdaqomx.am
9	EU-Georgia	Association Agreement	Sep-13	Annex XV-A Rules Applicable to Financial Services		http://eeas.europa.eu/georgia
10	Georgian Journal	Article	Jul-13	Banks vs. Georgian Stock Exchange Georgian Journal		http://www.georgianjournal.ge
11	BG Capital / GEC	Presentation	May-13	Georgian capital market development concept		http://bgcapital.ge
12	IMF-WB	ROSC	Jan-13	ROSC: FATF recommendations for AML/ATF	N13/5	http://www.imf.org
13	IMF-WB	Country Report	Mar-12	ROSC-data module	N12/58	https://www.imf.org
14	USAID	Sector Assessment	Nov-11	Analytical Foundations Assessment -Financial Sector Assessment		http://gfsis.org
15	EBRD	Assessment	Jun-07	Securities Markets Legislation Assessment Project	N/A	N/A
16	WB	FSAP update	Jan-07	Financial Sector Assessment Georgia	WP 38397	https://openknowledge.worldbank.org
17	WB	Report	Jan-07	ROSC: Accounting and Auditing	38977	http://www.worldbank.org
18	IMF-WB	Tech Note	Jul-06	Technical Note Securities markets	N/A	N/A
19	WB	Report	Sep-03	Georgia: Country Financial Accountability Assessment	28941-GE	http://www-wds.worldbank.org
20	IMF-WB	Country Report	Mar-02	ROSC: Corporate Governance Country Assessment	35876	http://www.worldbank.org
21	WB	Report	Mar-02	ROSC: Accounting and Auditing	35876	https://openknowledge.worldbank.org
22	IMF	Country Report	Nov-01	Financial System Stability Assessment	N-01/210	http://www.imf.org
23	IMF-WB	FSAP	Aug-01	Compliance Assessment for IOSCO P	N/A	N/A
24	IMF-WB	Tech Note	Feb-01	Caucasus Region and CAR: External Debt and Fiscal Sustainability	N/A	http://www.imf.org
25	ADB	Sector Assessment		Sector assessment: Finance and Public Sector Management: RRP GEO 48044		http://www.adb.org

Annex 5: GSE Listing Requirements

Fees	**A Level**	**B Level**
Initial Fee	2,500 GEL	1,500 GEL
Quarterly Fee	2,500 GEL	1,500 GEL
Criteria		
Shareholders' Equity	> 1,000,000 GEL	> 100,000 GEL
Profitability: at least 1 profitable year	Within the last 2 years	Within the last 3 years
Number of issued securities	> 100,000	> 50,000
Reports in compliance with IFRS	Required	Required
In compliance with LSM periodic reporting requirements	Required	Required
Market Capitalization	> 10,000,000 GEL	> 500,000 GEL
Annual Turnover	> 2,000,000 GEL **OR** > 5% of outstanding securities	> 200,000 GEL **OR** > 5% of outstanding securities
Monthly Volume (average 3 months)	> 100,000 GEL **OR** > .25% of outstanding shares	> 10,000 GEL **OR** > .25% of outstanding shares
Free Float	> 25% of issued securities **OR** Mkt Cap > 2,500,000 GEL	> 10% of issued shares **OR** Mkt Cap > 100,000 GEL

Annex 6: GSE Unconsolidated Financial Results (in GEL) (historical)

BALANCE SHEET	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	Dec-14
Assets									
Total current assets	278,846	145,294	142,283	130,754	104,105	358,833	337,523	340,408	298,972
Total long term assets	225,662	432,333	510,655	482,896	492,549	137,908	141,159	135,479	141,468
Total Assets	504,508	577,627	652,938	613,650	596,654	496,741	478,682	475,887	440,440
Liabilities									
Total current liabilities	53,090	9,554	11,191	19,305	38,776	58,050	42,460	23,631	31,034
Total long- term liabilities	12,160	9,472	19,017	19,129	23,337	-		-	-
Total Liabilities	65,250	19,026	30,208	38,434	62,113	58,050	42,460	23,631	31,034
Total Shareholders' Equity	439,258	558,600	622,730	575,216	534,541	438,691	436,222	452,256	409,406
Total Liabilities & Equity	504,508	577,626	652,938	613,650	596,654	496,741	478,682	475,887	440,440
INCOME STATEMENT	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	Dec-14
Total Operating Revenues	367,350	175,686	172,063	108,558	93,422	62,306	160,360	161,027	153,526
Total Operating Expenses	132,809	171,883	201,976	215,273	212,198	216,062	194,737	183,422	237,482
Operating Profit	234,541	3,803	(29,913)	(106,715)	(118,776)	(153,756)	(34,377)	(22,395)	(83,956)
Total Non-Operating Revenues	49,665	30,239	119,552	82,082	104,528	68,396	36,415	42,788	46,109
Total Non-Operating expenses	15,540	6,332	14,192	22,881	26,426	27,267	4,755	-	-
Non-Operating Profit	34,125	23,907	105,360	59,201	78,102	41,129	31,660	42,788	46,109
Income before taxes	268,666	27,710	75,447	(47,514)	(40,674)	(112,627)	(2,717)	20,393	(37,847)
Income tax	53,733		11,317				(248)	4,359	5,003
Total Net Income	214,933	27,710	64,130	(47,514)	(40,674)	(112,627)	(2,469)	16,034	(42,850)

Figure 27: GSE Unconsolidated Balance Sheet (historical)

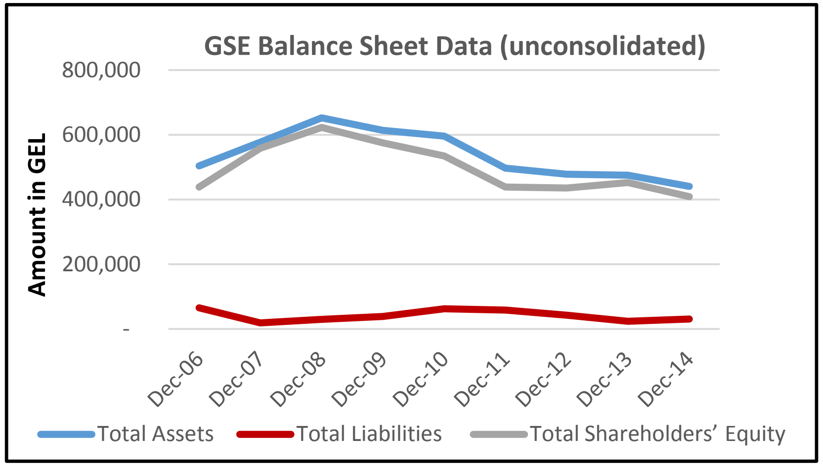


Figure 28: GSE Unconsolidated Revenues (Historical)

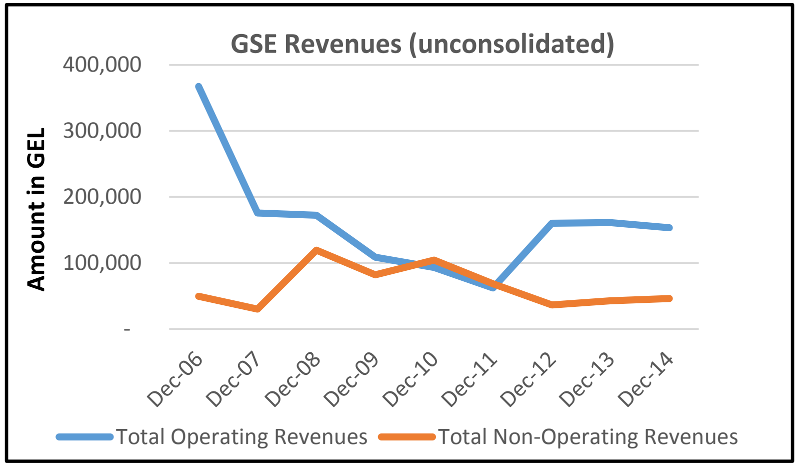
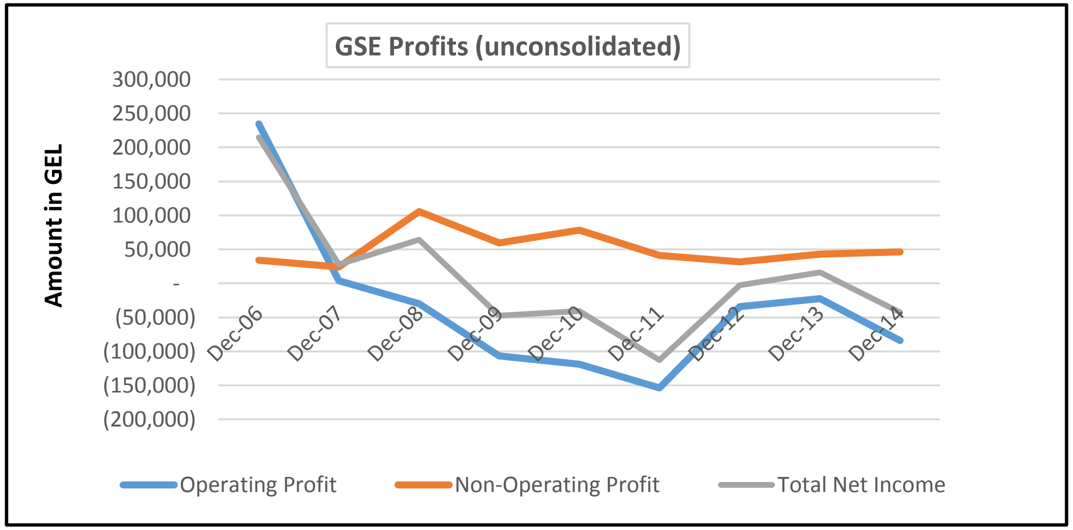


Figure 29: GSE Unconsolidated Incomes (Historical)



Annex 7: GSCD Financial Results (in GEL) (historical)

BALANCE SHEET	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	Dec-14
Assets									
Total Current Assets	212,246	20,956	137,956	45,530	64,978	334,977	338,597	353,280	386,545
Total Long-Term Assets	137,878	356,597	255,741	334,994	336,657	11,351	6,302	6,445	1,183
Total Assets	350,124	377,553	393,697	380,524	401,635	346,328	344,899	359,725	387,728
Liabilities									
Total Current Liabilities	33,886	19,474	9,731	3,020	6,514	3,487	1,527	818	2,083
Total Long- Term Liabilities	2,379	7,946	11,829	11,829	11,829	-	195	216	38
Total Liabilities	36,265	27,420	21,560	14,849	18,343	3,487	1,722	1,034	2,121
Total Shareholders' Equity	313,859	350,133	372,138	365,675	383,292	342,841	343,177	358,691	385,607
INCOME STATEMENT	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	Dec-14
Total Operating Revenues	249,251	105,528	35,005	31,553	46,634	47,919	35,975	32,530	42,674
Total Operating Expenses	51,748	58,842	81,721	76,676	75,504	72,304	67,822	61,481	70,870
Operating Profit	197,503	46,686	(46,716)	(45,123)	(28,870)	(24,385)	(31,847)	(28,951)	(28,196)
Total Non-Operating Revenues	10,882	13	81,727	46,870	62,323	35,543	33,530	46,309	54,934
Total Non-Operating Expenses	398	1,357	9,124	7,494	12,275	19,140	-	-	-
Non-Operating Profit	10,484	(1,344)	72,603	39,376	50,048	16,403	33,530	46,309	54,934
Income before taxes	207,987	45,342	25,887	(5,747)	21,178	(7,982)	1,683	17,358	26,738
Income Tax	41,597	9,068	3,883	716	3,561	-	1,347	1,844	(178)
Net Profit	166,390	36,274	22,004	(6,463)	17,617	(7,982)	336	15,514	26,916

Figure 30: GSCD Balance Sheet (historical)

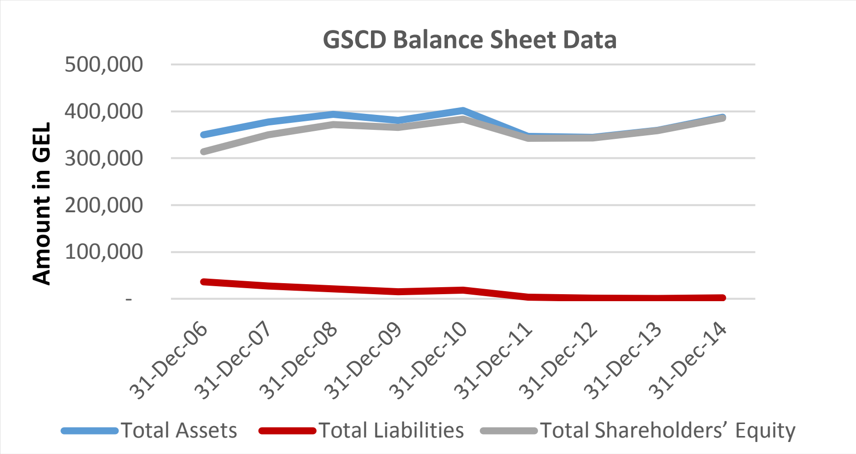


Figure 31: GSCD Revenues (Historical)

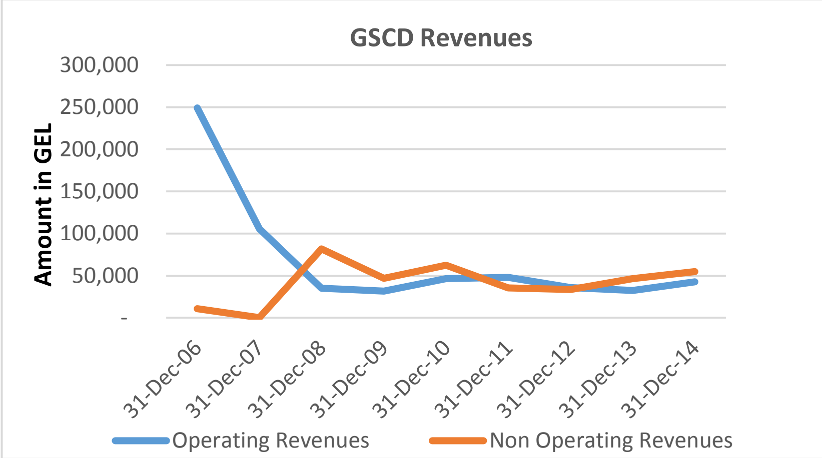
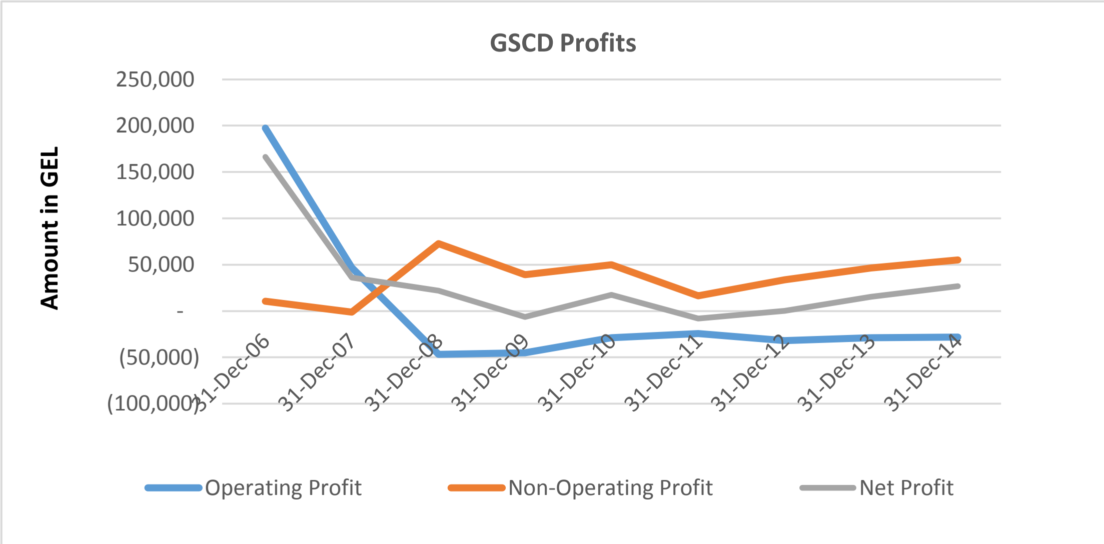


Figure 32: GSCD Profits (Historical)



Annex 8: Summary Financial Results for Investment Firms (GEL and USD) (2013)

#	Company Name	Total Revenues (GEL)	Net Income (GEL)	Total Assets (GEL)	Shareholders' Equity (GEL)	Return on Assets	Return on Equity	Profit Margin
1	JSC Galt & Taggart	48,792,607	(6,275,258)	19,159,617	14,587,321	-32.75%	-43.02%	-12.86%
2	JSC Abbey Asset Management	137,109	(2,826)	554,975	551,781	-0.51%	-0.51%	-2.06%
3	LLC Caucasus Financial Services	98,468	68,154	479,240	360,453	14.22%	18.91%	69.21%
4	JSC Liberty Securities	65,192	87,168	1,364,473	1,251,261	6.39%	6.97%	133.71%
5	LLC TBC Broker	57,849	5,129	575,837	450,255	0.89%	1.14%	8.87%
6	LLC Georgian Investment Group +	54,206	12,258	375,713	280,104	3.26%	4.38%	22.61%
7	JSC Caucasus Capital Group	9,093	16,259	405,589	378,053	4.01%	4.30%	178.81%
8	LLC Cartu Broker	33,203	6,580	408,166	407,583	1.61%	1.61%	19.82%
9	STOX LLC	65,700	(2,046,834)	4,240,792	3,810,056	-48.27%	-53.72%	-3115.42%

#	Company Name	Total Revenues (USD)	Net Income (USD)	Total Assets (USD)	Shareholders' Equity (USD)	Return on Assets	Return on Equity	Profit Margin
1	JSC Galt & Taggart	$28,101,484	($3,614,155)	$11,034,739	$8,401,383	-32.75%	-43.02%	-12.86%
2	JSC Abbey Asset Management	$78,966	($1,628)	$319,631	$317,791	-0.51%	-0.51%	-2.06%
3	LLC Caucasus Financial Services	$56,711	$39,252	$276,012	$207,598	14.22%	18.91%	69.21%
4	JSC Liberty Securities	$37,547	$50,203	$785,851	$720,648	6.39%	6.97%	133.71%
5	LLC TBC Broker	$33,317	$2,954	$331,646	$259,319	0.89%	1.14%	8.87%
6	LLC Georgian Investment Group +	$31,219	$7,060	$216,387	$161,322	3.26%	4.38%	22.61%
7	JSC Caucasus Capital Group	$5,237	$9,364	$233,594	$217,735	4.01%	4.30%	178.81%
8	LLC Cartu Broker	$19,123	$3,790	$235,078	$234,742	1.61%	1.61%	19.82%
9	STOX LLC	$37,839	($1,178,848)	$2,442,430	$2,194,354	-48.27%	-53.72%	-3115.42%

Annex 9: Summary Financial Results for Securities Registrars (GEL and USD) (2013)

#	Company Name	Total Revenues (GEL)	Net Income (GEL)	Total Assets (GEL)	Shareholders' Equity (GEL)	Return on Assets	Return on Equity	Profit Margin
1	JSC Georgian Securities United Registrar	298,706	54,601	899,305	899,167	6.07%	6.07%	18.28%
2	LTD National Registrar	133,898	78,179	377,507	363,711	20.71%	21.49%	58.39%
3	JSC Caucasus Registry	115,446	17,111	955,667	925,914	1.79%	1.85%	14.82%

#	Company Name	Total Revenues (USD)	Net Income (USD)	Total Assets (USD)	Shareholders' Equity (USD)	Return on Assets	Return on Equity	Profit Margin
1	JSC Georgian Securities United Registrar	$172,036	$31,447	$517,943	$517,864	6.07%	6.07%	18.28%
2	LTD National Registrar	$77,117	$45,026	$217,420	$209,475	20.71%	21.49%	58.39%
3	JSC Caucasus Registry	$66,490	$9,855	$550,404	$533,268	1.79%	1.85%	14.82%

Annex 10: Timetable for EU Approximation

Number	Status	Securities Markets	Deadline
2004/39/EC	Repealed	~~Markets in Financial Instruments Directive~~	~~5 years~~
2014/65/EU	Replaced by	Markets in Financial Instruments Directive 2	
2006/73/EC		Organizational requirements for investment firms	7 years
1287/2006		Record-keeping obligations for investment firms	7 years
2003/71/EC		Prospectus Directive	7 years
809/2004		Prospectus Regulation	7 years
2004/109/EC		Harmonization of transparency requirements	7 years
2007/14/EC		Implementation rules for Transparency Directive	7 years
97/9/EC		Investor-compensation schemes	6 years
2003/6/EC	Repealed	~~Market Abuse Directive~~	~~5 years~~
2004/72/EC	Repealed	~~Implementing Market Abuse Directive~~	~~7 years~~
2003/124/EC	Repealed	~~Implementing Market Abuse Directive~~	~~7 years~~
2003/125/EC	Repealed	~~Implementing Market Abuse Directive~~	~~7 years~~
2273/2003	Repealed	~~Implementing Market Abuse Directive~~	~~7 years~~
596/2014	Replaced by	Market Abuse Regulation NEW	
1060/2009		Credit Rating Agencies	7 years
		Collective Investment Schemes	
2009/65/EC		UCITS Directive	6 years
2007/16/EC		UCITS Directive	6 years
		Market Infrastructure and Settlement	
2002/47/EC		Financial collateral arrangements	5 years
98/26/EC		Finality of settlement	5 years
2009/44/EC		Finality of Settlement	5 years
		Related Directives	
2002/87/EC		Investment firms in financial conglomerate	4 years
2006/49/EC	Repealed	~~Capital adequacy of investment firms~~	~~5 years~~
2013/36/EU	Replaced by	Capital adequacy of investment firms Directive	
2001/65/EC		Valuation rules for other financial institutions	4 years
Applicable Items Not Contained in the Association Agreement			
2001/34/EC		Admission of securities to official stock exchange Listing Directive	
2004/25/EC		Takeover Bids Directive	
2014/57/EU		Criminal sanctions for market abuse Directive	
909/2014		Central Securities Depositories Directive	

Annex 11: Summary Financial Information for Reporting JSCs in USD (2013)

#	Company Name	Ticker	Revenues (USD)	Net Income (USD)	Total Assets (USD)	Total Liabilities (USD)	Shareholders' Equity (USD)	Revenues to Assets	Debt to Equity	RoA	RoE	Net Profit Margin
Financial Sector Companies												
1	Bank of Georgia	GEB	$314,560,848	$123,135,403	$3,757,549,963	$3,040,902,494	$716,647,469	8.37	4.24	3.28%	17.18%	39.15%
2	Liberty Bank	BANK	$53,468,295	$10,404,308	$745,040,604	$679,321,546	$65,719,058	7.18	10.34	1.40%	15.83%	19.46%
3	VTB Bank (Georgia)	UGB	$33,891,609	$7,649,024	$480,121,523	$426,806,427	$53,315,095	7.06	8.01	1.59%	14.35%	22.57%
Real Sector Companies												
1	Sarajishvili	ENIS	$12,533,548	$3,134,827	$31,944,940	$12,008,869	$19,936,071	39.23	0.60	9.81%	15.72%	25.01%
2	Bechdviti Sitkvis Kombinati	BSK	$1,321,776	$433,681	$7,342,049	$510,280	$6,831,769	18.00	0.07	5.91%	6.35%	32.81%
3	Tbilisi School Inventory Factory	TSIF	$805,140	$326,338	$2,847,195	$104,690	$2,742,505	28.28	0.04	11.46%	11.90%	40.53%
4	Isani-Kartu	ISKA	$491,177	$59,842	$2,198,351	$37,357	$2,160,994	22.34	0.02	2.72%	2.77%	12.18%
5	Saqsashenmetsniereba	SSM	$173,063	$58,412	$1,902,154	$20,152	$1,882,008	9.10	0.01	3.07%	3.10%	33.75%
6	Imeri	IMER	$1,186,992	$169,525	$1,753,951	$294,507	$1,459,444	67.68	0.20	9.67%	11.62%	14.28%
7	TbilChemFarm	TQFF	$586,749	$0	$1,549,379	$270,890	$1,278,489	37.87	0.21	0.00%	0.00%	0.00%
8	Janmrteloba	JANM	$311,928	$48,724	$1,742,210	$536,313	$1,205,898	17.90	0.44	2.80%	4.04%	15.62%
9	Tbilabreshumi - Tsisartkela	TABR	$931,233	$38,645	$1,124,748	$921	$1,123,827	82.79	0.00	3.44%	3.44%	4.15%
10	Maglivmsheni	MAGM	$252,127	$22,337	$1,051,818	$50,216	$1,001,602	23.97	0.05	2.12%	2.23%	8.86%
11	Trading House "Kid's World"	SSBS	$1,319,172	$708,834	$1,040,181	$48,829	$991,352	126.82	0.05	68.15%	71.50%	53.73%
12	Elektroavtomati	ELAV	$355,929	$12,671	$867,362	$25,917	$841,444	41.04	0.03	1.46%	1.51%	3.56%
13	Saqpetqmtretsvi	SFM	$1,775,239	$637,305	$954,614	$211,165	$743,449	185.96	0.28	66.76%	85.72%	35.90%
14	Graali-92	GR92	$585,922	$28,152	$777,404	$201,561	$575,843	75.37	0.35	3.62%	4.89%	4.80%
15	Business Center "Sopmsheni"	SOPM	$537,136	$28,163	$556,989	$25,456	$531,533	96.44	0.05	5.06%	5.30%	5.24%
16	Avtoshemketebeli	AVSH	$578,116	$295,083	$626,450	$107,306	$519,144	92.28	0.21	47.10%	56.84%	51.04%
17	Saqtskalproeqti	STSP	$972,816	$112,365	$498,704	$32,022	$466,682	195.07	0.07	22.53%	24.08%	11.55%
18	Amtse (Tbilisi)	AMCE	$96,009	$17,508	$325,232	$2,246	$322,986	29.52	0.01	5.38%	5.42%	18.24%
19	Kartuli Shali	KAMV	$0	$25,318	$354,086	$60,877	$293,210	0.00	0.21	7.15%	8.63%	0.00%
20	Aqati	AKAT	$82,345	$28,550	$279,007	$18,566	$260,441	29.51	0.07	10.23%	10.96%	34.67%
21	Vaziani	VAZI	$752,405	$8,340	$783,563	$555,664	$227,898	96.02	2.44	1.06%	3.66%	1.11%
22	Tbilisi Tea Packing Factory	TTEA	$317,881	$33,976	$288,959	$120,855	$168,104	110.01	0.72	11.76%	20.21%	10.69%
23	Kvali Pirveli	KV1	$7,552	$7,210	$158,084	$5,249	$152,836	4.78	0.03	4.56%	4.72%	95.47%
24	Kashanuri	QASH	$43,023	$1,094	$150,608	$4,262	$146,346	28.57	0.03	0.73%	0.75%	2.54%
25	Industria-21	IN21	$4,430	$286	$414,910	$314,232	$100,678	1.07	3.12	0.07%	0.28%	6.46%
26	Kutaisi Confectionary "Nugbari"	KCON	$145,905	$2,116	$277,002	$269,032	$7,970	52.67	33.76	0.76%	26.55%	1.45%

#	Company Name	Ticker	Revenues (USD)	Net Income (USD)	Total Assets (USD)	Total Liabilities (USD)	Shareholders' Equity (USD)	Revenues to Assets	Debt to Equity	RoA	RoE	Net Profit Margin
Companies with Negative Net Income												
1	Industria-Investi	IND	$17,439	($2,338)	$167,657	$13,768	$153,890	10.40	0.09			
2	Investment Co "LiderInvesti"	LINV	$8,480	($2,826)	$157,986	$100,151	$57,835	5.37	1.73			
3	Matsne	MACN	$380,926	($5,956)	$376,980	$160,506	$216,474	101.05	0.74			
4	Meskheti	MESX	$75,725	($8,484)	$200,162	$6,548	$193,613	37.83	0.03			
5	Ekrani Lilo	EKRL	$5,496,631	($8,985)	$2,860,854	$268,790	$2,592,064	192.13	0.10			
6	Bambis Narti	BANA	$132,682	($10,687)	$517,352	$120,469	$396,883	25.65	0.30			
7	Nino	NINO	$71,013	($13,938)	$548,523	$1,901	$546,622	12.95	0.00			
8	Mamuli	MAM	$155,595	($14,354)	$419,390	$98,422	$320,968	37.10	0.31			
9	Elektroizoliti	EIZO	$13,822	($18,027)	$235,155	$1,901	$233,255	5.88	0.01			
10	Uksovadi Ksovilebi	UQQS	$194,782	($26,954)	$614,352	$4,320	$610,033	31.71	0.01			
11	Samto Kimia-2000	SAMT	$61,450	($26,968)	$68,619	$61,087	$7,532	89.55	8.11			
12	Kutaisi Autoservice "Rashi"	KASR	$57,306	($28,854)	$197,604	$59,149	$138,398	29.00	0.43			
13	Amaltea	AMA	$66,580	($32,959)	$597,837	$216,701	$381,139	11.14	0.57			
14	Kutaisi litofon Plant	KLPQ	$103,748	($33,717)	$595,791	$31,908	$563,884	17.41	0.06			
15	Maspindzeli	MASP	$14,375	($39,940)	$102,942	$4,318	$98,624	13.96	0.04			
16	Circus	CIRK	$722,686	($52,986)	$942,464	$0	$942,464	76.68	0.00			
17	Likani	LIKN	$14,572	($73,491)	$1,074,919	$265,740	$809,179	1.36	0.33			
18	Andza-94	ANDZ	$446,253	($87,951)	$757,712	$146,016	$611,696	58.89	0.24			
19	Oxino	OXIN	$95,321	($163,392)	$4,669,908	$14,448	$4,655,460	2.04	0.00			
20	Green Capital	STP	$393,104	($174,507)	$6,205,315	$4,007,845	$2,197,470	6.33	1.82			
21	Liberty Consumer	GTC	$20,258,020	($237,862)	$25,824,454	$11,254,967	$14,569,487	78.45	0.77			
22	Khidmsheni	KHID	$1,824,429	($1,155,269)	$9,195,617	$6,548,129	$2,647,488	19.84	2.47			
23	Charkhmshenebeli	CHAR	$386,698	($1,280,813)	$716,739	$81,040	$635,699	53.95	0.13			
24	Caucasus Energy & Infrastructure	NRGY	$61,625	($2,759,892)	$28,988,078	$1,375,914	$27,612,164	0.21	0.05			
25	Telasi	AEST	$144,312,619	($21,818,234)	$131,667,339	$81,751,425	$49,915,913	109.60	1.64			
Companies with Negative Shareholders' Equity												
1	Tamarioni	KRT1	$61,113	($19,789)	$108,602	$136,435	($27,833)	56.27				
2	Saktelephonmsheni	STLM	$30,061	($19,108)	$197,129	$237,938	($40,809)	15.25				
3	Saktsivprodukti	ME92	$763,522	($69,711)	$890,262	$1,566,179	($675,917)	85.76				
4	Traktebi	TRQT	$64,717	$872	$213,563	$1,467,318	($1,253,755)	30.30				

Annex 12: Treasury and NBG CD Trading Levels 2010 to Present

Trading Month	Monthly Totals (GEL)		Monthly Totals (USD)		3 Month Rolling Average (USD)	
	NBG CDs	**Treasuries**	**NBG CDs**	**Treasuries**	**NBG CDs**	**Treasuries**
Jan-11	21,775,818	4,789,780	$12,038,155	$2,647,897		
Feb-11	2,939,130	8,629,760	$1,673,002	$4,912,204		
Mar-11	0	7,459,432	$0	$4,372,725	$4,570,386	$3,977,609
Apr-11	8,989,867	2,152,848	$5,478,954	$1,312,072	$2,383,985	$3,532,334
May-11	6,869,055	3,994,774	$4,123,577	$2,398,111	$3,200,844	$2,694,303
Jun-11	20,977,446	0	$12,587,727	$0	$7,396,752	$1,236,728
Jul-11	23,925,441	0	$14,457,333	$0	$10,389,546	$799,370
Aug-11	28,835,853	0	$17,521,938	$0	$14,855,666	$0
Sep-11	17,958,393	1,284,374	$10,811,796	$773,254	$14,263,689	$257,751
Oct-11	9,736,223	5,991,669	$5,868,023	$3,611,180	$11,400,585	$1,461,478
Nov-11	19,972,422	790,113	$12,043,913	$476,459	$9,574,577	$1,620,298
Dec-11	36,376,559	26,984,987	$21,778,458	$16,155,772	$13,230,131	$6,747,804
Jan-12	14,967,752	23,604,679	$8,968,096	$14,143,007	$14,263,489	$10,258,413
Feb-12	29,915,580	18,408,556	$17,982,436	$11,065,494	$16,242,997	$13,788,091
Mar-12	70,485,267	22,124,885	$42,461,004	$13,328,244	$23,137,179	$12,845,582
Apr-12	83,088,442	18,490,827	$51,074,774	$11,366,380	$37,172,738	$11,920,039
May-12	40,915,927	29,975,031	$25,166,642	$18,437,096	$39,567,473	$14,377,240
Jun-12	5,980,216	51,303,815	$3,635,169	$31,185,834	$26,625,528	$20,329,770
Jul-12	47,935,880	27,480,511	$28,890,959	$16,562,507	$19,230,923	$22,061,812
Aug-12	9,989,080	21,688,322	$6,015,344	$13,060,534	$12,847,157	$20,269,625
Sep-12	32,940,975	33,595,692	$19,852,332	$20,246,906	$18,252,879	$16,623,316
Oct-12	27,835,118	0	$16,761,076	$0	$14,209,584	$11,102,480
Nov-12	27,850,970	2,966,643	$16,813,142	$1,790,910	$17,808,850	$7,345,939
Dec-12	23,683,008	0	$14,295,291	$0	$15,956,503	$596,970
Jan-13	25,969,068	44,907,585	$15,668,558	$27,095,200	$15,592,330	$9,628,703
Feb-13	22,956,682	22,540,513	$13,882,011	$13,630,352	$14,615,287	$13,575,184
Mar-13	29,948,140	30,697,085	$18,066,079	$18,517,877	$15,872,216	$19,747,810
Apr-13	36,948,279	35,017,359	$22,382,045	$21,212,357	$18,110,045	$17,786,862
May-13	23,975,261	0	$14,609,263	$0	$18,352,462	$13,243,411
Jun-13	29,950,825	29,651,235	$18,142,119	$17,960,649	$18,377,809	$13,057,669
Jul-13	94,543,651	90,279,481	$57,160,611	$54,582,516	$29,970,665	$24,181,055
Aug-13	27,347,985	85,274,167	$16,459,816	$51,323,603	$30,587,516	$41,288,923
Sep-13	3,997,125	9,506,943	$2,401,541	$5,711,934	$25,340,656	$37,206,018
Oct-13	71,925,577	0	$43,051,163	$0	$20,637,507	$19,011,846
Nov-13	42,774,271	20,160,066	$25,280,302	$11,914,932	$23,577,669	$5,875,622
Dec-13	3,988,679	1,524,209	$2,297,229	$877,849	$23,542,898	$4,264,260
Jan-14	0	3,608,343	$0	$2,024,998	$9,192,510	$4,939,260
Feb-14	60,468,130	4,988,233	$34,563,092	$2,851,234	$12,286,774	$1,918,027
Mar-14	0	21,391,815	$0	$12,239,981	$11,521,031	$5,705,404
Apr-14	0	13,091,665	$0	$7,392,662	$11,521,031	$7,494,626

Trading Month	Monthly Totals (GEL)		Monthly Totals (USD)		3 Month Rolling Average (USD)	
	NBG CDs	**Treasuries**	**NBG CDs**	**Treasuries**	**NBG CDs**	**Treasuries**
May-14	0	0	$0	$0	$0	$6,544,214
Jun-14	0	0	$0	$0	$0	$2,464,221
Jul-14	0	9,587,123	$0	$5,504,147	$0	$1,834,716
Aug-14	0	0	$0	$0	$0	$1,834,716
Sep-14	0	3,678,823	$0	$2,099,306	$0	$2,534,484
Oct-14	0	7,981,631	$0	$4,549,493	$0	$2,216,266
Nov-14	0	0	$0	$0	$0	$2,216,266
Dec-14	5,995,401	3,681,586	$3,217,107	$1,975,524	$1,072,369	$2,175,006
Jan-15	0	4,869,791	$0	$2,368,921	$1,072,369	$1,448,148
Feb-15	4,849,445	4,995,689	$2,239,514	$2,307,051	$1,818,874	$2,217,165
Mar-15	23,982,063		$10,766,358	$0	$4,335,291	$1,558,657

Annex 13: Treasury Yields at Auction 2010 to Present

Issue Month	6 Months	1 Year	2 Years	5 Years	10 Years
Jan-10	4.52	6.46			
Feb-10	4.14	7.11	10.21		
Mar-10	5.98	6.31			
Apr-10	4.69	6.75			
May-10	5.81	7.94	10.35		
Jun-10	7.86	10.92			
Jul-10	9.48	13.13	14.29		
Aug-10	9.530	14.55	14.84		
Sep-10	9.61	14.57	15.63		
Oct-10	11.29	14.23	15.20		
Nov-10	10.85	13.57	14.39		
Dec-10	10.26	12.42	13.82		
Jan-11	10.16	11.73			
Feb-11		11.31	12.85		
Mar-11		10.01			
Apr-11	9.17	9.51	12.58	15.30	
May-11	8.84	9.46	12.21		
Jun-11	8.74	9.39	11.96	14.64	
Jul-11	8.79	9.20	11.74	14.14	
Aug-11	8.57		10.54	13.52	
Sep-11	8.02	8.87	10.09	13.04	
Oct-11	8.00	9.32			
Nov-11	8.69		9.59		
Dec-11	8.13		9.14		
Jan-12	7.24	8.03	8.95	11.30	
Feb-12	7.04	7.59	8.20	10.52	
Mar-12	6.54	6.91	7.31	9.62	12.31
Apr-12	6.03	6.84	7.43	9.81	
May-12	6.51	6.72	6.95	9.21	11.59
Jun-12	6.58	6.76	6.91	8.64	
Jul-12	6.30	6.42	6.89	8.51	
Aug-12	6.16	6.46	6.91	8.44	10.90
Sep-12	6.25	6.24		8.25	10.38
Oct-12	6.15			8.07	10.19
Nov-12	6.25	6.50	6.90	8.34	10.61
Dec-12	6.22	6.28	6.87	8.69	11.12
Jan-13	6.09	6.09		8.35	
Feb-13	6.08	5.85			10.46
Mar-13	5.70	5.44	6.15	7.59	
Apr-13	5.24	5.64	6.50	8.55	
May-13	5.48	6.03			10.30
Jun-13	5.84	5.59	6.16	8.12	
Jul-13	5.23	5.22		7.91	
Aug-13	4.53	4.95	5.87		
Sep-13	4.11	4.45	5.53	7.44	

Issue Month	6 Months	1 Year	2 Years	5 Years	10 Years
Oct-13	4.00	4.13	5.17	7.25	
Nov-13	3.91	4.25			10.04
Dec-13	4.07	4.30	5.19	7.51	
Jan-14	4.04	5.23	6.19		
Feb-14	4.080	6.330	6.810		11.700
Mar-14	4.400	6.660	7.750	10.070	
Apr-14	4.400	6.860		10.260	
May-14	4.380	6.770	8.010		11.590
Jun-14	4.310	6.580	7.790	9.890	
Jul-14	4.250	6.330	7.460	9.510	
Aug-14	4.190	6.010	7.430		11.100
Sep-14	4.160	5.800		9.280	
Oct-14	4.190		6.920	9.010	
Nov-14	4.460	5.670	6.690		10.600
Dec-14	4.710	5.970	6.960	8.960	
Jan-15	4.770	5.870	6.670	9.050	
Feb-15	4.700	6.110	7.120	9.430	10.460
Mar-15	4.830	6.250	7.430	9.910	

Annex 14: Private Equity Funds Operating in Georgia

Name	Scope	Began	Ownership	Assets under Management	Types of Investment	Stage of Investment	Minimum Maximum	Sector Focus
Georgian Co-Investment Fund	Georgia	2013	SOFAZ Calik Holdings Batumi Industrial Holdings Limited Milestone International Holdings Dhabi Group RAKIA Mr. Bidzina Ivanishvili Estate of B. Patarkatsishvili Mr. Alexander Mashkevich	$6 billion	Equity participation 25% to 75%	Greenfield and Brownfield projects as well as in distressed companies	Minimum $5 million; maximum not specified	Energy (up to $3 billion) Manufacturing (up to $1.5 billion) Hospitality and Real Estate (up to $1 billion) Agriculture (up to $.5 billion) Logistics (up to $.5 billion) Others (up to $.5 billion)
Partnership Fund	Georgia	2011	100% State Owned	$1.4 billion	Equity to 50%; mezzanine debt	Early stage growth	$3 million to $760 million	Agribusiness; Energy; Infrastructure & Logistics; Manufacturing; Real Estate; Tourism
Black Sea Trade & Development Bank	Black Sea Regional	2000	Black Sea Economic Cooperation (BSEC)	€ 601 million	Debt, Equity and Guarantees	Green field investments, modernization of technology expansion of capacity.	Amount not specified; 10% to 25% of equity.	Agribusiness, telecommunications, transportation, energy and natural resources, tourism and real estate
SEAF Caucasus Growth Fund	Regional	2012	EBRD IFC Netherlands Development Bank (FMO) Black Sea TD Bank SEAF	$40 million	Equity, quasi equity and debt with participation features	Growth stage	Not specified	Agricultural Construction Energy Financial services Health care, retail Vocational training
SEAF Georgia Regional Development Fund	Regional	2006	Millennium Challenge Georgia Fund (upon liquidation to Georgian State Budget)	$15 million	Equity and debt	SMEs in early stage, mid venture, and expansion capital	Maximum $2 million	Tourism Agribusiness

Name	Scope	Began	Ownership	Assets under Management	Types of Investment	Stage of Investment	Minimum Maximum	Sector Focus
JSC Liberty Consumer (Formerly Galt & Taggart Capital)	Georgia	2006	JSC Galt & Taggart Holdings 51.64% Sakaropel 14.49% JSC Bank of Georgia 13.6% Firebird Avrora Fund Ltd. 3.84% Firebird Republics Fund Ltd. 3.64% East Investor Ltd. 2.88% Parex Banka Clients Account (Bank of New York) 2.5% Ewald Poellner 1.81% Vytenis Rasutis 1.02% Other 4.58%	$16 million	Equity	Not specified	Not specified	Consumer goods production, Packaging materials production, retail trade, distribution, logistical support and provision, commercial, tourist and residential real estate, transport infrastructure, financial service, telecommunications service, media and advertising, tourism, leisure, entertainment
Smartex	Georgia	2011	JSC Liberty Capital 77.74% JSC Liberty Bank 21.26% UGT LLC 1%	Not specified	Equity	Seed financing, Early-stage financing, Growth-stage financing	Minimum $50k; maximum $300k	Digital wallets & payments, Online financial services, Local deals, social gifting & electronic commerce, VoIP, Digital & user generated content

Annex 15: Analysis of Commercial Banks as Potential Issuers and Purchasers

INTRODUCTION

331. In order to estimate the roles of Georgia's commercial banks in a renewed capital markets this Study reviewed the 2013 audited financial statements of 21 commercial banks. The 21 banks analyzed have been assigned random identifying numbers for listing in the tables.[103]

A. THE BANKS AS ISSUERS OF SECURITIES - OVERVIEW

332. **Our analysis of Georgia's banks as possible issuers of securities has taken into consideration their bifurcated nature.** First, banks are corporate entities. They have a need to structure their balance sheet the same as real sector corporations. In terms of issuing securities, the choices available are (1) equity, in the form of common and/or preferred shares, and (2) debt, in the form of corporate bonds. Second, banks have a need to manage their liquidity, leverage and regulatory capital given the specialized nature of their business. It is possible for them to issue additional types of securities to meet these goals: (1) covered bonds, and (2) securitizations.

333. The main business drivers for the banks issuing securities are as follows:

h) to generate liquidity;
i) protect against deposit flight risk;
j) fix asset – liability mismatches;
k) refinance assets;
l) leverage the balance sheet
m) replace bank borrowings;
n) deleverage the balance sheet

B. CURRENT BUSINESS DRIVERS FOR ISSUING SECURITIES

334. **Do the Banks Face Overall Liquidity Constraints?** One of the most frequent business drivers leading to a bank's issuance of securities is the need to generate liquidity for more lending operations. In order to measure whether Georgia's banks face liquidity constraints we have calculated the "lending to available funds" ratio.[104] For these purposes two parameters were used: (1) a "narrow" scope, which includes lending to customers compared to available funds, and (2) a "broad" scope which includes lending to both customers and banks compared to available funds. In general, a lending to available funds ratio greater than 80% indicates a bank approaching liquidity constraints.

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[103] USD/GEL exchange rate used is the official exchange rate of NBG as of 31 December, 2013

[104] The calculation of "available funds" begins with the bank's total assets and then subtracts all illiquid resources. For this Study, available funds was calculated as follows:

Included in 'Available Funds' (Liquid Assets)	Not included in 'Available Funds' (Illiquid Assets)
Cash and Balances with NBG	Required Reserves with NBG
Loans to Banks	Prepaid Expenses
Loans to Customers	Equity Investments
Financial Assets	Construction in Process
Accounts Receivable	Property Plant and Equipment
	Deferred Taxes
	Other Assets

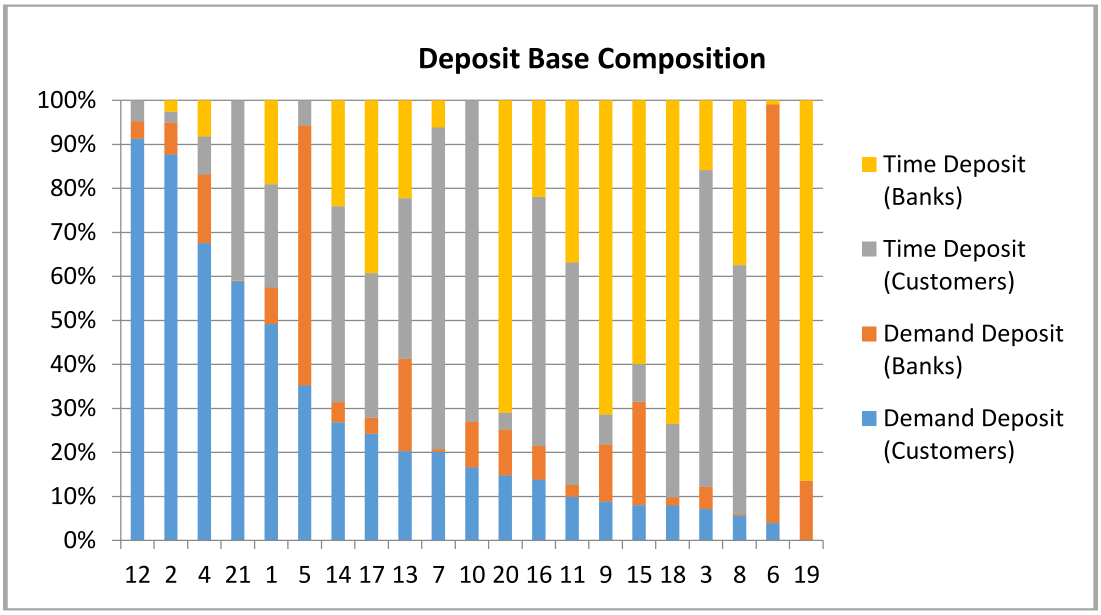
335. **The analysis based on the financial statements alone indicates that there are 12 banks within the liquidity constraint range**. They need additional funds of GEL 559 million ($322 million) to reset their liquidity to 80%. Since their D/E ratios are not high, these banks can either issue debt or equity securities (common or preferred shares).

Table 24: The Banks' Liquidity Constraints and Needed Funds

Bank Code	Available Funds	Lending to Available Funds (Customers)	Lending to Available Funds (Customers and Banks)	Debt / Equity	Amount of Additional Equity (GEL) Needed to Reduce to 80%	Amount of Additional Equity (USD) Needed to Reduce to 80%
15	106,580,000	76.50%	97.02%	2	22,670,000	13,056,499
10	11,751,020	50.61%	95.42%	1	2,265,559	1,304,820
19	130,320,280	84.70%	92.89%	3	20,998,881	12,094,040
17	517,545,000	76.57%	91.88%	1	76,852,500	44,262,224
18	308,300,000	91.53%	91.53%	6	44,436,250	25,592,496
3	3,274,547,000	86.65%	86.70%	5	274,244,250	157,947,503
7	46,830,000	77.01%	85.62%	3	3,288,750	1,894,114
11	865,787,000	80.03%	85.23%	6	56,558,000	32,573,864
13	854,512,000	78.78%	84.31%	5	46,074,250	26,535,881
2	306,771,000	82.44%	82.44%	4	9,339,000	5,378,679
9	97,863,000	74.79%	82.00%	3	2,443,250	1,407,159
6	22,330,000	23.01%	80.18%	0	51,250	29,517

336. **Do the Banks Need to Protect Against Deposit Flight Risk?** Issuing bonds helps build a "floor" of source funds that cannot be extracted from the bank on demand, thus building in a component of permanent-source financing. This is a technique to protect against deposit flight as a result of a shock to a particular bank or the system overall. In order to determine if the banks need to follow this strategy it is necessary to examine the make-up of the deposit base.

Figure 33: Deposit Base Composition for Georgia's Banks



337. **The data indicate that there are 7 banks with demand deposits in excess of 50% of the total base.** The following table indicates the amount of debt securities that would need to be issued to bring the demand deposit component to 50% of total base.[105]

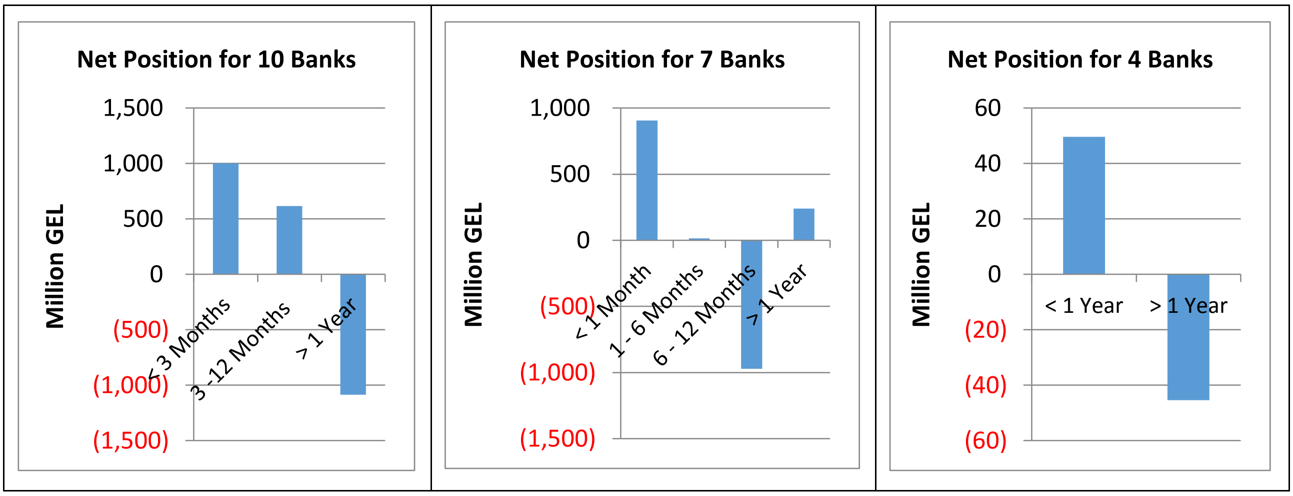
Table 25: Funds Needed to Reduce Demand Deposits

Bank Code	Total Demand Deposits	Total Demand Deposits	50% Demand Deposit Level	Needed Reduction in Demand Deposits (GEL)	Needed Reduction in Demand Deposits (USD)
6	99.02%	10,823,000	5,465,000	5,358,000	$3,085,872
12	95.20%	10,901,000	5,725,500	5,175,500	$2,980,764
2	94.89%	311,931,000	164,367,500	147,563,500	$84,987,329
5	94.29%	98,929,000	52,460,500	46,468,500	$26,762,944
4	83.14%	21,466,566	12,910,625	8,555,941	$4,927,686
21	59.01%	685,110,000	580,507,500	104,602,500	$60,244,485
1	57.48%	185,827,000	161,642,500	24,184,500	$13,928,757
				341,908,441	**$196,917,837**

338. **Do the Banks Need to Fix Asset-Liability Mismatches?** Issuing corporate bonds allows the bank to match the time period of the source funds exactly to the time period of the loans extended. The amount (interest rate) to be earned on the loan is fixed and known. Similarly, the amount of interest to be paid on the bonds is also fixed and known. But the price for this “insurance” (the amount of interest to be paid on the bonds) is usually higher than the costs of deposits. Thus, issuing bonds addresses the classic asset-liability mismatch faced by banks, but at a cost.

339. Analyzing this issue for Georgia is somewhat problematic because the banks report their liquidity positions using different sets of time intervals (3 months, 6 months and 12 month)

Figure 34: Net Asset Liability Positions



340. While it is not feasible to attach here the asset-liability matching tables for each individual bank, the following is the net position for each bank for the maturities greater than 1 year.

105 The 50% demand deposit level is used for illustration purposes only. In addition, the definition of ‘time deposit’ is any deposit greater than 1 month. The data is taken from the notes to the financials statements of each bank (on liquidity risk) which provides greater differentiation of time periods.

Table 26: Net Asset Liability Position for > 1 Year

Bank Code	Net Positions	
	> 1 Year (GEL)	> 1 Year (USD)
8	226,631,000	$130,525,255
17	166,251,000	$95,750,158
2	114,501,000	$65,945,401
1	100,215,000	$57,717,560
14	61,619,000	$35,488,683
13	55,790,000	$32,131,544
5	33,178,000	$19,108,449
15	14,972,000	$8,622,934
6	9,397,000	$5,412,083
7	6,956,000	$4,006,220
4	5,456,626	$3,142,675
12	2,308,000	$1,329,263
10	2,270,950	$1,307,925
20	1,248,854	$719,262
9	(8,673,000)	($4,995,105)
18	(15,042,000)	($8,663,249)
11	(22,792,000)	($13,126,764)
19	(29,555,671)	($17,022,214)
16	(73,262,000)	($42,194,321)
21	(202,489,000)	($116,620,976)
3	(1,340,531,000)	($772,061,856)

341. **Thus, the data indicate that several banks have a need to better match their assets to liabilities possibly by issuing bonds with maturities that match the longer end asset classes**. Full optimization would require GEL 800 million ($461 million). However it should be noted that these bonds would carry a higher cost than shorter maturity borrowings and thus the business decisions on using bonds to match durations must take this into account.

342. **Do the Banks Need to Refinance their Assets?** Banks usually issue covered bonds when they have reached their liquidity limits but not their leverage limits. Further, banks use securitization when they have reached both their liquidity and leverage limits.

343. **The most common type of loan to be refinanced relates to mortgage lending.** This is because mortgage lending tends to be long-term and distorts a bank's asset-liability matching. Banks tend to prefer to refinance their mortgage loans using covered bonds because in this manner they retain the high rate of return, but flatten the asset-liability net positions.

344. **The data indicate that there are 5 banks where mortgage loans constitute 20% or more of their total lending to customers.** The amount of refinancing that would be needed to bring this percentage to 15% (a notional threshold only) is GEL 127 million. Thus, while the total amount of needed refinancing is not a precise sum, it does provide a sense of the scale of possible financing through the securities markets.

Table 27: Mortgage Lending Levels and Possible Refinancing Needs

Bank Code	Loans and Other Credits Provided to Customers	Debt / Equity Ratio	Mortgage Loans Outstanding (GEL)	% of Mortgage Lending to Total Customer Lending	Refinancing Amount Needed to Reduce to 15% of Portfolio (GEL)	Refinancing Amount Needed to Reduce to 15% of Portfolio (USD)
5	47,235,000	4	18,932,000	40.08%	11,846,750	6,822,986
7	36,066,000	3	13,559,000	37.59%	8,149,100	4,693,371
13	673,200,000	5	197,024,000	29.27%	96,044,000	55,315,326
12	6,479,000	2	1,411,000	21.78%	439,150	252,923
1	188,539,000	2	39,495,000	21%	11,214,150	6,458,648

345. **Do the Banks Need to Leverage their Balance Sheets (increase their D/E ratios)?** A bank may wish to leverage up its balance sheet if it has a D/E ratio below the maximum and can use the acquired funds for more lending. Leveraging up a positive impact on the profitability of a bank as it increases the RoE.

346. Leveraging up can be achieved either by borrowing more from banks and other financial institutions and/or by issuing debt securities. Cost of funds from bank borrowings needs to be compared to the expected interest rate to be paid on the debt securities to make a decision whether this option is feasible.

Table 28: Possible Increased Leverage and Needed Debt

Bank Code	Debt / Equity Ratio	Lending to Available Funds (Customers and Banks)	Additional Debt (GEL) to Increase D/E to 3	Additional Debt (USD) to Increase D/E to 3	Return on EQUITY	Cost of Funds (Depositors)	Cost of Funds (Bank Borrowing)
6	0.3	80.18%	85,097,000	$49,010,540	-9.45%	2.76%	0.62%
10	0.5	95.42%	37,182,769	$21,414,945	0.59%	0.29%	5.81%
17	1.1	91.88%	518,752,000	$298,768,646	25.58%	3.62%	3.14%
4	1.5	68.38%	24,620,396	$14,179,805	-2.70%	0.69%	0.54%
12	1.5	61.25%	10,972,000	$6,319,184	-69.52%	1.58%	0.00%
20	1.5	56.74%	17,749,602	$10,222,659	-2.51%	7.38%	0.08%
15	2.0	97.02%	43,736,000	$25,189,195	3.47%	4.20%	3.91%
1	2.2	75.88%	91,789,000	$52,864,712	11.06%	2.32%	9.11%
7	2.5	85.62%	7,143,000	$4,113,920	-2.53%	4.23%	2.60%
19	2.7	92.89%	12,054,171	$6,942,447	21.35%	0.00%	6.34%
			849,095,938	**$489,026,054**			

347. **The data indicate that 10 banks have debt to equity ratio below 3 and could leverage up their balance sheets**. Total amount needed to bring the debt to equity ratio to 3 amounts to GEL 850 million. Some of these banks have reached their lending limits; therefore they need additional liquidity. However, their costs of funds from both deposits and from bank borrowing appear lower than the expected interest rates on bonds, therefore it might not be feasible to issue debt securities for cost optimization purposes to leverage up their balance sheets.

348. It should be noted that most of the attracted funds for banks in Georgia are in US dollars and therefore loans issued by banks, especially the long term are in the same currency. This carries a currency risk for the banks, especially in times of a currency shock. If a local currency substantially devaluates against the US dollars, it would in turn increase the GEL value of the banks' loan book and hit the banks' capital adequacy ratio refraining them from further lending activities. Therefore, it is of importance for the banks to reduce the dollarization level of the banks' balance sheet. Therefore,

despite lower cost of attracted funds in foreign currency, banks might still be interested in issuing bonds denominated in the local currency to attract long term GEL funds, but at a cost. The results show that banks have the capacity to leverage up the balance sheet.

349. **Do the Banks Need to Replace their Bank Borrowings?** Banks may choose to replace their borrowings from other banks by issuing debt securities, in order to reduce interest costs. (The need to issue debt securities to protect against deposit flight and to fix asset-liability mismatches is discussed above). Analyzing the need to use this 'debt for debt' substitution is relatively simple; it depends on relative costs and whether it is feasible to issue debt for the maturities desired.

Table 29: Bank Borrowings from Other Banks

Bank Identifying Code	Bank Borrowing as % of Total Attracted Funds	Cost of Funds (Bank Borrowing)
19	100.00%	6.34%
6	95.86%	0.62%
9	84.41%	7.97%
15	83.30%	3.91%
20	81.44%	0.08%
18	75.31%	8.18%
5	58.85%	7.73%
17	42.99%	3.14%
13	42.72%	2.37%
8	37.69%	5.33%
11	36.21%	5.63%

350. **The data indicate that there are 9 banks that obtain 40% or more of their attracted funds from bank borrowings.** This opens the question of whether they might wish to replace these borrowings by issuing debt. But the low cost of these funds would appear to indicate this option is not feasible. While the question cannot be definitively determined without knowing the expected rates for debt securities, the very low cost of funds of bank funds make this strategy appear unlikely. For this reason, there does not appear to be a need for Georgia's banks to issue debt to replace borrowings from other banks on a 'cost of funds' reasoning.

351. **Do the Banks Need to De-Leverage their Balance Sheets?** The need to deleverage the balance sheet can arise from 2 interrelated business drivers (1) an unacceptably high D/E ratio, and/or (2) a CAR below required minimums. We focused on the D/E ratio in this Study. There is no definitive maximum D/E limit for banks. However, the minimum capital ratios operate to control this aspect and provide some rough guidance on the acceptable upper D/E range. For purposes of this Study we have used a D/E of 12.5.

Table 30: Debt to Equity Ratios

Bank Code	Debt / Equity	Return on Equity
21	10	15.83%
16	8	14.32%
11	6	13.45%
18	6	22.48%
13	5	16.61%
3	5	18.26%
14	4	28.43%
5	4	-27.05%
8	4	18.08%
Average	4	16.73%

352. **The above data indicates that none of the 21 banks have a need to reduce their D/E ratios**. There is a trade-off between balancing the need to reduce the leverage versus the desire to maximize return on equity, as "equity for debt" substitution has a negative impact on RoE due to broadening of the equity base. Therefore, there is no need to raise additional equity for the purposes of deleveraging the balance sheet as suggested by the results.

<u>Tentative Conclusions</u>

353. From all of the foregoing, it appears that:

a) **Twelve banks would appear to have a need for additional liquidity, as they have lending to available funds ratios more than 80%**. According to the financial statements, additional funds of GEL 559 million ($322 million) would be needed to bring their lending to available funds ratio to 80%.

b) **Seven banks may need to issue debt securities to replace demand deposits**. Their demand deposits exceed 50% of the total base. At least 4 of these banks have severe deposit flight risk. The total amount of corporate debt needed to bring the level of demand deposits down to only 50% of the overall base for these banks is GEL 342 million ($197 million).

c) **Fourteen banks may need to issue debt securities to address asset-liability mismatches**. Complete matching of maturities greater than 1 year would require issuing debt securities in the amount of GEL 801 million ($461 million). However this would result in higher interest costs; a full optimization may not be advisable.

d) **Five banks may need to refinance part of their portfolios**. Each of these banks has 20% or more of their lending to mortgage lending. If the banks chose to reduce that percentage to 15% as a way of addressing asset liability matching concerns, the total amount of refinancing needed would be GEL 127 million (USD 73 million).

e) **Ten banks could issue debt securities as a method of leveraging up their balance sheets, but this does not seem advisable** for cost optimization purposes. The total amount of additional debt to take these banks to 3 D/E ratio would be GEL 849 billion ($489 billion). However, their existing cost of funds appears to be lower than the expected interest cost on bonds.

f) The banks do not appear to have a need to issue debt securities to replace their bank borrowings, at least on a relative cost of funds basis. Bank borrowing from other banks is relatively inexpensive. Cost of funds for interbank borrowing is below 6% on average for all banks.

g) **None of the 21 banks have D/E ratios below notional 12.5.** This means that Georgian banks are well capitalized and have enough cushion for capital adequacy limits.

Table 31: Summary of Needed Funds, by Bank (amounts in millions)

	Need to Generate Liquidity with Equity Issuance		Need to Address Deposit Fight Risk with Debt Issuance		Need to Address Asset-Liability Mismatch with Debt Issuance		Need to Refinance Portfolio with Securitization		Total Securities Issuance Needed[106]	
Bank Code	GEL	USD	GEL	USD	GEL	USD	GEL	USD	GEL	USD
18	44	$26							44	$26
3	274	$158							274	$158
19	21	$12							21	$12
2	9	$5	148	$85	115	$66			271	$156
11	57	$33							57	$33
13	46	$27			56	$32	96	$55	198	$114
7	3	$2			7	$4	8	$5	18	$11
17	77	$44			166	$96			243	$140
15	23	$13			15	$9			38	$22
1			24	$14	100	$58	11	$6	136	$78
8					227	$131			227	$131
9	2	$1							2	$1
16									0	$0
14					62	$35			62	$35
21			105	$60					105	$60
20					1	$1			1	$1
5			46	$27	33	$19	12	$7	91	$53
10	2	$1			2	$1			5	$3
12			5	$3	2	$1		-	7	$4
4			9	$5	5	$3			14	$8
6			5	$3	9	$5			15	$8
	559	**$322**	**342**	**$197**	**801**	**$461**	**127**	**$73**	**1,829**	**$1,053**

106 The total cumulative securities issuances needed may be less than the row totals because some transactions serve more than one business goal.

C. THE BANKS AS PURCHASERS OF SECURITIES - OVERVIEW

354. The main business drivers for bank purchases of securities are (1) liquidity management, (2) investment, and (3) trading.

Table 32: Banks as Purchasers of Securities

Security Type	Purpose for Purchase		
	Liquidity Management	Investment	Trading
Central Bank Debt	√		
Treasury Securities	√	√	√
Securitizations		√	
Covered Bonds (Mortgage bonds)		√	
Corporate Bonds		√	√

D. CURRENT BUSINESS DRIVERS FOR PURCHASING SECURITIES

355. In order to gauge the banks' appetite for liquidity-driven purchases it is necessary to explore whether in fact the banks have excess cash on hand. Low levels of lending to available funds tend to correlate to the need to invest the excess liquidity.

356. Gauging the banks' interest in investment-driven purchases must consider the level of cash on hand, but should take two additional factors into consideration:

a) **First, what is the cost of the funds to be invested?** Banks should seek to invest funds at returns higher than they pay for those funds. In the investment-driven category the banks have a choice of uses for the funds. Investing them at a built-in loss should not be expected.

b) **Second, what are the banks' return expectations?** In this category the banks have a choice between further lending and making investments. The expected yield on the investment should compare favorably to the yield on the loan portfolio.

357. **The data indicate that there are 9 banks with a lending to available funds ratio less than 80%.** Excess available funds for these 9 banks are GEL 1.88 billion, which comprises of GEL 1.76 billion in cash and balances with the NBG. Weighted average portfolio yield for these 9 banks is high, but banks have lower levels of lending to available funds, which imply that banks either cannot or do not wish to lend more to their customers. Therefore, the banks would have a high degree of interest in suitable investments, with a large portion of it in making long term investment driven purchases, given that the weighted cost of funds for these 9 banks is low and comprises to 5.97%.

Table 33: Parameters of Funds Available for Securities Purchases (Part 1)

Bank ID	Lending to Available Funds	Excess Available Funds (GEL)	Cash and Balances with NBG (GEL)	Cash and Balances with NBG (USD)	Cost of Funds	Portfolio Yield
20	56.74%	12,617,662	12,617,662	7,266,983	1.43%	8.49%
12	61.25%	5,527,000	5,490,000	3,161,896	2.52%	15.34%
21	62.45%	362,400,000	355,089,000	204,509,013	8.51%	24.32%
5	66.90%	27,688,000	27,429,000	15,797,385	7.84%	23.85%
4	68.38%	8,879,937	8,695,019	5,007,786	0.68%	3.28%
14	72.65%	116,138,000	105,844,000	60,959,512	9.35%	21.75%
8	75.69%	1,139,590,000	1,049,069,000	604,198,007	5.19%	15.18%
1	75.88%	59,941,000	59,506,000	34,271,727	3.17%	12.37%
16	77.00%	152,308,000	146,175,000	84,187,640	4.21%	13.24%
		1,885,089,599	1,769,914,681	1,019,359,950	5.97%	17.24%
					Weighted Average	Weighted Average

358. **The data also indicate that there are 12 banks with a lending to available funds ratio more than 80%.** However**,** these still have excess available funds in the amount of GEL 861 million, which comprises of GEL 777 million in cash and balances with the NBG. These funds can be used for liquidity rather than investment driven purchases for short term money market instruments.

Table 34: Parameters of Funds Available for Securities Purchases (Part 2)

Bank ID	Lending to Available Funds	Excess Available Funds (GEL)	Cash and Balances with NBG (GEL)	Cash and Balances with NBG (USD)	Cost of Funds	Portfolio Yield
6	80.18%	4,425,000	4,425,000	2,548,523	0.71%	7.88%
9	82.00%	17,618,000	17,274,000	9,948,742	7.52%	18.38%
2	82.44%	53,883,000	47,167,000	27,165,236	6.60%	16.19%
13	84.31%	134,043,000	132,015,000	76,032,368	3.44%	12.06%
11	85.23%	127,911,000	125,714,000	72,403,387	4.97%	15.48%
7	85.62%	6,735,000	5,963,000	3,434,314	4.13%	13.70%
3	86.70%	435,514,000	390,465,000	224,883,373	5.30%	15.65%
18	91.53%	26,111,000	24,537,000	14,131,774	7.67%	26.28%
17	91.88%	42,027,000	17,391,000	10,016,126	3.41%	14.58%
19	92.89%	9,264,951	9,264,951	5,336,031	6.34%	30.27%
10	95.42%	537,757	537,757	309,714	0.75%	6.48%
15	97.02%	3,180,000	3,167,000	1,823,994	3.95%	8.23%
		861,249,708	777,920,708	2,486,753,482	5.06%	15.50%
					Weighted Average	Weighted Average

359. Total excess available funds in the system are GEL 2.7 billion out of which GEL 2.5 billion is in the form of cash or balances with NBG and other banks. These funds can be used for both liquidity driven and investment-driven purchases.

Tentative Conclusions

360. From the above analysis, it can be concluded that:

a) Nine banks have excess liquidity of GEL 1.8 billion that needs to be invested in central bank bonds or treasury bonds. In other words the level of liquidity-driven purchases could reach this level.

b) These same nine banks could use these funds for investment-driven purchases of securities if the expected return on these investments is greater than 5.67% their weighted average cost of funds. The implied interest by these banks in investments is high given their low levels of lending to available funds. It would appear they are not able or willing lend more and may be looking for other outlets for their attracted funds.

c) **Total excess available funds in the system are GEL 2.7 billion**, which can be used for both liquidity-driven and investment-driven purchases.

E. SUMMARY

361. There are 5 categories of business drivers applicable in Georgia that would appear to guide banks towards being issuers of securities, if the capital market system is developed.

362. Out of 21 banks analyzed 20 banks have a need to issue securities in at least one of the categories of business drivers.

363. The cumulative amount of securities that could be issued to satisfy these business needs is as much as GEL 1.8 billion, or over USD 1 billion. By any measure this is a significant sum for a capital market system.

364. At the same time, Georgian banks have excess funds of GEL 2.7 billion that could be used to purchase securities. This could be used for corporate securities.

365. The implied interest by these banks in investments is high given that they are not able or willing lend more and may be looking for other outlets for their attracted funds, especially when their cost of funds are low.

Annex 16: Summary Financial Data for State-owned Enterprises (GEL) (2013)

	Company Name	Sector Classification	Revenues (GEL)	Net Income (GEL)	Total Assets (GEL)	Shareholders' Equity (GEL)	Return on Equity	Profit Margin	Debt to Equity Ratio	Revenues to Assets
1	Georgian Railway JSC	transportation	495,298,000	65,230,000	2,885,227,000	1,569,127,000	4.16%	13.17%	83.87%	17.17%
2	Georgian Oil and Gas Corporation JSC	oil and gas service	325,761,000	94,293,000	1,054,893,000	568,923,000	16.57%	28.95%	85.42%	30.88%
3	Telasi JSC	electricity	261,753,000	(37,883,000)	228,614,000	86,669,000	-43.71%	-14.47%	163.78%	114.50%
4	Electricity System Commercial Operator JSC	electricity	116,854,142	936,507	33,985,845	5,652,832	16.57%	0.80%	501.22%	343.83%
5	TBILAVIAMSHENI LLC	military and civilian engineering and weapons	82,640,341	11,004,722	221,142,499	97,584,706	11.28%	13.32%	126.62%	37.37%
6	Georgian State Electrosystem JSC	electricity	75,413,000	(63,035,000)	1,023,270,000	219,806,000	-28.68%	-83.59%	365.53%	7.37%
7	SAKAERONAVIGATSIA LLC	air communication	55,468,700	14,447,544	126,104,929	93,319,000	15.48%	26.05%	35.13%	43.99%
8	United Water Supply Company of Georgia LLC	service of water supply	47,068,000	(11,910,000)	456,156,000	295,052,000	-4.04%	-25.30%	54.60%	10.32%
9	State Construction Company LLC	construction	25,316,538	(4,419,410)	64,317,355	41,204,730	-10.73%	-17.46%	56.09%	39.36%
10	Georgian Airports Union LLC	transportation	15,327,377	(1,010,198)	175,642,617	166,792,999	-0.61%	-6.59%	5.31%	8.73%
11	Nikoloz Kipshidze Central University Clinic LLC	medical service	14,405,068	537,873	24,488,759	18,005,536	2.99%	3.73%	36.01%	58.82%
12	Center for Mental Health and Addiction Prevention LLC	medical service	8,983,903	128,346	9,927,442	9,317,250	1.38%	1.43%	6.55%	90.50%
13	DEMETRE 96 LLC	sewing factory	8,505,174	803,933	6,115,094	4,778,564	16.82%	9.45%	27.97%	139.08%
14	National Center for Tuberculosis and Lung Diseases LLC	medical service	7,003,222	(929,733)	25,456,304	21,013,827	-4.42%	-13.28%	21.14%	27.51%
15	AIDS Center JSC	medical service	6,549,061	73,772	5,314,356	3,955,369	1.87%	1.13%	34.36%	123.23%
16	Georgian Amelioration Systems Company Ltd.	irrigation service	6,092,055		362,552,844	339,818,008	0.00%	0.00%	6.69%	1.68%
17	Georgian Tele-Radio Center LLC	telecommunication	4,869,138	1,203,894	19,457,940	17,499,706	6.88%	24.73%	11.19%	25.02%
18	B. Naneishvili National Center of Mental Health LLC	medical service	4,377,247	157,201	3,710,302	3,338,434	4.71%	3.59%	11.14%	117.98%
19	Universal Medical Center LLC	medical service	2,371,748	572,896	15,481,016	14,639,063	3.91%	24.16%	5.75%	15.32%
20	National High Technology Center of Georgia LLC	scientific researches	1,738,161	159,728	4,576,088	4,520,204	3.53%	9.19%	1.24%	37.98%
21	Tbilisi Mental Health Center LLC	medical service	1,564,965	57,574	760,871	659,368	8.73%	3.68%	15.39%	205.68%

	Company Name	Sector Classification	Revenues (GEL)	Net Income (GEL)	Total Assets (GEL)	Shareholders' Equity (GEL)	Return on Equity	Profit Margin	Debt to Equity Ratio	Revenues to Assets
22	Chkhobadze Disabled and Elderly Rehabilitation Clinic LLC	medical service	1,511,594	15,790	1,896,196	1,069,274	1.48%	1.04%	77.33%	79.72%
23	Tbilisi Children's Infectious Diseases Hospital LLC	medical service	1,471,296	201,145	450,955	311,870	64.50%	13.67%	44.60%	326.26%
24	Regional Health Center LLC	medical service	1,144,044	(15,132)	7,282,275	7,230,890	-0.21%	-1.32%	0.71%	15.71%
25	TBILGVIRABMSHENI LLC	tunnel construction	1,076,165	563,362	2,894,251	2,659,863	21.18%	52.35%	8.81%	37.18%
26	Nazirashvili Kutaisi Center for Family Medicine LLC	medical service	954,245	101,028	663,287	607,383	16.63%	10.59%	9.20%	143.87%
27	V. Sanikidze War Veterans Clinical Hospital LLC	medical service	815,378	10,802	754,433	678,136	1.59%	1.32%	11.25%	108.08%
28	Abastumani Antituberculosis Hospital LLC	medical service	767,777	(33,872)	629,520	361,776	-9.36%	-4.41%	74.01%	121.96%
29	West Georgia Center for Tuberculosis and Lung Diseases LLC	medical service	753,653	30,117	371,590	246,910	12.20%	4.00%	50.50%	202.82%
30	Kutaisi Mental Health Center LLC	medical service	740,760	(11,271)	669,320	628,465	-1.79%	-1.52%	6.50%	110.67%
31	Bediani Psychiatric Hospital LLC	medical service	701,298	14,206	577,786	528,868	2.69%	2.03%	9.25%	121.38%
32	Georgian Oil and Gas Service Company	Oil and gas service	665,716	(29,197)	1,709,032	1,059,571	-2.76%	-4.39%	61.29%	38.95%
33	National Health and Rehabilitation Practice Center LLC	medical service	647,020	3,431	2,057,719	1,495,374	0.23%	0.53%	37.61%	31.44%
34	Al. Kajaia Surami Psychiatric Hospital LLC	medical service	568,546	1,700	259,057	200,240	0.85%	0.30%	29.37%	219.47%
35	Kutaisi Regional Blood Bank LLC	medical service	542,945	(62,979)	373,662	266,551	-23.63%	-11.60%	40.18%	145.30%
36	SERVISI - 8 LLC	construction & development	507,016	(620,010)	14,266,882	14,032,065	-4.42%	-122.29%	1.67%	3.55%
37	Infrastructure Development company Ltd	Building and projecting	477,759	383,165	24,738,439	24,663,419	1.55%	80.20%	0.30%	1.93%
38	SAMTOMASHVELI LLC	rescue activities	442,564	4,449	578,356	561,017	0.79%	1.01%	3.09%	76.52%
39	Marine Technical Service LLC	technical service	409,647	7,435	1,250,511	1,097,433	0.68%	1.82%	13.95%	32.76%
40	Makhviladze Institute of Labor Medicine and Ecology JSC	medical service	399,586	13,201	70,675	49,025	26.93%	3.30%	44.16%	565.39%
41	SAKAVTOTRANS LLC	passenger and truck service	334,976	(82,033)	7,344,257	6,216,089	-1.32%	-24.49%	18.15%	4.56%

	Company Name	Sector Classification	Revenues (GEL)	Net Income (GEL)	Total Assets (GEL)	Shareholders' Equity (GEL)	Return on Equity	Profit Margin	Debt to Equity Ratio	Revenues to Assets
42	Inter-regional Psych neurological Dispensary LLC	medical service	320,310	986	83,617	81,591	1.21%	0.31%	2.48%	383.07%
43	TSALKAGAZI LLC	Service in the field of gas	265,583	9,762	187,402	93,894	10.40%	3.68%	99.59%	141.72%
44	TUSHETGZA LLC	Road service	246,745	8,925	78,676	73,870	12.08%	3.62%	6.51%	313.62%
45	Akhtala Resort JSC	resort service	245,572	30,790	1,648,653	1,628,671	1.89%	12.54%	1.23%	14.90%
46	AUTOBASE LLC	transportation	233,577	28,161	3,934,948	3,814,998	0.74%	12.06%	3.14%	5.94%
47	Ambulatoric Policlinic Union LLC	medical service	207,450	9,862	262,830	195,311	5.05%	4.75%	34.57%	78.93%
48	Kutaisi №5 Adult Policlinic LLC	medical service	199,637	8,477	72,782	52,630	16.11%	4.25%	38.29%	274.30%
49	Abasha Road Division LLC	medical service	194,571	10,049	34,310	29,413	34.17%	5.16%	16.65%	567.10%
50	Examination of Construction Projects LLC	construction researches	188,436	1,194	19,136	18,798	6.35%	0.63%	1.80%	984.72%
51	Senaki Maternity Hospital LLC	medical service	175,107	(16,801)	246,001	107,089	-15.69%	-9.59%	129.72%	71.18%
52	Telavi Psychoneurological Dispensary LLC	medical service	164,340	8,474	280,099	266,157	3.18%	5.16%	5.24%	58.67%
53	Senaki Children’s Hospital LLC	medical service	154,236	8,169	170,665	132,211	6.18%	5.30%	29.09%	90.37%
54	Clinical Pathology Scientific-Practical Center LLC	medical service	147,900	917	1,676,755	1,669,559	0.05%	0.62%	0.43%	8.82%
55	Anaklia LLC	aqua park	134,308	(1,804,365)	5,220,059	5,209,842	-34.63%	-1343.45%	0.20%	2.57%
56	Technical Specialists Training Center LLC	educational activity	122,658	579	1,253,055	1,234,329	0.05%	0.47%	1.52%	9.79%
57	Disinfection, Sterilization Epidemic Monitoring Center LLC	medical service	114,718	10,811	38,973	37,065	29.17%	9.42%	5.15%	294.35%
58	ZUGDIDSERVISI LLC	medical service	97,218	36,547	199,217	192,356	19.00%	37.59%	3.57%	48.80%
59	SAKGEOLOGIA LLC	Geological researches	88,912	2,103	930,212	447,680	0.47%	2.37%	107.79%	9.56%
60	Solid Waste Management Company of Georgia Ltd	Waste & Landfill Management	88,204	(2,637,631)	32,125,221	13,468,835	-19.58%	-2990.39%	138.52%	0.27%
61	NEVRON LLC	medical service	86,424	830	11,997	3,733	22.24%	0.96%	221.38%	720.38%
62	SAKTSIGNI LLC	trading (book)	83,086	6,593	287,943	183,497	3.59%	7.94%	56.92%	28.86%
63	Senaki Hospital-Policlinic Union LLC	medical service	70,219	994	373,674	349,239	0.28%	1.42%	7.00%	18.79%
64	Medical Ambulatory Clinic Ponichala LLC	medical service	65,319	9,725	55,726	34,513	28.18%	14.89%	61.46%	117.21%
65	Tbilisi #1 Dental Policlinic LLC	medical service	53,795	2,254	307,442	299,254	0.75%	4.19%	2.74%	17.50%
66	Tbilisi Zonal Research and	construction	52,364	(28,952)	727,471	488,830	-5.92%	-55.29%	48.82%	7.20%

	Company Name	Sector Classification	Revenues (GEL)	Net Income (GEL)	Total Assets (GEL)	Shareholders' Equity (GEL)	Return on Equity	Profit Margin	Debt to Equity Ratio	Revenues to Assets
	Design Institute TBILZNIIEPI LLC	researches								
67	Tkviani Hospital LLC	medical service	42,141	(217)	81,640	54,774	-0.40%	-0.51%	49.05%	51.62%
68	Telavi Regional Center of Narcology LLC	medical service	35,840	2,763	78,161	56,133	4.92%	7.71%	39.24%	45.85%
69	Bee keeping (apiculture) regulatory board LLC	apiculture	32,642	(600)	474,161	349,046	-0.17%	-1.84%	35.84%	6.88%
70	MKURNALI LLC	medical service	31,285	(27,548)	1,112,169	918,934	-3.00%	-88.05%	21.03%	2.81%
71	RENTA LLC	rental service	24,005	6,737	106,339	105,150	6.41%	28.06%	1.13%	22.57%
72	Zugdidi House of Culture and Art LLC	House of Culture	17,470	1,873	34,670	34,340	5.45%	10.72%	0.96%	50.39%
73	SPECGEO 2008 LLC	Geological researches	10,625	1,425	570,317	465,927	0.31%	13.41%	22.40%	1.86%
74	PANACEA LLC	medical service	3,820	(27,251)	2,788	2,710	-1005.58%	-713.38%	2.88%	137.02%
75	Mountain Resorts Development Company LLC	construction & development	2,676	(2,391,492)	34,722,844	34,515,128	-6.93%	-89368.17%	0.60%	0.01%
76	State Service Bureau LLC	state service	0	(12,041,849)	424,773,078	372,353,745	-3.23%	0.00%	14.08%	0.00%
77	Marabda-Kartsakhi Railway LLC	transportation	0	(49,566,145)	879,009,167	18,036,602	-274.81%	0.00%	4773.47%	0.00%
78	Mtskheta Bridges Construction and Repair Division LLC	construction	0	26,981	342,010	340,496	7.92%	0.00%	0.44%	0.00%
79	Tetnuldi Development LLC	Building tourist infrastructure	0	(383,329)	12,260,329	12,129,833	-3.16%	0.00%	1.08%	0.00%

Annex 17: Summary Financial Data for State-owned Enterprises (USD) (2013)

	Company Name	Sector Classification	Revenues (USD)	Net Income (USD)	Total Assets (USD)	Shareholders' Equity (USD)	Return on Equity	Profit Margin	Debt to Equity Ratio	Revenues to Assets
1	Georgian Railway JSC	transportation	$285,260,612	$37,568,393	$1,661,709,958	$903,718,827	4.16%	13.17%	0.84	0.17
2	Georgian Oil and Gas Corporation JSC	oil and gas service	$187,617,923	$54,306,859	$607,552,266	$327,663,998	16.57%	28.95%	0.85	0.31
3	Telasi JSC	electricity	$150,753,326	($21,818,234)	$131,667,339	$49,915,913	-43.71%	-14.47%	1.64	1.14
4	Electricity System Commercial Operator JSC	electricity	$67,300,663	$539,369	$19,573,717	$3,255,677	16.57%	0.80%	5.01	3.44
5	TBILAVIAMSHENI LLC	engineering	$47,595,658	$6,338,030	$127,364,222	$56,202,676	11.28%	13.32%	1.27	0.37
6	Georgian State Electrosystem JSC	electricity	$43,433,162	($36,304,210)	$589,339,400	$126,594,483	-28.68%	-83.59%	3.66	0.07
7	SAKAERONAVIGATSIA LLC	air communication	$31,946,495	$8,320,880	$72,628,537	$53,745,896	15.48%	26.05%	0.35	0.44
8	United Water Supply Company of Georgia LLC	service of water supply	$27,108,219	($6,859,414)	$262,717,272	$169,931,463	-4.04%	-25.30%	0.55	0.10
9	State Construction Company LLC	construction	$14,580,740	($2,545,303)	$37,042,766	$23,731,343	-10.73%	-17.46%	0.56	0.39
10	Georgian Airports Union LLC	transportation	$8,827,609	($581,811)	$101,159,141	$96,062,316	-0.61%	-6.59%	0.05	0.09
11	Nikoloz Kipshidze Central University Clinic LLC	medical service	$8,296,417	$309,781	$14,103,991	$10,370,061	2.99%	3.73%	0.36	0.59
12	Center for Mental Health and Addiction Prevention LLC	medical service	$5,174,165	$73,920	$5,717,585	$5,366,152	1.38%	1.43%	0.07	0.90
13	DEMETRE 96 LLC	sewing factory	$4,898,447	$463,015	$3,521,911	$2,752,153	16.82%	9.45%	0.28	1.39
14	National Center for Tuberculosis and Lung Diseases LLC	medical service	$4,033,417	($535,468)	$14,661,236	$12,102,647	-4.42%	-13.28%	0.21	0.28
15	AIDS Center JSC	medical service	$3,771,849	$42,488	$3,060,736	$2,278,045	1.87%	1.13%	0.34	1.23
16	Georgian Amelioration Systems Company Ltd.	irrigation service	$3,508,642	$0	$208,807,720	$195,713,879	0.00%	0.00%	0.07	0.02
17	Georgian Tele-Radio Center LLC	telecommunication	$2,804,318	$693,368	$11,206,554	$10,078,734	6.88%	24.73%	0.11	0.25
18	B. Naneishvili National Center of Mental Health LLC	medical service	$2,521,020	$90,538	$2,136,901	$1,922,729	4.71%	3.59%	0.11	1.18
19	Universal Medical Center LLC	medical service	$1,365,978	$329,952	$8,916,095	$8,431,183	3.91%	24.16%	0.06	0.15

	Company Name	Sector Classification	Revenues (USD)	Net Income (USD)	Total Assets (USD)	Shareholders' Equity (USD)	Return on Equity	Profit Margin	Debt to Equity Ratio	Revenues to Assets
20	National High Technology Center of Georgia LLC	scientific researches	$1,001,072	$91,993	$2,635,540	$2,603,354	3.53%	9.19%	0.01	0.38
21	Tbilisi Mental Health Center LLC	medical service	$901,322	$33,159	$438,214	$379,755	8.73%	3.68%	0.15	2.06
22	Chkhobadze Disabled and Elderly Rehabilitation Clinic LLC	medical service	$870,583	$9,094	$1,092,090	$615,835	1.48%	1.04%	0.77	0.80
23	Tbilisi Children's Infectious Diseases Hospital LLC	medical service	$847,374	$115,847	$259,722	$179,617	64.50%	13.67%	0.45	3.26
24	Regional Health Center LLC	medical service	$658,898	($8,715)	$4,194,134	$4,164,540	-0.21%	-1.32%	0.01	0.16
25	TBILGVIRABMSHENI LLC	tunnel construction	$619,804	$324,461	$1,666,907	$1,531,914	21.18%	52.35%	0.09	0.37
26	Nazirashvili Kutaisi Center for Family Medicine LLC	medical service	$549,585	$58,186	$382,012	$349,815	16.63%	10.59%	0.09	1.44
27	V. Sanikidze War Veterans Clinical Hospital LLC	medical service	$469,607	$6,221	$434,506	$390,564	1.59%	1.32%	0.11	1.08
28	Abastumani Antituberculosis Hospital LLC	medical service	$442,191	($19,508)	$362,564	$208,360	-9.36%	-4.41%	0.74	1.22
29	West Georgia Center for Tuberculosis / Lung Diseases LLC	medical service	$434,057	$17,345	$214,013	$142,205	12.20%	4.00%	0.50	2.03
30	Kutaisi Mental Health Center LLC	medical service	$426,631	($6,491)	$385,486	$361,956	-1.79%	-1.52%	0.07	1.11
31	Bediani Psychiatric Hospital LLC	medical service	$403,904	$8,182	$332,768	$304,595	2.69%	2.03%	0.09	1.21
32	Georgian Oil and Gas Service Company	Oil and gas service	$383,411	($16,815)	$984,295	$610,247	-2.76%	-4.39%	0.61	0.39
33	National Health and Rehabilitation Practice Center LLC	medical service	$372,643	$1,976	$1,185,117	$861,242	0.23%	0.53%	0.38	0.31
34	Al. Kajaia Surami Psychiatric Hospital LLC	medical service	$327,447	$979	$149,201	$115,326	0.85%	0.30%	0.29	2.19
35	Kutaisi Regional Blood Bank LLC	medical service	$312,702	($36,272)	$215,206	$153,517	-23.63%	-11.60%	0.40	1.45
36	SERVISI - 8 LLC	construction & development	$292,010	($357,087)	$8,216,830	$8,081,590	-4.42%	-122.29%	0.02	0.04
37	Infrastructure Development company Ltd	Building and projecting	$275,159	$220,679	$14,247,791	$14,204,584	1.55%	80.20%	0.00	0.02
38	SAMTOMASHVELI LLC	rescue activities	$254,889	$2,562	$333,097	$323,111	0.79%	1.01%	0.03	0.77

	Company Name	Sector Classification	Revenues (USD)	Net Income (USD)	Total Assets (USD)	Shareholders' Equity (USD)	Return on Equity	Profit Margin	Debt to Equity Ratio	Revenues to Assets
39	Marine Technical Service LLC	technical service	$235,931	$4,282	$720,216	$632,053	0.68%	1.82%	0.14	0.33
40	Makhviladze Institute of Labor Medicine and Ecology JSC	medical service	$230,136	$7,603	$40,704	$28,235	26.93%	3.30%	0.44	5.65
41	SAKAVTOTRANS LLC	passenger and truck service	$192,925	($47,246)	$4,229,832	$3,580,078	-1.32%	-24.49%	0.18	0.05
42	Inter-regional Psychoneurological Dispensary LLC	medical service	$184,478	$568	$48,158	$46,991	1.21%	0.31%	0.02	3.83
43	TSALKAGAZI LLC	Service in the field of gas	$152,959	$5,622	$107,932	$54,077	10.40%	3.68%	1.00	1.42
44	TUSHETGZA LLC	Road service	$142,110	$5,140	$45,312	$42,544	12.08%	3.62%	0.07	3.14
45	Akhtala Resort JSC	resort service	$141,434	$17,733	$949,521	$938,012	1.89%	12.54%	0.01	0.15
46	AUTOBASE LLC	transportation	$134,526	$16,219	$2,266,283	$2,197,200	0.74%	12.06%	0.03	0.06
47	Ambulatoric Policlinic Union LLC	medical service	$119,478	$5,680	$151,374	$112,487	5.05%	4.75%	0.35	0.79
48	Kutaisi №5 Adult Policlinic LLC	medical service	$114,978	$4,882	$41,918	$30,312	16.11%	4.25%	0.38	2.74
49	Abasha Road Division LLC	medical service	$112,061	$5,788	$19,760	$16,940	34.17%	5.16%	0.17	5.67
50	Examination of Construction Projects LLC	construction researches	$108,527	$688	$11,021	$10,826	6.35%	0.63%	0.02	9.85
51	Senaki Maternity Hospital LLC	medical service	$100,851	($9,676)	$141,681	$61,677	-15.69%	-9.59%	1.30	0.71
52	Telavi Psychoneurological Dispensary LLC	medical service	$94,650	$4,880	$161,320	$153,290	3.18%	5.16%	0.05	0.59
53	Senaki Children's Hospital LLC	medical service	$88,830	$4,705	$98,292	$76,145	6.18%	5.30%	0.29	0.90
54	Clinical Pathology Scientific-Practical Center LLC	medical service	$85,181	$528	$965,706	$961,561	0.05%	0.62%	0.00	0.09
55	Anaklia LLC	aqua park	$77,353	($1,039,201)	$3,006,427	$3,000,543	-34.63%	-1343.45%	0.00	0.03
56	Technical Specialists Training Center LLC	educational activity	$70,643	$333	$721,681	$710,896	0.05%	0.47%	0.02	0.10
57	Disinfection, Sterilization Epidemic Monitoring Center LLC	medical service	$66,071	$6,226	$22,446	$21,347	29.17%	9.42%	0.05	2.94
58	ZUGDIDSERVISI LLC	medical service	$55,991	$21,049	$114,736	$110,785	19.00%	37.59%	0.04	0.49
59	SAKGEOLOGIA LLC	Geological researches	$51,208	$1,211	$535,744	$257,836	0.47%	2.37%	1.08	0.10

	Company Name	Sector Classification	Revenues (USD)	Net Income (USD)	Total Assets (USD)	Shareholders' Equity (USD)	Return on Equity	Profit Margin	Debt to Equity Ratio	Revenues to Assets
60	Solid Waste Management Company of Georgia Ltd	Waste & Landfill Management	$50,800	($1,519,110)	$18,502,114	$7,757,205	-19.58%	-2990.39%	1.39	0.00
61	NEVRON LLC	medical service	$49,775	$478	$6,910	$2,150	22.24%	0.96%	2.21	7.20
62	SAKTSIGNI LLC	trading (book)	$47,852	$3,797	$165,837	$105,683	3.59%	7.94%	0.57	0.29
63	Senaki Hospital-Policlinic Union LLC	medical service	$40,442	$572	$215,213	$201,140	0.28%	1.42%	0.07	0.19
64	Medical Ambulatory Clinic Ponichala LLC	medical service	$37,620	$5,601	$32,095	$19,877	28.18%	14.89%	0.61	1.17
65	Tbilisi #1 Dental Policlinic LLC	medical service	$30,983	$1,298	$177,067	$172,352	0.75%	4.19%	0.03	0.17
66	Tbilisi Zonal Research and Design Institute TBILZNIIEPI LLC	construction researches	$30,159	($16,674)	$418,978	$281,536	-5.92%	-55.29%	0.49	0.07
67	Tkviani Hospital LLC	medical service	$24,271	($125)	$47,020	$31,546	-0.40%	-0.51%	0.49	0.52
68	Telavi Regional Center of Narcology LLC	medical service	$20,642	$1,592	$45,016	$32,329	4.92%	7.71%	0.39	0.46
69	Bee keeping (apiculture) regulatory board LLC	apiculture	$18,800	($346)	$273,087	$201,029	-0.17%	-1.84%	0.36	0.07
70	MKURNALI LLC	medical service	$18,018	($15,866)	$640,540	$529,248	-3.00%	-88.05%	0.21	0.03
71	RENTA LLC	rental service	$13,825	$3,880	$61,245	$60,560	6.41%	28.06%	0.01	0.23
72	Zugdidi Culture and Art LLC	House of Culture	$10,062	$1,079	$19,968	$19,778	5.45%	10.72%	0.01	0.50
73	SPECGEO 2008 LLC	Geological researches	$6,119	$820	$328,467	$268,345	0.31%	13.41%	0.22	0.02
74	PANACEA LLC	medical service	$2,200	($15,695)	$1,606	$1,561	-1005.58%	-713.38%	0.03	1.37
75	Mountain Resorts Development Company LLC	construction & development	$1,541	($1,377,350)	$19,998,182	$19,878,551	-6.93%	-89368.17%	0.01	0.00
76	State Service Bureau LLC	state service	$0	($6,935,351)	$244,642,676	$214,452,425	-3.23%	0.00%	0.14	0.00
77	Marabda-Kartsakhi Railway LLC	transportation	$0	($28,546,994)	$506,254,199	$10,387,952	-274.81%	0.00%	47.73	0.00
78	Mtskheta Bridges Construction and Repair Division LLC	construction	$0	$15,540	$196,976	$196,104	7.92%	0.00%	0.00	0.00
79	Tetnuldi Development LLC	Building tourist infrastructure	$0	($220,774)	$7,061,181	$6,986,024	-3.16%	0.00%	0.01	0.00

Annex 18: Insurance Industry Summary Financial Data in (GEL and USD) (2013)

#	Company Name	Revenues (GEL)	Net Income (GEL)	Total Assets (GEL)	Shareholders' Equity (GEL)	Profit Margin	Return on Assets	Return on Equity	Debt to Equity Ratio
1	JSC Aldagi	203,553,000	23,870,000	344,495,000	118,239,000	11.73%	6.93%	20.19%	1.91
2	JSC GPI Holding	78,547,000	6,362,000	84,049,000	28,315,000	8.10%	7.57%	22.47%	1.97
3	IC Group LLC	50,039,000	(390,000)	66,728,000	2,277,000	-0.78%	-0.58%	-17.13%	28.31
4	LTD Irao	44,488,000	(1,532,000)	48,322,000	5,038,000	-3.44%	-3.17%	-30.41%	8.59
5	LTD Alpha	24,863,622	(1,352,724)	25,941,044	4,944,099	-5.44%	-5.21%	-27.36%	4.25
6	LTD PSP	14,869,721	(56,573)	19,628,812	5,672,835	-0.38%	-0.29%	-1.00%	2.46
7	LTD Ardi	13,562,676	202,991	27,106,248	2,674,537	1.50%	0.75%	7.59%	9.13
8	LTD Cartu Insurance	11,869,053	(1,857,299)	3,972,710	2,586,190	-15.65%	-46.75%	-71.82%	0.54
9	LTD Tao	7,210,005	(84,454)	8,312,572	3,581,046	-1.17%	-1.02%	-2.36%	1.32
10	LTD Unison	4,665,984	107,713	29,480,370	2,610,991	2.31%	0.37%	4.13%	10.29
11	JSC Standard Insurance Georgia	4,339,086	(18,332)	6,002,810	1,957,174	-0.42%	-0.31%	-0.94%	2.07

#	Company Name	Revenues (USD)	Net Income (USD)	Total Assets (USD)	Shareholders' Equity (USD)	Profit Margin	Return on Assets	Return on Equity	Debt to Equity Ratio
1	JSC Aldagi	$117,233,773	$13,747,624	$198,407,533	$68,098,255	11.73%	6.93%	20.19%	1.91
2	JSC GPI Holding	$45,238,150	$3,664,113	$48,406,957	$16,307,666	8.10%	7.57%	22.47%	1.97
3	IC Group LLC	$28,819,328	($224,616)	$38,431,147	$1,311,409	-0.78%	-0.58%	-17.13%	28.31
4	LTD Irao	$25,622,300	($882,336)	$27,830,444	$2,901,572	-3.44%	-3.17%	-30.41%	8.59
5	LTD Alpha	$14,319,888	($779,084)	$14,940,416	$2,847,491	-5.44%	-5.21%	-27.36%	4.25
6	LTD PSP	$8,564,028	($32,583)	$11,304,966	$3,267,197	-0.38%	-0.29%	-1.00%	2.46
7	LTD Ardi	$7,811,252	$116,910	$15,611,500	$1,540,366	1.50%	0.75%	7.59%	9.13
8	LTD Cartu Insurance	$6,835,831	($1,069,688)	$2,288,032	$1,489,483	-15.65%	-46.75%	-71.82%	0.54
9	LTD Tao	$4,152,511	($48,640)	$4,787,521	$2,062,458	-1.17%	-1.02%	-2.36%	1.32
10	LTD Unison	$2,687,314	$62,036	$16,978,846	$1,503,767	2.31%	0.37%	4.13%	10.29
11	JSC Standard Insurance Georgia	$2,499,042	($10,558)	$3,457,242	$1,127,210	-0.42%	-0.31%	-0.94%	2.07

Annex 19: Timetable for Implementation

[This section will be completed and inserted after the public-private consultation process and agreement on tasks and deadlines.]