

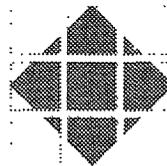
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**USAID DEVELOPMENT OF THE
SECURITIES MARKET IN
KAZAKHSTAN AND KYRGYZSTAN**

The Pragma Corporation

Contract No.: OUT-EPE-I-802-95-00040-00



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COMPLETION REPORT

**USAID – DEVELOPMENT OF
KAZAKHSTAN/KYRGYZSTAN SECURITIES MARKET**

THE PRAGMA CORPORATION

**Contract Nos: OUT-EPE-1-802-95-00040-03
OUT-EPE-1-802-95-00040-00**

**Kazakhstan November 1999 – August 2000
Kyrgyzstan February 1999 – March 2000**

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SECTION I. EXECUTIVE SUMMARY

This report (hereinafter – the “**Completion Report**” or “**Report**”) summarizes the successful completion of the Development of the Securities Market Project/Kazakhstan and Kyrgyzstan (hereinafter - the “**Project**”) funded by the United States Agency for International Development (hereinafter -“**USAID**”). The Pragma Corporation was awarded a contract by USAID/CAR to develop capital markets in both the Republic of Kazakhstan and the Republic of Kyrgyzstan. The timeframe for work on this project, by country, was November 1999 through August 2000 for Kazakhstan and February 1999 through March 2000 for Kyrgyzstan.

In Kazakhstan, the project activities consisted of the continuation of USAID’s technical assistance and support of the development of capital markets in Kazakhstan that began in August 1994.

The original Task Order of the Project was signed in September 1998. It envisioned support that involved virtually all aspects of capital market development. The priorities of the Project for that period were defined as follows:

1. Assist the NSC in drafting regulations, establish enforcement powers, move off-exchange trading to KASE, establish NSC date warehouse/trade reporting system;
2. Facilitate the privatization process through assisting and monitoring the privatization of state owned shares, assist and involve broker/dealers in promoting the Government of Kazakhstan’s (“GOK”) privatization efforts, advocate listing of shares of blue chip companies on KASE;
3. Further develop the markets by encouraging companies to list and trade on the KASE;
4. Continue to assist the KASE and the Central Depository by guiding the KASE into accepting the SRO responsibilities of the ABD; assist the KASE in finalizing rules for market makers/work in conjunction with broker-dealers; to improve broker-dealer operational efficiency and transparency;
5. Provide assistance to the Central Depository;
6. Explore the possibilities of introducing new financial instruments into Kazakhstan’s capital market; and
7. Perform other activities namely towards making the USAID web site a self-sustaining entity.

Since September 1998, a number of events have occurred that were unforeseen when the original task order was written.

First, concern was raised that Kazakhstani pension funds, the country’s best-established institutional investors¹, were limited to buying short-term government securities. The inability to diversify investment risk posed a serious potential problem to the new pension system especially in light of the short-term treasury default in Russia. Therefore, USAID redirected the Project’s activities to concentrate on developing new investment

¹ As of October 1999 pension fund accumulation reached \$402.92 million (KZT 56.41 million)



instruments, such as corporate bonds, municipal bonds, mortgage-backed bonds, and additional equity and fixed income products. This required additional expertise and effort in the area of corporate finance and investment banking not envisioned in the original task order.

Secondly, a significant amount of earlier work was based on the premise that the Government of Kazakhstan would adhere to their stated commitment to privatize their "blue chip" companies. Unfortunately this did not happen. As a result, USAID shifted its emphasis to providing technical assistance to second tiered companies interested in selling shares. This assistance utilizes the established market infrastructure, which includes the regulatory system and an efficient stock exchange.

Finally, to further develop the capital market, USAID decided to provide technical assistance to the Department of Insurance Supervision, which entailed evaluating the need for drafting a new insurance law and providing a modest documentation and reference center at the Department.

The above-mentioned events triggered several modifications to the original task order. As the result of these changes, and taking into consideration the original scope of work, under the guidance of the project COTR, Mr. Rick Gurley, the USAID/Pragma team redirected the Project's priorities to concentrate on the following activities:

1. Investigate and develop new financial instruments and pursue those, which are found to be viable, and address the needs of the public finance industry (in order to meet the needs of institutional and individual investors for diverse financial products, mostly fixed-income securities; to address corporate finance issues and ensure institution building);
2. Continue assistance to the NSC (in order to strengthen its enforcement and rule-making capabilities; develop its legal and regulatory relationship with KASE as an SRO; and help the KASE in using IAS standards);
3. Assist on privatization of second-tier state companies (in order to develop internet resources that provided access to updated information on companies in the program; to assist and involve broker/dealers in working with the GOK privatization; and to advocate listing of shares of blue chip companies on the KASE);
4. Continue assistance to the Kazakhstan Stock Exchange and Central Depository (in order to develop their regulatory and operational structure, including assistance with listing requirements, trading rules and development of business plans);
5. Continue assistance on further development of the OTC market (to help the KASE further develop the organizational structure of the OTC market with a clear focus on listing of shares of smaller and less liquid companies);
6. Develop the KASE and SRO processes (in order to develop the regulatory structure of the KASE necessary for it to formally function as an SRO); and
7. Provide assistance to the Department of Insurance Supervision at the National Bank of Kazakhstan (in order to explore ways of developing the insurance industry, especially life, that could provide a structure and mechanism for significant capital accumulation).



Thus, the modified Task Order, by acknowledging the changes in market conditions - especially the slowdown in blue chip privatizations and the increased emphasis on corporate and mortgage finance in fixed income - marked the beginning of a new effort that was successfully accomplished by the Project.

In Kyrgyzstan:

The Kyrgyzstan portion of this completion report reflects the activities and accomplishments of the project in two phases. Phase I (February 1999 through August 1999) which consisted of continuation of all support activities in Kyrgyzstan which were in effect under a previous task order and Phase two which consisted of a single systems development activity (August 1999 through March 2000). The latter reflected a change in USAID's focus for the project, which also resulted in a change of reporting methods and styles, which differs from that of Kazakhstan.

For the early part of the project, Ms. Mary Jae Abbitt served as Chief of Party (COP) in Kyrgyzstan from February 1999 through August of 1999. Upon Ms Abbitt's departure, with USAID's directive, the project's activities were reduced to installation of supplementary hardware at the National Securities Commission (NSC) and Kyrgyzstan Stock Exchange (KSE) and a programming and systems development of the USAID's trading, registry and central depository systems suite. The Project resources and expenditures in Kyrgyzstan were streamlined, in-line with budget considerations

Mr. Timothy Smith administered this distinct activity of the project from August until its completion in March 2000. The goal was to ensure that the systems development work that was in progress before August 1999 would reach completion by March 2000.

The balance of the Report will summarize USAID/Pragma's accomplishments under the guidance of the USAID COTR Mr. Rick Gurley and specify the extent to which the above targets have been achieved.



SECTION II. PROJECT IMPLEMENTATION TEAM

USAID/Pragma's Project in Kazakhstan was conducted by a staff that totaled five long-term, two short-term expatriates, and 25 local technical, administrative, and support personnel.

For the life of the Project the following individuals formed the core of the senior resident advisory personnel:

Chief of Party:

1. David Lucterhand, Corporate Finance/Investment Banker

Senior Capital Market Advisors, Level 1:

1. Richard Dvorin (Stock Exchange/Broker-Dealers) (November 1, 1999 -- March 31, 2000)
2. Steven Moody (Corporate Finance)
3. Timothy Smith (Systems Development) (November 1, 1999 -- March 31, 2000)

Attorneys, Level 2:

1. Kevin Fogarty (November 1999 -- March 31, 2000)

In Kyrgyzstan, USAID/Pragma's Project was conducted by a staff that totaled 14 Local professionals, 6 of whom were the members of the Task Force for Company Assistance (TFCA), and a group of three Expatriate Advisors, whose level of effort consisted of 10 person months for the life of the project only.

The following individuals formed the core of the senior resident advisory personnel for the life of the project:

Expatriate Advisors:

- 1- Mary Jae Abbitt (Senior Capital Markets Development Specialist/ Acting Chief-of-Party) (February 1999 through August 1999)
- 2- Timothy Smith (Senior Systems Development Specialist) (April 1999 through March 2000)
- 3- Chris Johnson (Corporate Finance Advisor) (February 1999 through April 1999)



SECTION III. BACKGROUND AND OVERALL ASSESSMENT OF PROJECT PERFORMANCE

KAZAKHSTAN

By the time the Project began in November 1999, Kazakhstan had reached the point where the development of a securities market was accelerating. The private sector was expected to play the dominant role in market development, thus diminishing the need for technical assistance by USAID or other donor agencies. USAID's role in this phase of capital market assistance was to create the institutions and conditions under which the private sector market participants, both domestic and foreign, could thrive. by broadening the range of available financial instruments for pension funds and other investors.

With this major objective, USAID-Pragma was successful in the following areas:

- (1) establishing the infrastructure of a functioning fixed-income market in Kazakhstan;
- (2) strengthening regulatory and enforcement powers of the securities market regulator;
- (3) developing regulatory and operational structures of the stock exchange and securities depository;
- (4) developing an efficient and accessible Over the Counter (OTC) market (OTC I and OTC II subject to different disclosure and financial requirements);
- (5) improving broker/dealers' overall operational efficiency and transparency;
- (6) facilitating listings on the stock exchange;
- (7) triggering changes in insurance legislation.

The following is a list of the most salient tangible achievements of the Project.

- By the conclusion of the task order, USAID/Pragma provided technical assistance to four municipalities, nine corporations, and four commercial banks in developing public debt issuances and corporate debt instruments, such as corporate bonds and mortgages. By the Project's end, over \$98 million in corporate securities were issued (compared to \$30,574,000 before the Project began in October 1999) with an additional \$ 30 million in the pipeline, and over \$11.5 million in municipal debt (compared to \$3.0 in October 1999).
- USAID/Pragma initiated and promoted development of several new financial products: a mortgage-backed security and social obligation bond, in addition to asset-backed corporate securities, to meet the need of institutional investors (mainly pension funds) for investment diversification.
- With USAID/Pragma's assistance, a Concept Paper on Long-Term Mortgage Lending System in Kazakhstan was designed and adopted by the RK Government. It outlines major approaches and instruments that can be used for development of the mortgage industry in the country. The Paper is expected to serve as a blueprint for further initiatives by the Government.



Development of the Securities Market in Kazakhstan and Kyrgyzstan

- USAID/Pragma was instrumental in initiating the development of a domestic ratings capability.
- With USAID/Pragma's assistance, the National Securities Commission (the NSC) now possesses both the legal/regulatory and operational capability to discipline market participants for securities violations. The Team provided the regulator with a set of powerful and efficient enforcement tools, which address disclosure matters, corporate governance and other related issues that were all based on best international standards and practices. The NSC now has sufficient legal and organizational frameworks in place to enforce legal requirements and binding orders. To date, a total of 6 effective laws and regulations contain main enforcement provisions that can be used by the securities regulator to discipline violators in the securities market. The NSC also has a supervisory department and trained personnel (approximately 10 people) to perform enforcement tasks (examinations, documentation surveys, etc.)
- In the course of the Project, USAID/Pragma assisted the NSC in developing both the internal and external procedures for rule making. The NSC is now a capable rule-maker that has appropriate authorities and trained personnel for drafting rules and regulations. To date, a total of 233 regulations have been adopted by the NSC and properly registered with the Ministry of Justice.
- USAID/Pragma proved instrumental in ensuring that the NSC prospectus for emission review staff would be trained in International Accounting Standards and would be fully capable of reviewing and certifying company prospectuses.
- USAID/Pragma successfully completed packaging and documentation of the two capital market systems modules: the NSC software system and the integrated capital market website.
- With USAID/Pragma's support and assistance, an efficient OTC market system able to accommodate a large volume of trading and capable of providing reliable OTC information was established. It has been fully tested and is functional.
- USAID/Pragma ensured that the information technology staff, who are part of the KASE, were fully trained in the use and maintenance of the new OTC system and capable of operating it without additional expatriate assistance.
- USAID/Pragma successfully completed the installation of software enabling remote access capabilities for the broker/dealers.
- The Romanian Depository and Registry software was translated and made available for installation in Kazakhstan.
- USAID/Pragma's listing efforts proved successful resulting in a total of 49 companies (70 issues) listed on the KASE by the end of the Project; 28 issuers (35 issues) were listed on the OTC market.
- The broker/dealers' operational efficiency and transparency were improved through intensive training.



- Insurance legislation was reviewed and a rationale for development of a new insurance law was determined.

KYRGYZSTAN

During the first phase of project implementation, the USAID/Pragma team continued with the provision of technical assistance to the National Securities Commission (NSC), the Kyrgyz Stock Exchange (KSE), Central Depository (CD), broker dealer, investment fund, and registrar communities. Until May, due to Russian crisis, although KSE trading volume was exceptionally low, the Project team continued to offer advice on ways to increase trading and to create a local market, which could become self-sustainable. The team worked under the auspices of a MOU with professional participants which was signed on November 27, 1998.

In May, KSE trading volume increased significantly with the passage of the Presidential Decree. The change required timely reporting for all trade to the exchange. The government has consistently requested technical assistance that led to the development of the Decree from its inception. The signing of the Decree by the President was a significant step in the development of the country's capital market. It increased transparency, and provided better protection and liquidity for investors in the securities of the Kyrgyz Republic. The Decree effectively eliminated the "grey" market in Kyrgyzstan, and was one of the most significant fundamentals needed to create a stock market in which investors can feel trust and confidence.

With the USAID/Pragma team's continual effort, the professional participants worked together and communicated more in order to sustain the momentum gained by this exceptional Presidential initiative. In this vein, Pragma spearheaded a Roundtable discussion where all market participants met and discussed issues and coordinated solutions to problems that arose from a previous lack of coordination between all participants. In one session, the team helped with the simulation of trade routings, so that all participants would experience and observe the steps involved in a complete cycle of trade execution. In that setting, the route (audit trail) of a trade execution from initial client instruction to final settlement – through broker order, via computerized trading system, registrar confirmation of shares, CD clearing, etc. was followed by the participants. This was done through the newly installed automated system by the USAID/Pragma system's team. It utilized, for the first time, an automated system (the USAID system), which gave the KSE a state-of-the-art trading system with the capability of remotely linking the exchange to other exchanges worldwide.

In addition to one-to-one training events during the life of the project, the USAID/Pragma team has also spearheaded significant regional training exercises. In April, a group of market participants from Kryrgyzstan (with the assistance from the team) gave a presentation on the status of the capital market at the USAID/Pragma sponsored Fixed Income Conference in Almaty. In May, a major regional seminar with financing from The World Bank was organized. NSC, with assistance from the Team, played host to a large delegation consisting of high government officials, key market participants and the



USAID and Pragma team members from Kazakhstan who actively participated in this successful conference.

In August of 1999, the USAID/Pragma Securities Market Development project was downsized. The project was given a completion date of December 1999. The main focus of the project was reduced to systems development. As a result of this decision, a Senior Expatriate Advisor continued the work of the project. This work involved a supplemental installation of hardware at NSC and KSE and the completion of several long-term computer system development projects. In this regard, project activities from September 1999 through May 2000 reflected a tight focus on the systems work of the project as it came to a close. The result of USAID/Pragma team's work during this phase of the project was the development of the highly successful USAID system's suite, which finally came to fruition due to the efforts of the project's team members. A highly sophisticated and successful software system, the USAID suite has immediately caught the attention of other USAID missions. The capital markets of Montenegro and Bosnia will be the next immediate countries that will benefit from the installation of this system. The system, which consists of a multi lingual trading system, clearance and settlement, registry, and central depository will be made available worldwide by USAID free of charge, in mid-2000.



SECTION IV. USAID-PRAGMA'S MAJOR ACHIEVEMENTS

4.1. Development of New Financial Instruments in Kazakhstan

A major impediment to the development of the capital markets in Kazakhstan was the lack of viable financial products to trade in the market. In Kazakhstan, although nearly 2,500 firms passed through the mass privatization program, many of these were of very poor quality and consequently, not of great interest to potential investors or market makers. Furthermore, while Kazakhstan is a potentially rich country with an abundance of natural resources and a substantial number of "blue chip" companies in extraction and metallurgy sectors, the most valuable of these companies (approximately 150) were retained by the government and slated for case-by-case privatization. Although the government initially had two or three major successes-for example, a \$300 million sale to RJR Nabisco of the major cigarette manufacturer in Central Asia-the majority of the enterprises on the case-by-case list languished without buyers.

The investment picture in Kazakhstan was made worse by the August 1998 treasury default in Russia; at least, temporarily. In 1999, Kazakhstan was again forced to devalue its currency to bring the Tenge-Ruble exchange rates back into equilibrium, and as a result of the devaluation, commercial bank deposits diminished, and along with them, the money supply. Shell-shocked by Russia's default, foreign investors fled Kazakh markets in droves. This, coupled with the Asian crisis, aptly illustrated the destabilizing capability of underdeveloped debt markets. Asian domestic debt markets were slow to develop due to the predominance of banking systems, fiscal surpluses, and the lack of disintermediation. The disruption in capital flows eventually engulfed the region, having negative consequences for the economic, political, and social order in many countries. It also served as another reason for the flight of foreign capital investment from Kazakhstan. Through a geographical quirk, Kazakhstan was situated between two seismic financial meltdowns. Foreign investors did not differentiate. With the value of bank deposits almost halved by devaluation and foreign funds fleeing in fear, the largest stock of capital in Kazakhstan became mattress money. That left only institutional money in the form of pension funds to invest. And they were risk adverse - not the kind of investors equity markets need. However first, issuers and investors had to be exposed to the opportunities a different kind of market could offer.

The new accumulation pension system in Kazakhstan was launched in 1998. The leading proponent of pension fund reform in Kazakhstan was the National Bank. Concerned with increasing the national savings rate, as national banks should be, the bank's officers pushed for the creation of accumulation pension funds, where workers' contributions could be invested in the local economy at competitive rates by professional asset managers. The law requires that pension funds invest half of their receipts in Government of Kazakhstan securities, but the other half may be placed in domestic corporate stock and bond issues. In Kazakhstan, pension fund investments are closely regulated and monitored by the National Securities Commission.

USAID was not the first to realize that pension fund accumulations represented a new source of private investment funds or that, at projected growth rates, they would soon rival mattress money as the largest stock of capital in Kazakhstan. However, it was



perhaps the first to understand that pension funds are primarily fixed income investors. The first priority of accumulation pension funds is capital preservation; therefore, pension funds must largely forego speculative capital gains in favor of predictable future income streams. Fixed income instruments were the only investments Kazakh asset managers should consider.

But there was a problem. The only fixed income securities available for investment in Kazakhstan were short-term Government of Kazakhstan treasuries and Eurobonds. At the beginning of 1999, pension fund asset managers had more than 95 percent of their investments in state securities. Such concentration of investment in one asset class would spell doom for pension funds should anything similar to what occurred in Russia be repeated in Kazakhstan. Kazakh asset managers obviously needed to diversify into other fixed income instruments to mitigate their risk exposure.

Early in 1999, USAID recognized that, in the absence of Blue Chip privatization and predictable economic conditions, it should reorder its priorities, changing its focus from equities to concentrate on development of a fixed income market in Kazakhstan. With this objective, in April 1999, USAID-Pragma organized the first Central Asian Fixed Income Conference. Its goal was to direct the attention of professional participants in the Kazakh marketplace to the importance of bonds as instruments for both investment and borrowing. The conference highlighted both corporate and municipal debt issuance.

With the new objective in mind, USAID-Pragma concentrated its efforts on providing technical assistance to corporations, financial institutions, municipalities and oblasts in all aspects of securities issuance with emphasis on pre-design of financial instruments eligible for investment by pension funds. The specific activities fell into the three categories of Corporate Finance, Financial Instruments (Pilot Projects) and Institution Building.

4.1.1. Corporate Finance

Since 1998, the SMD project educated Kazakh companies on the benefits of listing their stocks on the KASE. With the focus now on developing a fixed income market, the project redirected its efforts to identify companies with financial needs traditionally met by debt issuance—new equipment purchases, project development, debt consolidation. The most common need the project encountered, however, was working capital finance. In the absence of commercial bank intermediation, Kazakh companies were in dire need of working capital.

Corporate Bonds

Having identified companies and their specific needs, USAID/Pragma assisted company management in the procedural aspects of bond issuance: securing the services of an auditor and preparing for audit; preparing the offering memorandum; registering the issue with the National Securities Commission and the Depository (Registrar); and making application for listing the security on the Kazakhstan Stock Exchange. Here are just a couple of success stories, which marked the development of a bond market in Kazakhstan.



With assistance of USAID/Pragma, the first-ever issue of Small-to-Medium corporate bonds, the "Vita" company specializing in vegetable oils, was originated in September and redeemed on December 29th, 1999. The enterprise issued bonds for the amount of 10,000,000 Tenge, which after devaluation equaled approximately \$71,000 (face value of 100 T, which a coupon rate of 15% annually). While the issue in US dollar terms is modest, this issuance is very significant for the Kazakhstani market for several reasons. The successful issuance and redemption indicated that small-to-medium enterprises, and not only prominent domestic corporations, were able to issue and place bonds. Thus it increased the creditworthiness of SMEs, allowing subsequent issues to be placed more easily. This issuance also paved the way for other corporate instruments to be issued in the fixed-income market. Finally, Vita was able to borrow at rates significantly below comparable banking rates saving approximately 6-8%.

A second success story in small-and-medium corporate issuance was RG Brands. This domestic producer of non-alcoholic beverages, with a capitalization of about \$4,000,000, issued 500,000 coupons worth of three-month bonds (face value of \$100, annual coupon rate of 17%) on October 29 of last year. What made this issue significant was that it represented the first successful placement of an insured bond; the issue was 50% insured by BTA Insurance, a subsidiary of TuranAlem Bank. On January 26, 2000, the issue was fully redeemed. The RG Brands issue was also important for securities market development since it is the largest SME (small-to-medium size enterprise) issuance to date and the second issuance of bonds to be quoted and placed on the Exchange. This issue added to the liquidity of the marketplace, demonstrating that the VITA issue was not an isolated incident. The redemption in late January increased the company's creditworthiness and made it possible for the company to consider a second issue.

Upon listing on KASE, the Project then assisted the companies in negotiations with broker-dealers who subsequently placed the issues with institutional buyers. The entire issuance process, from initial financial analysis to final placement, was inevitably long, if not always complicated. Pragma worked with AO Almaty Kus, a poultry processor, for nine months on a one-year \$3.5 million issue. The average length of time between inception and issue was about seven months.

Not surprisingly, initial "bond" issues in Kazakhstan bore a striking resemblance to commercial bank loans: they were for relatively small face amounts (as little as \$75,000) and for very short terms (three to six months). All were unsecured backed solely by the faith and trust of the issuer. These three characteristics—small amounts, short-term, unsecured—reveal a great deal more about the nature of debt in Kazakhstan than simply the lack of commercial bank intermediation. Among others things, they revealed the need for new financial products, credit enhancements and infrastructure (legal and institutional) reform.

Municipal Bonds

Earlier efforts to create new financial instruments involved the introduction of municipal debt issuance. Following the Central Asian Fixed Income Conference (organized by USAID/Pragma in the spring), interest in municipal borrowing burgeoned. Since that time, almost every akimat in Kazakhstan in one form or another expressed its interest in



accessing this newly created source of financing for municipalities. In particular, Pragma's consultants provided advice on the organization and conditions for municipal issuance for Almaty and Astana. These recommendations included advice on structuring, budget planning and technical matters. In later December 1999, Almaty and Astana city bonds were placed.

The proceeds of the Almaty issuance were to be used for public utility projects, public transportation, and enterprise development: namely gas station facilities, utility meters assembly, bus-stop reconstruction, and the Almaty margarine factory project. Proceeds from the Astana project were supposed to be used for programs of residential housing provided through mortgage mechanisms. Funds will be used for the completion of construction of the "VIP City" project, as well as setting up a mortgage lending mechanism to sell housing units within the project.

4.1.2. New Financial Instruments - Pilot Projects

In order to wean pension funds off of state issued securities because of an over-concentration of exposure, a major effort was undertaken to design new products that could offer diversification alternatives for asset managers. Additionally, these products could complement other needed market developments such as a mortgage industry or public finance.

Mortgage-Backed Securities

In the fall of 1999, the project and USAID identified Lariba Bank as the only bank in Kazakhstan making retail mortgages. Consequently, the structuring of a mortgage-backed security commenced with two objectives in mind: to provide alternative fixed-income product to the market and to demonstrate to financial institutions that after origination, mortgage portfolios could be liquefied. A further benefit of a "live fire pilot" was to identify the legal and procedural impediments to issuance. Upon completion, such a process would lead to development of a template for future issues. It was also essential that the issue be successfully placed in the market. Given that the issue was new and required educating buyers, the project underwrote the rating of the issue by S&P and a USAID guarantee was sought for 50% of the portfolio. By end of the Project, the bond indenture was well underway, the credit review committee, which approves proposals from the Developmental Credit Authority within USAID was ready to meet. All that remained was to identify a third party financial institution that would agree to function as a guarantor of the issue in order to solve deficiencies in the pledge law and to provide bond holders a privileged position in the event of bankruptcy by Lariba bank.

Development of a Mortgage Industry

Further to demonstrate to banks that mortgage portfolios could be liquefied through securitization was the importance of mortgage origination itself. The Institute of Urban Economics (IUE) was retained in the summer of 1999 to assess the conditions in Kazakhstan necessary to support the development of a mortgage lending industry. Its findings formed the basis of a separate USAID project. These were reflected in the Request for Proposal related to the Financial Protection Initiative.



During the remaining ten months of the project, Pragma met with representatives of tier one banks to apprise them of USAID's plans to offer mortgage training through IUE and to gauge their interest in participating. The National Bank of Kazakhstan formed a working group that was tasked with developing a concept paper for the development of a mortgage industry for the Republic. USAID/Pragma participated in this working group offering its ideas for developing the mortgage industry in Kazakhstan and providing the working group with a copy of IUE's findings and conclusions. The working group subsequently produced a concept paper, which was adopted by the Government as the model for developing a mortgage lending industry in Kazakhstan, coincidentally the last day of The Project.

Securitization of Social Obligations

In mid-Summer, 1999, USAID-Pragma undertook a study to determine the potential for municipal finance in Kazakhstan. Four oblasts were analyzed, Atyrau, Aqtau, Astana and Almaty. Of the four, findings led USAID-Pragma to conclude that except for Almaty, growth in municipal finance to fund infrastructure projects would be constrained by the lack of sufficient tax revenues retained by the oblasts due to the donor structure of the republic's budget. Only a major increase in oil revenue might stabilize oblast revenues sufficient to support debt issues, which only recently occurred. At least several years of tax revenue will be needed to stabilize oblast budgets before municipalities have the underlying creditworthiness to issue. In the meantime, the need for infrastructure improvement becomes more acute with each passing day. Recognizing the budgetary limitations for municipal issuance, the Project looked for other sources of revenue, which could be used on an interim basis, to fund infrastructure improvements. This, in turn, led to the development of the social obligation bonds (SOB).

Concurrent with the development of mortgage bonds was the structuring of a pilot bond issue to securitize the social obligations of multi-national corporations operating in Kazakhstan. Many multi-national companies operating in Kazakhstan have signed Production Sharing Agreements (PSAs) requiring them to make social obligation payments to oblasts in which they operate. Typically these payments are used to fund needed social improvements, but their utility is limited by a feature that requires annual payments. The social obligation bond (SOB) is designed to capture future social payments that multi-nationals are required to make in one lump sum payment derived from the sale of the bond to pension funds. The multi-national credit rating would pass through to the investor creating a credit that could surpass Kazakhstan's sovereign debt rating. The proceeds are then used by the oblast to fund needed long-term improvements such as water purification. The issue is structured in order to marginalize corruption by employing a project selection committee and trust administration. Most importantly, three constituencies benefit: the multi-national which satisfies its social obligation and makes no payments during the life of the bond; the oblast which achieves the ability to fund larger multi-year infrastructure projects; and pension funds which have new credit worthy instruments in which to invest helping to diversify risk.

Since late fall, 1999, Pragma/USAID has been working to design and identify target oblasts for issuance of a pilot SOB. During the last month of the Project, Pragma/USAID met with appropriate government counterparts and oblast officials in a working group to



create a working consensus regarding the methodology of the structure of a pilot project. The parties also agreed on specific social projects to be funded from the proceeds of the pilot issue. This work should continue under any subsequent project.

4.1.3. Institution Building

Ratings industry

One of the objectives in developing a bond market was to extend the yield curve through longer dated issues. This would free up capital for longer terms and make it easier to match the useful life of assets being financed. Pension funds in Kazakhstan had few corporate issues to be concerned with when making investment decisions and issues the funds did invest in were relatively well known to them. However, as the market develops and more issues come to the market, the ability to analyze issues becomes more difficult and investors typically rely on third party evaluations i.e. rating agencies. Anticipating this, Pragma met with representatives of S&P and Fitch IBCA to encourage them to set up a local rating agency either through affiliation or stand alone presence. In addition, the National Securities Commission made its interest known to have a ratings capability for Kazakhstan and used its suasion to get local banks to submit to the ratings process in order to demonstrate the potential for business. USAID-Pragma, in its discussions with S&P was able to negotiate a rate that represented a discount in fees if more than one bank committed to being rated. While it is unlikely that either S&P or Fitch IBCA will establish a local ratings agency presence in the short-term, a sufficient number of in-country ratings could lead to the development of a domestic ratings capability. In either case, the prototype for such an activity would be the S&P affiliate in Russia, EA Ratings. Pragma identified one possible provider of local ratings financed through the Eurasia Foundation and was working with them in the remaining days of the Project.

4.2. Continued Assistance to the NSC

A strong, independent Securities Commission is critical to promoting the development of a capital market. It is essential that the National Securities Commission can ensure a level playing field for all market participants, and that investors have confidence that investments in the securities market are properly regulated. While most of the legislative infrastructure for the NSC was in place by the time of Project's initiation, there were several key areas that required the development of the NSC's regulatory and institutional structure on a more in-depth basis.

With that in mind, USAID/Pragma provided continued assistance to the NSC in furthering development and understanding of the culture of enforcement: development of NSC rule-making capability; development of the NSC legal and regulatory relationship with KASE as an SRO; and development of the NSC's capability to understand accounting.

Further development and understanding of the culture of enforcement

During the life of the Project, USAID/Pragma's legal team addressed various enforcement issues that were of immediate and more long-term concern. These concerns were aimed at developing a National Securities Commission that would be able to



effectively expose and challenge non-disclosure, self-dealing, and other securities market violations that are rife in developing markets.

USAID-Pragma's legal staff also gave recommendations on general structural issues involving the enforcement capacity of NSC. The NSC is planning to seek legal amendments augmenting its power to obtain fines from securities law violators. However, Pragma recommended that NSC use its existing powers to impose remedies heavier than censure but lighter than license revocation. In some cases, a violator could agree to accept censure, implement remedial internal controls, and/or pay for an inspection by an auditor of the NSC's choice or the NSC itself (with expenses paid by violator).

USAID-Pragma also completed and submitted its plan to the NSC that would establish an enforcement division by concentrating on existing NSC resources, re-organizing them in a way that would allow the NSC to focus on bringing enforcement actions. Since the plan would mainly involve re-arranging existing employees, the most significant cost would be recruiting an experienced outside prosecutor to head the new division.

While some aspects of the enforcement plan have been addressed the majority of points have not been accepted or remain under consideration.

Regulatory drafting

Pragma-USAID continued providing comprehensive assistance to the NSC in developing a legislative framework sufficient for effective regulation of the securities market in Kazakhstan. During the life of the Project, the following major laws and regulations were either developed or commented on by the USAID-Pragma legal advisory team in close cooperation with the NSC officials:

- Draft Amendments to the Law on Securities Market legislation aimed at the following: 1) prohibition of taking deceitful or fraudulent actions in case of securities purchase or sale, or in the case of any other services enacted by a professional participant (broker-dealer, registrar, custodian); 2) vesting the NSC with authority to detect fraudulent and deceitful actions;
- Draft Amendments to the Administrative Code legislation aimed at strengthening NSC enforcement powers;
- Draft Amendments to the Criminal Code legislation aimed at enlarging the range of securities law violations, and providing for (a) liability of the manager of a professional participant (broker/dealer, registrar, or custodian) for a failure to follow lawful instructions of the authorized body (NSC); (a) liability of a professional participant's manager for intentionally avoiding securities emission registration;
- Draft Amendments to the Civil Code legislation aimed at bringing the Civil Code into conformity with amendments in the Joint Stock Company Law, and permitting legitimate debt-for-equity transactions, and allowing bond issuers to pledge collateral to a trustee on the behalf of bondholders;
- Draft Pension Law Amendments legislation aimed at expanding protection against conflicts of interest in the management of pension assets;



- Draft Pension Investment Rule addressing conflict-of-interest features, ceilings on different types of investment, and others;
- Draft Law on Bonds;
- The NSC Draft Investor Protection Law;
- Draft Rule on Ratings for Pension-Eligible Securities;
- Draft Amendments to the Joint Stock Company Law;
- Licensing Regulation;
- Draft Share prospectus;
- Municipal Bond Eligibility Criteria; and others.

Most of the Team's proposed comments and drafts were well received and considered by the NSC. However, due to the NSC's very sophisticated procedure for adopting regulations, only a few of the foregoing documents became effective. Nevertheless, thanks to USAID-Pragma's efforts the NSC is now equipped with all the necessary legislative and regulatory information to adequately respond to the future increase in the market's activity.

Development of NSC rule-making capability

USAID-Pragma assisted the NSC in developing internal procedures for staff in elaborating new or modified rules. The ultimate goal was to get the NSC more comfortable in using its explicit and implicit authority to develop securities regulations by rule making rather than by using a more formal legislative process. As of now, the NSC is one of the most prolific rule makers among the state bodies, with a total of 233 rules and regulations adopted to date.

Development of the NSC legal and regulatory relationship with KASE as an SRO

In December 1998, USAID-Pragma, acting within the framework of its prior project, elaborated on a plan for the development of SRO capability by the KASE and for training at the KASE to ensure proper functioning in the KASE's SRO capacity. Though the plan was readily accepted by the NSC, it became obvious that the KASE would not be able to acquire an SRO status in the near future, due to internal reasons.

Nevertheless, during the life of the Project USAID-Pragma's consultants continued to advocate KASE's evolution into a fully functioning SRO by assisting the KASE and NSC in drafting all relevant SRO documents, including Rules of Fair Practice (Ethics Code) and Disciplinary Code, and others. However, adoption of SRO normative documents was postponed pending transfer of oversight authority from the NSC. No further action had occurred by the close of the project.



4.3. Continued assistance on privatization of second-tier state enterprises

The Government's plan to privatize its shares in "second-tier" companies (and some blue chips) through the Exchange was seen as an opportunity for further development of the securities market in Kazakhstan. Under the previous task order, USAID/Pragma had successfully encouraged the government to offer blue chip shares through the stock exchange with the local broker/dealer community. In regard to the privatization of second-tier companies, by the end of the previous project initiative (October 1999), a total of 57 second-tier companies had been listed on the exchange.

Under this Task Order, USAID- Pragma was expected to build on the successes of the previous efforts and ensure that at least 8 "blue chip" and 30 second-tier companies were privatized through the exchange. However, the expectations could not be met.

In November 1999, USAID-Pragma advocated to the Committee on Privatization that the 78 small-to-medium sized enterprises slated for privatization in late 1999-2000 be executed on the Exchange (in which case broker-dealers would be involved.)

Later, it became clear that, even though 26 second-tier companies were identified for privatization, they would not be sold through the KASE - at least not in the near future.

Privatization of blue chips stopped, according to statements made by State Property and Privatization Committee head, Maksutbek Rakhanov, due to the Government not knowing what in fact it owned. Any further blue chip privatization is likely to occur through investment by strategic partners not portfolio investors. At the conclusion of the Project, the status of "blue chip" privatization was unchanged.

4.4. Continued assistance to the Kazakhstan Stock Exchange and the Central Depository

The Kazakhstan Stock Exchange (KASE) was originally founded by the major banks in Kazakhstan. As part of the merger with the International Exchange, the KASE opened membership to the broker/dealer community in Kazakhstan. The banks that founded the KASE spent approximately \$1 million on developing the technical hardware and software necessary to support Treasury bill trading. Under the previous task order, USAID/Pragma proved instrumental in enhancing the capabilities of the KASE, its regulatory and operational infrastructure, ensuring its financial self-sufficiency, and improving its regulatory structure for acquiring an SRO status. Under this Project, USAID-Pragma continued to assist the KASE on an as-needed basis to develop its regulatory and operational structure, including assistance with listing requirements, trading rules and development of business plans.

KASE's now has four listing categories-A, B, OTC I, OTC II subject to different disclosure and financial standards. "A" board category has the most stringent requirements, whereas OTC II is suitable for small and less liquid companies. Different listing categories have made the KASE affordable for, and accessible by, different categories of companies, thus contributing to the elimination of off-exchange trading and overall transparency of the market.



USAID/Pragma, in accordance with the task order, also devoted much time and effort to equip the KASE with all the necessary trading software and mechanisms for trading corporate securities. Today, exchange trading in equities and fixed-income is possible because the KASE has adopted the use these technologies.

The Central Depository was initially operated manually at the National Bank. In 1996 the Government issued a decree whereby, the Central Depository was established as an organization (closed end corporation) privately owned by market participants, mostly banks and the broker/dealers. In the framework of the Project, USAID-Pragma provided necessary technical assistance to the Central Depository to ensure that it operated efficiently as a privately owned and managed institution having a well-developed regulatory framework in place.

At the Depository's request, a manual describing how to use the Romanian software developed by USAID-Pragma for clearing and registrars was translated into Russian and delivered to the CD and USAID/CAR.

4.5. Development of Markets

One of the key tasks assigned to USAID-Pragma under this Project was to contribute to the development of the securities market and, in particular, to its major components and players. USAID-Pragma's activities in this task were divided into three parts: 1. To develop the OTC system based on the Integrated Stock Market System (ISMS) developed by USAID for the Kyrgyzstan market; 2. To encourage listing and trading on the KASE; and 3. To assist the broker/dealer community in providing corporate finance and investment banking skills to selected pilot companies. The results of USAID-Pragma's involvement in performing this task are presented below.

4.5.1. Development of OTC Market

A major goal of the task order was to help the KASE develop an OTC market for shares of smaller and less liquid companies to generate immediate trading and revenue for the broker/dealer community, while also helping to minimize much of the gray, "off-market" trading into an organized market. As noted earlier, the primary difference between the stock exchange and OTC models were less stringent listing requirements for issuers on the OTC market. USAID, therefore, saw no conflict between supporting the stock exchange and a second tier privatization process, and assisted the development of an OTC market. As was stated in the task order, both may even be complementary, as banks and independent broker/dealers should be able to trade using either market.

With its less stringent listing requirements, the OTC system was seen as a means of bringing the significant volume of trades that had been occurring off-exchange during previous months onto a transparent trading floor. In connection with this, companies formerly categorized as "non-listed" came under the new OTC category. This created three categories of shares – "A", "B", and OTC. To facilitate on-exchange trading, USAID/Pragma successfully urged the NSC to adopt a regulation that required all broker-to-broker trades to be executed through the stock exchange. Moreover, to further encourage broker-dealers to use the newly established OTC system, the USAID/Pragma



procured and delivered equipment that allowed the broker-dealers to access the trading system from off-site locations.

It should be noted, however, that in the context of the OTC market development, the task order called for adaptation of the so-called ISMS system (developed as an integrated stock market system including trading, clearing and settlement, depository and broker back-office functions under the task order for Kyrgyzstan capital markets) to an OTC system for Kazakhstan. However, after the task order was written and approved, Kazakhstani securities officials decided to develop their own system rather than adapt the ISMS.

The OTC trading system developed by USAID-Pragma proved to be successful and able to accommodate a large volume of trading. Over a short period of time, the number of companies listed on the OTC boards (I and II) went from 0 in July 1998 up to 28 with total of 35 issues in August of 2000.

4.5.2. Encouragement of Listing and Trading on KASE

Gradual elimination of off-exchange trading, the launch of the OTC system, and other positive developments in the securities market significantly increased the number of companies considering the listing of their shares on the KASE. However, the majority of companies lacked knowledge of listing options, benefits and requirements and were hesitant to actually undertake a listing campaign. For example, in October 1997, a total of only 3 issues were listed on KASE.

With USAID/Pragma's assistance, numerous listing, and exchange promotion seminars and workshops were held throughout Kazakhstan. By working closely with perspective listing candidates, cooperating with the broker/dealers, and NSC and KASE officials, a total of 49 companies were listed on the KASE with a total of 70 issues by mid-August of 2000. By that time the volume of trade on KASE amounted to \$ 63.2 million (compared to \$132,000 in 1997).

In the course of the Project, USAID-Pragma consultants rendered targeted assistance (e.g. in getting shares listed on "A", "B" boards or at the OTC system, upgrading from OTC II to OTC I and from OTC to "A" or "B" listings, providing consultations on execution of trades through the exchange, issuing bonds, etc.) to more than 100 companies. In association with KASE and NSC, the USAID/Pragma also developed additional sources for new listings; worked to ease the listing requirements and made listing easier and less arduous by modifying the requirements and lowering fees; explored the potential for listing of corporate bonds and Eurobonds on the exchange; worked to establish the regulatory and market practices framework that resulted in real growth of the amount of Kazakhstani securities available for investment through the stock exchange.

4.5.3. Development of broker/dealer capabilities

USAID-Pragma proved instrumental in assisting broker/dealers in selecting companies to work with and in providing corporate finance and investment banking assistance. Such corporate finance work involved assisting companies to list on the KASE, to have



secondary offerings of shares, private placements, or obtaining loans from banks or other financial institutions.

In addition, USAID-Pragma consultants worked with various broker/dealers to evaluate their abilities to market shares and with several outside fund managers to determine their criteria for making investment decisions. Broker/dealers were also encouraged to discuss the potential for marketing and trading mortgage-backed securities, corporate and municipal bonds.

USAID/Pragma was an active supporter in the development of market makers. USAID-Pragma helped to draft the Rules and Procedures for Market Makers, provided comments, and pushed for their adoption. Included among other requirements is that "A" and "B" listed companies must have a Market Maker by January 1, 2001. As of mid-August, Market Makers included: KazKommertz Securities for ten issues; KazKommertz Bank for one issue; Turan Alem Securities for two issues, KIB Asset Management for one issue, Taskaba Asset Management for one issue, Fondovy Service for two issues, and KBS securities for two issues.

USAID/Pragma also performed a series of successful training activities. In February 2000, a four-day seminar was offered to broker/dealers as well as to personnel from the KASE, the NSC, Pension Fund Asset managers, and local training groups of professional participants. During the course, presentations on front and back-office techniques, on effective trading and market making, and on the relationship between corporate finance and trading on the stock exchange to broker/dealers. Additionally, local trainers were invited to attend the seminar in order to use this knowledge for future training courses.

4.6. Assisting the Department of Insurance Supervision at the National Bank of Kazakhstan

A developed insurance industry can provide a structure and mechanism for significant capital accumulation. Insurance premiums and annuity payments can provide a major source of investment capital. The Department of Insurance Supervision (hereinafter – the "DIS") in the National Bank of Kazakhstan (hereinafter – the "NBK") requested USAID's assistance in drafting a general law on insurance that would help establish life insurance and annuities, as well as property and casualty insurance. USAID-Pragma was tasked to provide technical assistance to the DIS in drafting a new insurance law.

The insurance legislation in Kazakhstan is represented by the Presidential Decree having the Force of Law "On Insurance", provisions of the Civil Code of the Republic of Kazakhstan and by approximately nine regulations adopted to supplement the laws. In addition, the Law on the National Bank of Kazakhstan contains provisions outlining the authorities of the NBK in regulating the insurance industry in Kazakhstan. However, the existing legislation was deemed as insufficient for fostering the development of an insurance industry in the country.

Based on expert assessments of the insurance legislation, USAID/Pragma developed a technical paper entitled: *Existing Legislation and the Rationale for Enacting a New Insurance Law in Kazakhstan*. The paper analyzed the existing and proposed insurance legislation setting forth the main reasons why Kazakhstan needed a new law on



insurance. It was hoped that the paper would help the DIS in promoting its new draft law when sent to the legislature.

USAID/Pragma also provided support for the establishment of a reference/documentation center on insurance-related matters at the National Bank. A total of 15 reference materials were transferred to the DIS.

4.7. Information Technology Support

Under this Project, USAID/Pragma continued its IT assistance to the NSC, broker/dealer community and Central Depository. The following is a list of most significant accomplishments.

- The NSC reporting system for Pension Asset Management Companies was developed and upgraded;
- The broker/dealer reporting system was adjusted to reflect necessary changes associated with changing territorial affiliations;
- The internal NSC information system was upgraded;
- User friendly technical manuals for persons needing to use the thirteen data bases at the NSC and the KASE were designed and distributed;
- Four data bases were created for the NSC external web site to display in real time non-confidential NSC information: normative and legal documents, registration of issues, licenses, and certificates of qualification;
- A new version of the state registry for registration of registered corporate share and bond issues was designed;
- Technical documentation for all software databases and products designed by USAID/Pragma was elaborated to allow the systems to be self-sustaining when used by NSC upon the expiration of the Project.

KYRGYZSTAN

4.1. Continued Assistance in Increasing Listings and Privatization:

The USAID/Pragma team of advisors activities for increase in listing and in furthering privatization in Kyrgyzstan were highly focused and resulted in several major achievements:

- 1- Signing of the Presidential Decree for eliminating the gray market activities in Kyrgyzstan. The USAID-Pragma team was actively involved in supporting the government with technical advice, which led to the Decree. The activities included: technical support to the Presidential Adviser D. Kaeser on comments to Mr. Akaev (The President) regarding the needs for further developing the Capital Markets; and the provision of



technical assistance on Capital Market development issues to the President's Office through the President's office of Economic Advisors.

- 2- Furthering privatization. The USAID-Pragma team provided written advise and analysis to the Prime Minister through the Rule Making Procedures of the NSC and SPF regarding privatization; the team Advised the new Chairman of the State Property Fund (SPF) on how to privatize its holdings of state-owned companies - while simultaneously supporting the securities market.
- 3- Increase in listing: With support form USAID/Pragma teams of TFCA and technical advisors, KSE achieved three new major listings – one Airline, a Bank, and an Investment Fund; several local news organizations carried articles stating that the SOF, with USAID/Pragma help, was finally able to announce privatization of 30% of several state companies on KSE before year's end. With USAID/Pragma team's assistance, the Kazakhstan NSC placed an inquiry to Kyrgyz NSC regarding the possibility of listing three KSE companies on the KASE- Kyrgyzenergo, KyrgyzTelecom, Kant Cement.

4.2. Continued Assistance for Development of Central Depository:

The USAID/Pragma team of advisors activities for furthering the development of the central depository in Kyrgyzstan resulted in following achievements:

- 1- CD's self-sustainability- The CD and Registrars finally agreed on principles involved for CD to become the Primary Registrar, with daily information sharing to independent Registrars; in achieving this goal, the project facilitated the travel of several of the CD Executives to Moscow to view CD and Exchange; and offered advise on establishing a fee structure for functions of Central Depository and Independent Registrars – to encourage CD self-sustenance.
- 2- Automation- the CD offered each Registrar standardized software Registration/Transfer Packages sponsored by USAID.

4.3. Continued Assistance in the Development of the Over The Counter (OTC) Market; Continued Assistance to Broker Dealers to Increase Listings and Secondary Offerings on the Exchange (KSE):

The USAID/Pragma team of advisors activities and accomplishments for the development of OTC, provision of support to the broker dealer community and increase in listing in Kyrgyzstan consisted of:



- 1- Working with the Asian Development Bank (ADB) and the Social Welfare Fund (SWF) to entrust the assets set aside for pensioners to an outside manager, and to ensure that pensioners will properly benefit from the securities market.
- 2- USAID-Pragma coordinated and participated in an Investment Fund Association (IFA) seminar on February 9, 1999 aimed at helping to restructure the investment fund industry and getting Kyrgyz investment funds to list on the KSE. USAID-Pragma's presentation in that seminar was noted by a good majority of attendees to be the most important and most interesting.
- 3- The Task Force for Company Assistance (TFCA), continued its focused activities to increase listings at the Kyrgyz Stock Exchange (KSE). At the end of project activities, JSC Ak Bulak became the 52nd company to list on the KSE.
- 4- With the USAID/Pragma team's assistance, on February 17, 1999, the KSE signed an agreement with the Kazakhstan Stock Exchange (KASE) to "integrate" their securities markets. This agreement was an attempt to make the concept of a regionally unified the securities markets in Central Asia a reality.
- 5- With the assistance from the USAID/Pragma team, KSE Council took the necessary steps towards self-sustainability, including: reduction in overhead costs, and creating of new products; the team provided the KSE with an analysis that, with continuation of increased trading volume, KSE could become self-sustaining by year end 1999;
- 6- The project provided KSE with the draft of exchange organizational structure and operating procedures. Immediately following the team's institutional building activities, a visit by the Istanbul Stock Exchange (ISE) to KSE was coordinated; as a result, the Istanbul Stock Exchange (ISE) and KSE as well as Turkish Central Depository (TAKAS Bank) and Kyrgyz CD signed two MOUS to establish, an extensive cooperation and coordination issues on Regional Central Asian Capital Market Development;
- 7- The KSE monthly volume totaled a record 139,291,908 som (\$3,482,985) in July vs. 8,674,241 (\$216,856) in June – a twenty fold increase;
- 8- With the introduction of the USAID system's suite by the team, the broker dealer community continued to express interest in system to trade non-listed securities

4.4. Continued Assistance to NSC:

The USAID/Pragma team of advisors activities and accomplishments in support of NSC in Kyrgyzstan primarily focused on improving the structural and regulatory infrastructure



of the capital markets. These efforts included advocating legislative changes that helped create and grow a securities market that supports the Kyrgyzstan economy. The major activities and accomplishments included:

- 1- Holding discussions and highlighting the advantages of an independent National Securities Commission (NSC) with the Chairman (Uran Abdynasyrov).
- 2- In legal and regulatory arena: The USAID/Pragma team:
 - Formed a working group, under the umbrella of both countries' NSCs, which was created to share regulatory & trading knowledge of Kyrgyz and Kazakhstan Capital Markets; continued to support NSC rule making function;
 - Composed the original draft of the Presidential decree;
 - Compiled up-to-date list of securities related to Kyrgyz laws and NSC rules and regulations;
 - Reviewed and updated the Kyrgyz Joint Stock Company Law, originally passed in 1997;
- 3- On institutional building matters: the USAID/Pragma team:
 - Submitted comments to NSC on its Securities Market Development Program for 1999-2000, and became a part of Working Group to write the plan.
 - Assisted the NSC Chairman to spearhead and implement a 3-Tiered approach to establishing higher KSE volume Secondary T-bill and Foreign Currency Trading and increased government privatization cooperation;
 - Installed an upgraded automation and network facilities at NSC headquarters.



SECTION V. CONCLUSIONS & RECOMMENDATIONS

The USAID SMD Project in succeeded in achieving the goals as specified in the Task Order in both countries. In Kazakhstan, it included such accomplishments as developing new financial instruments, providing assistance to the NSC, KASE, Central Depository, and developing broker/dealer capabilities and in Kyrgyzstan reaching a point in the development of capital market infrastructure that USAID brought capital market programming in that country to a closure. The following section includes our observations and further recommendations for future work in Kazakhstan.

USAID/Pragma, by implementing the Project,:

- a) developed new instruments for economic use in the fixed-income market;
- b) improved the regulatory structure of the NSC, KASE, Central Depository by performing drafting and legal assessment activities;
- c) aided market transparency and investment potential by increasing company listings and promoting broker-dealer quote activity;
- d) improved dissemination of securities market data through information technology support;
- e) encouraged the deepening and strengthening of legal infrastructure (corporation law, enforcement, bond regulations, etc.);
- f) advocated self-regulation of Kazakhstani capital markets; and
- g) initiated education and training on capital market developments (public finance, self-regulation, policy directions) - all accomplished in an environment of a previously socialist economy.

During a period of ten months, The Development of Securities Market/Kazakhstan Project completed its activities by leaving in place a securities market infrastructure fully capable of supporting continued growth and a functioning bond market characterized by: increasing volume, lengthening maturities, and declining rates. New viable financial products (a mortgage-backed security and social obligation bond) were introduced, in addition to corporate securities, to meet the need of institutional investors (mainly pension funds) for investment diversification.

However, by the end of the Project it was officially recognized that additional work would be needed to build on the successes achieved. To develop the market further, the following are needed:

- More financial products. More product provides diversification for investors, especially pension funds that hold more than 87% of their assets in state issues; it also provides alternative financing sources for borrowers.
- Longer maturities. Longer maturation periods are a source of long-term capital for corporations to make capital improvements, and for oblasts and municipalities to improve and pay for infrastructure investment. This also allows for the development of a real estate mortgage market, provides diversification for investors, i.e. medium and long-term products are added to existing short term ones. They create stability and predictability for investors and for issuers alike, and a greater use of money for longer terms.
- More corporate issues. More corporate issues mean diversification for investors, alternative financing sources for issuers, minimized dilution of ownership (an



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important feature in post-soviet economies), a greater use of capital for longer terms, and greater competition to bank borrowings.

- Ratings for issues and issuers. Ratings evaluate the risk of default and make it easier to place issues; issues become more attractive to investors by giving some guidelines and rationalization to investing.
- Increased transparency and disclosure. Increased transparency reduces risk premiums. This would result in lower costs (lower yields) for issuers and more reliability for investors.
- Legal reform. Trust indentures are needed to for asset-backed issues; a legal basis is needed for issuing mortgages/bonds.

It was also officially recognized that additional work would be needed to build on the successes achieved by USAID. Continuing development of the domestic capital markets would be necessary to accommodate a growth in capital investment and to meet the growing needs of various groups of investors - activities that would ultimately contribute to the overall economic growth and prosperity of the country. This was evidenced by USAID's issuing the Financial Protection Initiative RFP which had as a major component the continuation of capital markets development.

As evidenced over the past six years in capital markets development, governments will change, counterparts will change, and world economic conditions will change. Critical to success in achieving USAID's objectives is the necessity of being flexible and responsive to changing circumstances especially as they relate to project objectives. Past experience has demonstrated that a high level of cooperation and communication between USAID and USAID/Pragma can bring dramatic results and future project activity should attempt to continue this practice.

USAID should also continue its weekly or bi-weekly contractor meetings to ensure that information is shared. This often eliminates duplication of effort or can accelerate accomplishing project objectives more efficiently.

