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PRAGMA Corp ***Regional Mutual Funds Support***

BRIEFING BOOK

Introduction

Investment funds, being the most effective way to attract capital from small investors, are popular both in countries with mature and transition economies In Russia there are $20-30 billion of domestic savings which could be drawn into economy through effectively working investment funds In July 1995, the Presidential Decree No 765 put into action unit investment funds (UIFs) - a new investment vehicle with a legal framework designed to provide investor protection and a tax regime much softer than in all previous investment schemes

The idea of UIFs is close to that of American mutual funds, the main difference is that those funds are not legal entities but represent a pool of assets which are managed by the management company of the fund to provide the value growth and are kept in the specialized depositary to provide the safety of assets

By November 14, 1997, FCSM has licensed 22 management companies and 4 specialized depositaries of UIFs and registered 20 UIFs which accumulated at the moment 195 billion rubles ($33 million) The sum is too small in comparison with the total value of savings in the country Evidently, the funds need more investors and the country needs more funds There are two options to solve the problem

1) attract public attention to UIFs and explain to them all the benefits of investing and the associated risks,
2) establish more management companies and UIF both in the center and in regions,

Collective Investment Centers (CICs) working under the auspices of FCSM apart from private consulting firms interested in distribution of specific products, may become entities where people are informed and educated on a variety of investment vehicles available on securities markets People should have access to the information about their investments, their rights in connection with these investments and they should have enough information to make a proper decision

The second option is accessible ~~only~~ after a proper control is established over the activity of all management companies, specialized depositaries and other parties of the scheme bearing in mind recent scandals with financial pyramids As a result, the objectives and goals of the original PRAGMA Task Order were changed and the highest priority was put to

1) the creation and supporting of analytic groups in four CICs and the following analysis of the securities market development in these regions

2) organization of educational seminars for CIC's employees and Conferences with participation of regional professionals,

3) creation (in four regional CICs) of data bases on UIFs, stock and bonds issued and traded in the regions and on intermediary firms offering services and financial products to general public

Task 1 Collection & Analysis of information

1 Delivery and installation of equipment in 4 CICs
2 Supporting of regional analytic groups
3 Job descriptions & reporting standards for CICs' employees
4 Scope of analysis
5 Formats for collection of information
6 Standards for analysis of information collected
7 Exchange of information between regional CICs and the center

Delivery and installation of equipment in 4 CICs

The list of equipment for regional CICs comprises 3 Server, 24 computers Pentium 133 MHz and network equipment (HUB), 3 Laser-Jet and 3 Ink-Jet printers, 3 Xerox RX 5309 3 Color scanners, 3 Fax machines, 3 modems, 3 Telephone stations Panasonic 4/16, 26 telephone sets Panasonic, software, cable, accessories (At about ~ $45,000 for each CIC, totally ~ $135,000, including transportation, installation and taxes)

All the equipment was purchased from R-Style firm won the tender in June In Rostov-on-Don and Kazan the installation of equipment was completed on November 17 Then Rostov CIC contracted with local providers the connection to the Internet, Kazan will be connected by November 21 after the R-Style specialists put in place an appropriate trunking system 5 computers were sent to Omsk on November 15 through the transportation company contracted by the R-Style firm, now they are in the Omsk airport

Supporting of regional analytic groups

FCSM indicated 3 cities where CICs should start their work as soon as possible -- Rostov-on-Don, Kazan and S Petersburg, in October the Omsk city was added to the list It was recommended that 5 people in each CIC are paid from PRAGMA project -- 3 analysts, IT person and a librarian Then the CICs directors were added and the librarian position was deleted The Table below shows the schedule of payments

City	Date from which the salary is paid			
	Director	Analysts	IT	Librarian
Rostov-on-Don	October 16	August 1	August 1	August 1
Kazan	December 1	August 1	August 1	August 1
S Petersburg	October 16	2 -- October 16 1 – November 1	November 1	
Omsk	December 1	December 1	December 1	

Job descriptions & reporting standards for CICs' employees

To select appropriate people to the positions of CICs' analysts and IT specialists, the tests for employment and job descriptions were developed Tests then were used in interviews and job descriptions delivered to CICs directors Reporting forms were developed and sent to FCSM and USA ID for consideration Now a pack of standard documents necessary for organization of an analytic group work is available

Scope of analysis

FCSM indicated that the scope of analysis should provide evaluation of development of the securities market in the regions recommended for CICs support At the meetings with FCSM people it was formulated that the analysis must cover UIFs activities, securities – stock & bonds -- issued and actively traded in the indicated regions, intermediary firms offering financial products to the public, investment funds, organizers of trades & stock exchanges in regions, registrars, depositaries, clearing firms

Formats for collection of information

Formats and benchmarks for analysis were discussed with FCSM officials and CICs people and corresponding tables for collection, monitoring and exchange of information were built and approved

Standards for analysis of information collected

Standards for analysis are in the stage of development, there are indications that CICs have different analytic potential which depends both on the local peculiarities and staff skills The final version of the standards will be produced after on-job training (planned for December) of analysts and review of their reports (planned for January) Project analysts are assigned to each of the 4 regions to monitor and evaluate the quality and relevance of the data collected and coordinate regional analysis at CICs Each is responsible for the work product coming from CICs and working with senior analyst and coordinator to produce the final report and recommendations Additionally, each analyst will be responsible for the execution (all aspects) of regional training

Exchange of information between regional CICs and the center

This very important issue is not the area of the project and there is no clear decision how the CICs will exchange information, namely terms, channels, volumes, responsibilities, etc

Monitoring UIFs activities

In order to teach CIC staff on UIF"s performance analysis, PRAGMA analysts started monitoring UIFs performance from January 1, 1997 All the data are put in the Excel tables and the graphs of NAV change, unit price, number of units outstanding for each UIF separately and in comparison with others are built and updated every week

Task 2 Education

1 Educational materials for CICs
2 Eurobond Conference for the largest regional corporations - potential bond issuers
3 Conference on Munis for regional administrations
4 Educating seminars for CICs staff
5 Training sessions for CICs analysts

Educational materials for CICs

Four manuals were developed from March to September

1 "Collective Investments Securities market UIFs Investment portfolio evaluation & marketing Investors rights " was prepared in March for 5-days training session designed for CICs staff and local professional interested in the topic The table of content is given below

Table of Content

Day 1

1 Collective investments and their role in mobilizing people savings
2 International securities market Types of securities Bonds, shares, derivatives Issuance and trading
3 Sources of Information on the securities market
4 Rate of return on investment calculation & evaluation Total return concept
5 Workshop Rate of return calculation on stocks & bonds

Day 2

1 Russian securities market Legislation & Regulation Types of investment assets
2 American mutual funds Contracts, servicing, placement
3 UIF as a mechanism for collective investing Comparison with other types of funds
4 UIF's operation scheme Management company Special depositary and registrar Licensing and model contracts
5 Investment portfolio analysis Risk and return Diversification Balanced portfolio
6 Workshop Building of the stock index

Day 3

1 Rules and Prospectus of a UIF Placement and redemption of units Agents
2 UIF's assets Portfolio of open-end and interval UIF
3 Financial aspects of UIF's activity NAV evaluation Unit price
4 Independent appraiser and auditor Accounting and taxation
5 Workshop UIF Prospectus Preparing of extracts for CICs clients

Day 4

1 Regulation & control over UIFs activity UIF liquidation
2 Rights of investors in a UIF and in a shareholder investment fund Disclosure of information
3 Non-licensed financial companies Deceived investors Features of Russian investors
4 Types of CIC clients Their attitude to risk
5 Basics of fundamental and technical analysis
6 Workshop NAV Statement of a UIF Filling the forms

Day 5
1 Choosing a UIF Advantages and drawbacks How to choose an appropriate fund
2 Investment planning Investment consultants professional skills and ethics
3 Role playing Game Clients come to a CIC

Attachments

1 Investment Advisors Code of Ethics
2 Regulation of Join-Stock Companies activity and shareholders rights protection
3 Glossary

2 "Development of UIFs & their Agent Net" was prepared in April for 5-days training of specialist from local broker firms interested in providing agent services to UIFs management companies The schedule of the seminar is given below

Day 1
1 Collective investments and their role in mobilizing savings
2 Russian securities market Legislation & Regulation Types of investment assets
3 Workshop Rate of return calculation

Day 2
1 Classification of UIFs
2 Rules and Prospectus of UIF UIF registration in FCSM
3 Structure of UIF assets NAV evaluation Independent appraiser and auditor Accounting and taxation
4 Workshop Stock index construction

Day 3
1 Sales agents of UIFs
2 Management of UIF's assets & Information disclosure
3 Workshop Writing the UIF Rules and Prospectus

Day 4
1 UIFs legal framework & regulation UIF liquidation Unitholders rights
2 Non-licensed financial companies & Deceived investors Features of Russian investors
3 Types of clients & Their Attitude to risk

Day 5

1 Choosing a UIF
2 Investment planning Investment consultants professional skills and ethics

3 Manual for CIC's analysts completed in August contains criteria for collection of information on issuers of stock, professional participants of the securities market and debt securities issued by regions and cities The manual covers current regulation of the defined areas and provides tables for collection of information

4 Manual for CICs staff prepared for the training session in Galitsino covers both organizational, educational and analytic sides of CICs' activity The content of the manual is shown below

CONTENT

1 Information subject to be disclosed according to Russian legislation
2 Sources of Information accessible to CIC analysts
  2 1 Information published in the Attachment to the "Vestnik of FCSM"
  2 2 Information published in the Internet

Section 4 Investment Consultants Skills & Ethics
1 Investment Planning
2 Work with Clients Main Principles
3 Code of Ethics

Attachments

Attachment 1 Job descriptions for CIC staff
Attachment 2 Glossary

Eurobond Conference for the largest regional corporations - potential bond issuers

The conference "Eurobond Mobilizing Corporate Capital in Russia" was held on June 20 in Aerostar Hotel, Moscow It was one-day conference for industry leaders from different regions of Russia, totally 108 people from 18 regions They represented the most important industries of Russian economy -- Energetic, Manufacturing, Telecommunications, Transportation and Utilities Regional Governors and officers of regional departments of FCSM were also invited The chairman of the conference was Mr Kolesnikov, the Deputy Chairman of the FCSM The major topics for discussions were as follows

- **Overview of the Eurobond Market**
- **The deal Process How it works and What it Costs**
- **The Economics of Issuance**
- **Credit Ratings**
- **Pricing and Selling**

After the Conference it were prepared Proceedings titled "Proceedings Eurobonds Mobilizing Corporate Capital in Russia Conference held in Moscow, Russian Federation June 20, 1997"

Monitoring of Russian Dollar and DM Eurobonds

Since April till August 1996 the PRAGMA analysts have been issuing monthly reports "Russian Eurobonds on the International Market" The analysis was based on the data provided by the Bloomberg agency for the 1-st, 2-nd and 3-d Eurobond series, issued by the Ministry of Finance in November 1996, March and June 1997 respectively The analysis included the evaluation of changes of the yield on Russian Eurobonds, calculation of the spread over underlying benchmarks, further analysis of the results with respect to the overall economic and political situation in Russia and world-wide, as well as prognosis for the next month

Munis Conference for regional administrations

The Conference "Munis & their Role in Regional Infrastructure Development" was held on September 18-19, in Ekaterinburg 119 participants from 33 cities of Russia were invited to this 2-days conference deemed for governors and specialists from local administrations and regional departments of FCSM The Chairman of FCSM, Mr Vasiliev opened the conference and on the first session he and the Sverdlovsk Area Governor, Mr Rossel signed the Agreement of Cooperation Mr Kryssov, the chairman of the local FCSM department chaired the sessions The major topics for discussions were the following

- **Municipal bond Market Overview**
- **Legislation**
- **Credit Ratings**
- **The Deal Process**
- **Market Infrastructure**
- **Western Experience**

The Conference Proceedings are in progress

Educational seminars for CICs Staff in Galitsino

The seminar "Providing Information to Public & Market Analysis" was organized on October 9-10 in Galitsino and representatives from all established and potential CICs were invited with compensation of all trip expenses Mr Zavadnikov, Deputy Chairman of FCSM responsible for regional policy and CIC establishment provided welcoming remarks and program overview General Advisor to the FCSM Chairman, V Volkova, spoke about goals and objectives of CICs, their organizational structure and information exchange with regional FSCM departments and Moscow Then followed the lectures

- Collective investments and their role in mobilizing savings CIC as a channel for providing information to the public on investment
- Investment consultants skills & ethics Investment planning
- Practical issues of investment consulting FAQs Types of clients Consulting on UIF selection
- PR activity of a CIC Promotion of the CIC image
- Types of securities Issuance and trading of stocks and bonds Professional participants of the market Investment funds
- Collection and analysis of information in CICs Sources of information Information, disclosed through the Internet
- UIF's organizational structure Types of UIFs Issue and placement of units Agents' network Information, disclosed by UIF's Management Company
- UIF's rules and Prospectus Composition and structure of the investment portfolio NAV and price of units Calculation of the rate of return Taxation issues
- Analysis of UIFs' activity Bond funds vs stock funds NAV growth & unit price Number of units outstanding Comparative analysis

At the end of each training day panel discussions and Q & A sessions were organized Each participant got a printed copy of a manual and its electronic version together with the list of CICs and their telephones and contact persons

Training sessions for CICs analysts

Training for CICs' staff includes not only seminars but on-job training of analysts supported from the project The visits were scheduled for November but then were delayed to provide time for CICs staff to accommodate with the computer equipment and the Internet use

White Paper on Russian Municipal Debt by Robert G Serafini
October 13, 1997

Introduction

Municipal securities are the fourth largest financial market in the United States (approximately $160-billion in new issue volume in 1997) Russia resembles the US in geographic size and structural diversity but the market for municipal securities remains undeveloped despite lively markets in other financial instruments This condition exists, however, only because pressures for price discovery and liquidity developed quickly after privatization in the industrial and commercial sectors but have been slower to reach the public sector The market may make itself felt in the public sector just as quickly as infrastructure needs intensify and create the need for new capital

The conventional municipal market disappeared in 1917 and is just now re-emerging as a thin stream of ruble-denominated municipal debt issues which began in 1994 In addition, a large infusion of foreign capital will have reached four of the Oblasts by the end of 1997 from five Eurobond issues totaling in excess of $1-billion

The 89 Oblasts are known as Subjects of the Federation and the Ministry of Finance (MinFin) is where these subjects meet their federation in matters of economics and finance Public policy initiatives by MinFin will determine the extent and direction of that growth in the near future

Macroeconomic Issues

Like other Russian financial markets, the municipal market has to deal with the related issues of an apparently high savings rate by households and persistent investor fears of inflation and sovereign risk Russian mattress money is held as a large pool of hard currency, mostly dollars, which should be circulating through the Russian economy with increasing velocity as productive investment Foreign debt may be an acceptable substitute for domestic spending and investment in the short-term, but public policy makers in Russia have to release those unproductive dollar holdings to generate the economic multipliers available to other market economies throughout the world

Realistic pricing may be one means to loosen savings Historically subsidized municipal services forced to deal with current-account realities and future capital requirements could provide an effective engine to pull savings from the population and circulate it through the economy where it can labor alongside Russian workers to create national wealth The savings rate may have to be subordinated, as it has been in other market economies, to keep the engine pulling

Management Issues

Stories of irregularities in the privatization program have haunted the financial pages in 1997 Those privatization stories hold undeniable political appeal but the reality of the new Russia is a *fait accompli* Robber barons appropriated a disproportionate share of America's growing wealth in the last century but life went on and the nation outside Newport grew Perhaps scandals about the past will serve to make future privatization more distributionally fair but the privatization story will be largely history by the year 2000

Social overhead may be the big story of the industrial and commercial sectors in 1998 as new owners discover the extent to which the social contract explicit in the Russian Constitution dogs their efforts at streamlining operations The holder of last resort of social obligations is the Oblast, which inherits Soviet-style governmental machinery and Soviet-era levels of expectations and yet carries the burden of moving forward into a new century with limited Federation fund transfers The Oblast, moreover, is among the least transparent of organisms in the Russian landscape New industrial managers have had to bring orderly accounting practices - whether Russian, GAAP or IAS - to bear on their enterprises Consistent accounting remains a goal in the public sector

Communists and others continue to advocate local deficit spending For his part, President Yeltsin has announced his intention to see the Oblasts carry their own weight Despite acute financial pressures, though, the Oblasts have yet to embrace broad perestroika In the short term, one of the best things that MinFin can do is encourage the Oblasts into rationalizing their operations

That process might begin with a clear requirement that no Oblast run a budget deficit and that every Oblast develop a budget for some specified future year with a positive rate of return on assets These requirements might not be achievable in operational terms, but could serve as a general framework for specific actions to separate the municipal enterprise, including the multifarious Non-Budgetary Funds (NBFs), into functional units which can be studied by Oblast managers objectively to determine their cost or profitability and their future capital needs

Supply of Municipal Paper

Potentially enormous To date, limited Table 1 provides a breakdown note that the total of local issues is equivalent to $3-billion (All figures courtesy of SKATE Press and "Securities Markets") A survey of issue features is worthwhile

- Disclosure The local issues have sparse financial and other information The Eurobond issues are documented according to Rule 10-b-5 standards with the best available *unaudited* financial information

- Legal structure The local issues include simple promises by the municipality to pay all amounts when due, without specific security covenants Most of the issues have been structured by MinFin lawyers The Eurobond issues are also structured as simple obligations without further security features, though the Federation issues include a security interest in foreign-held currency reserve deposits Because the Eurobond issues have been done "hand in glove" with Federal authorities, most investors regard them as indirect obligations of the Federation
- Use of proceeds All local and Eurobond issues are designated for general governmental purposes The issues are short- to medium-term and not tied to specific projects or revenue streams
- Distribution All local issues but one are offered and traded on exchanges Some are very actively traded, suggesting that they are used as an alternative to Russian sovereign debt as a trading vehicle and not widely held by "going away" investors The Eurobond issues are also traded and there is enough volume to document the steady decline in premium pricing in recent months, the Eurobond issues, moreover, enjoy substantial investor holdings
- Tax exemption Some issues were once considered tax exempt, but this feature was abolished at the beginning of 1997
- Security Russian law protecting creditor rights is undeveloped and hindered by untested Constitutional guarantees of debtor rights Given the state of Russian law, the general promise to pay, under the aegis of MinFin for both Eurobond and local issues, may be the best security currently

possible The Tatarstan issue includes a debt service reserve of approximately 15%

It is clear that this market is in its very earliest stages Though the structuring of issues by MinFin is probably a plus on balance, it is worth noting that the legal and accounting infrastructure for a substantially larger industry is not in place Moreover, the distribution of significant amounts of municipal paper to end investors cannot yet be considered realistic

With potential new issue municipal volume of $35-billion per year based on the relative size of other markets and an extrapolation of current trends, these problems have to be overcome

Demand for Municipal Paper

Most of the dealers we have talked to think of municipal bonds in terms of trading rather than distribution to investors If there is real investment, it is probably minimal This situation will have to change if the market is to develop as a large supplier of capital

Tax exemption is widely viewed in the US as a costly subsidy to local government whose benefits are concentrated among the very wealthiest individuals One alternative to on-going tax exemption may be the creation of a fund in which invested proceeds are given a tax amnesty, valid if the investor keeps the investment for a specified period of time, perhaps five years This legally-sanctioned money laundering could make it easier for Russians to repatriate foreign financial asset holdings as well as liberate mattress money

There is an established market for long-term zero coupon bonds in the US, but it is a niche market Significant investment in long-term bonds, however, requires the right kind of bonds coupon bonds which pay a current return A motivated investor or fund could accumulate a ladder of discount maturities which might provide a similar effect, but the idea is awkward and difficult to imagine in practice So the goal is clear longer-term bonds with current interest payments

That form, though, is at considerable variance with current practice, underlining the current disparity between the needs of issuers and those of investors Because issuers are looking for funds for current account needs, they look to discount issues with no current payments which they hope to refinance at maturity Only when issuers break the municipal enterprise into objective revenue streams will they be able to issue long-term coupon bonds with a realistic likelihood of current payments

In summary, there currently exist two key barriers between supply and demand the macroeconomic issues surrounding mattress money and a structural imbalance between the needs of issuers for current-account borrowing and investor need for reliable current interest payments

Foreign Capital

The Eurobond market bridges the gap between supply and demand to a limited degree With the blessing of President Yeltsin and MinFin, five significant issues have been placed with foreign investors for terms ranging from 2 to 5 years and at initial placement yields 50% cheap to reserve currency sovereign benchmarks All the Eurobond issues have current coupon payments denominated in dollars or marks, satisfying the wishes of lenders at least until they have to be refinanced at maturity What is the significance of these issues?

First, they underline the acuteness of the need for capital by the few Russian municipalities which have accessed the market Moscow, for example, has a significant program of housing construction which has stumbled this year because of cost inflation and the absence of mortgage lending The 3 5-million square meters of new housing begun in

1996 cost $2 1-billion at the current cost of up to $600 per square meter It is believed at the City has a substantial balance of new construction from earlier years at construction costs of $500 per square meter The prospectus for the Moscow issue, however, lists "general purposes" as the use of proceeds but hints at the scope of housing development under other headings, including the note that housing and utilities represent 54% of total city expenditure by all budgetary and non budgetary funds

Second, the issues highlight the demand for yield paper in foreign markets, where conventional investment yields have fallen dramatically in recent years Though the secondary market has already trimmed the yield premiums on this paper from 350 to 230 basis points, it is unclear whether Russian borrowers should choose to pay the yield premiums required by this market or to assume the currency risk asssociated with foreign-denominated debt

Third, the issues underline the weaknesses in current Russian industry infrastructure The issues have all been structured by foreign law firms and foreign investment bankers

Fourth, the issues deflect attention from needed perestroika in the public sector by providing a quick anodyne to budgetary problems Unless and until the bond issues are tied to rational revenue streams for domestic distribution, the Oblasts will be forced to keep looking for the next infusion of temporary cash and will always have to subordinate their local needs to the economic concerns of the Federation in international markets A short-term goal for each Oblast should be careful analysis of all budgetary and non budgetary funds

Credit and Other Information

Moody's and Standard & Poor's have rated the Eurobonds, including those of the Federation, Ba2 and BB- (Most observers expect that the Federation's rating will jump in early 1998 after review) These below-investment-grade ratings limit the investment potential in the bonds by a substantial amount Moreover, because of the close supervision of the Eurobonds by the Federation, most observers regard the municipal Eurobond issues as surrogates of the federal issues

A subsidiary of Urban Institute, a Russian think-tank on urban issues, has issued its first rating on a Novgorod municipal bond Having discussed this rating, and the rating process, with the principals at the Urban Institute, it is clear that this piece of the municipal finance infrastructure is in place The analytical methodology employed by the Institute is very solid If they can survive financially, they will be a strong asset to the developing municipal industry

Finally, SKATE Press, a dynamic information provider in many sectors of Russia's financial markets, has begun a lively publication on fixed income securities, including municipal "ratings " The analytical methodology is doubtful - these ratings should *not* be relied upon in the conventional sense - but the market intelligence is good

Professional Infrastructure

Aside from The Urban Institute subsidiary rating sub-federal debt, Russian professional infrastructure is undeveloped Several English and American law firm offices offer solid expertise, but there are no Russian law firms specializing in municipal law and finance The same holds true for accounting firms Western lawyers and accountants are very expensive and are justified perhaps in international bond offerings or as ancillary advisors, but they must be replaced in the longer term with Russian specialists, including specialists at the Oblast level An early goal of policy makers should be identifying Russian lawyers motivated to develop expertise in this field

Russian bankers, despite resourcefulness and the experience gained during privatization, are also inexperienced in virtually all aspects of public finance They are, moreover, intensely competitive We are told by Russian bankers that left to their own devices they will fragment the originations business and may resist the type of syndication needed to assure the successful completion of bond issues

Conclusions

The municipal market is not sufficiently large to support the growth of a solid lending industry In addition, much of the work of the industry over the next few years will be as consultants in the process of Oblast-level perestroika As the volume of issues builds, the industry will have to be organized to achieve true distribution to investors In short, the municipal finance industry in Russia should be fee-based for some period of time

MinFin should seriously consider a private-sector partnership designed to bring sound financial analysis to the Oblasts and preparation for local bond issues organized around specific enterprises This ' missionary" phase might last as long as two years as financial advisors work closely with the Oblasts to restructure their financial and organizational basis In addition, The Urban Institute specialists should be retained at the *beginning* of the process, before ratable bond issues are prepared, to begin getting a handle on the finances of the Oblasts MinFin could make small ($250,000) loans to the Oblasts to pay for this work Upon successful completion of a bond issue, MinFin's developmental loan could be repaid from bond proceeds

As the Oblast-level revenue streams come into focus, bond issues can be structured with rate covenants and other security features At that point, the object will become effective distribution The financial advisor would then shift focus to organizing a selling group to distribute the bond issues The role would be similar to that of senior manager but the financial advisor would *not be in competition* with firms selling the issue Thus, the financial advisor would have the role of "deal manager" or wholesaler whose only concern is maximizing the distribution of bonds at the best interest rate and lowest cost

Another role for the financial advisor during this "distribution" phase will be the investigation of fund vehicles designed to bring convenience and other consumer features to municipal bond investment by individuals and to find institutional sources of "warehouse" capital to underwrite bond issues pending, or in lieu of, further distribution

Based on the relative sizes of other markets and the likely continuation of a "socialist style" local public sector, it is easy to imagine an annual new issue volume of $35-billion This estimate includes capital needed for hospitals, all levels of education, water, sewer, district heating, municipal electricity, pollution control and public transportation, but does NOT include housing, which will probably be financed by an FHA-type entity This level of municipal lending is currently impeded by structural weaknesses in the Russian economy and by an undeveloped municipal finance industry

The wide availability of inexpensive municipal capital may prove to be an important component of national stability in the next few years Infrastructure needs have to be addressed soon as an element of social and developmental policy First, however, the public enterprise must be reorganized and MinFin must take the lead in providing the financial resources for a fee-based industry

Interview with Robert G Serafini by the
"Securities Market" magazine

INSURANCE AS THE WAY TO INCREASE THE LIQUIDITY OF MUNICIPAL BONDS

SM Credit risk insurance for securities has become widely used in the West This especially applies to the municipal bonds industry Could you name specific features of this type of security that created such an active growth of insurance services?

RS I think it is fair to say that the insurance market developed partly because the municipal bond market is not at all specific it is very unhomogenous That is the market that is characterized by many good quality credits which are, not withstanding that very different Insurance is a way of kind of wiping away these differences and homogenizing the market Another aspect in the development of the municipal bond insurance market in America is that the general requirement for an obligor to be insured is to have good credit quality Basically, what the insurance concept is designed to do is to take a silver credit and plate it with gold In general a brass or a copper credit does not turn into gold The credit has to be of a good quality by itself In the last few years in America the percentage of insured bond issues which have come to market has increased dramatically In 1993 approximately 35 % of the long-term bond market was insured In 1996 approximately 65% of the market was insured This is attributable to the fact that in America the insurance industry developed around a large volume of issues So they have become very competitive with their insurance fees They have made it very easy for issuers to make the decision to go ahead with insurance The decision that an issuer makes about whether or not to buy an insurance is really straight-forward if he can issue his bonds at this interest rate uninsured and at this interest rate insured he saves money every year If he than takes the money saved every year all over the life of bond issue and discounts it back using appropriate rates he can compare the present value of savings against the cost of insurance Because the American insurance industry is very competitive, the cost of insurance is low It makes the decision very easy in almost all cases, or in 65% of the cases The cost of insurance is significantly less than the present value cost of the money saved

SM Can we say that there is a list of securities or issues that already is ' gold ?

RS Yes, there are many issues in America at the state level, that are on their own strength AAA or very high AA credit quality There are also issues which for technical reasons are also very high, AAA credit quality This might not be of interest for Russian readers but there are general obligations collateralized by US Government obligations So it is fair to say that above and beyond insurance there is probably another 10 or 15% of the US market that is close to AAA or AA on its own strength

SM You have looked at insurance from the standpoint of the issuer, we now know all advantages that it gives to him Can we now take the prospective of a potential investor and see what it gives to him?

RS One thing that it gives to him is a security that does not really require thorough analysis It puts a layer of gold over the underlying security and makes it possible

20

for the investor not to look at the particulars of the underlying obligation That is attractive to some extent for a market that we have characterized at the beginning of the interview as a very diverse As in Russia America has big cities and small towns, is geographically very wide-spread is widely rural but also very urban So the variety of instruments in America as it will be the case in Russia when this market develops, is exceptionally broad, much broader that in most countries in Europe The other side of that question is that there are many investors who would like the opportunity to invest not in AAA low-yielding paper but in A-rated higher-yielding paper or BAA-rated even higher-yielding paper This type of investor has fewer available instruments to pick from But the market as we all know is supply on one side and demand on the other And if insurers have made it so overwhelmingly attractive for issuers to supply insured paper and the market is willing to accept that insured paper it just means that the group of investors who can tolerate risk has to look elsewhere for higher yields

SM Could you please talk about insurance procedures at the primary or IPO market, when the issuer takes the initiative to insure his securities and what is the attitude of investors towards such an initiative?

RS The issuer of securities usually considers issuing both with and without insurance and looks at them both at the same time He is able to get advice as to what the likely interest rate would be either with or without insurance He than does what we described earlier - he simply compares the cost of insurance against the potential savings and decides which way he wants to go If the economics favor insurance he will submit an application to one of the insurance companies or to several of insurance companies They will then evaluate the financial information about the issuer and analyze it Their analysis is very much the kind of analysis that is done by a rating agency when a bond issue comes to market uninsured The analysts will review financial data based on which they will either say Da' or Niet' and will submit it to someone who will say what the percentage cost of the insurance would be This is basically what the issuer looks at He looks at the bids and does the computation that we described above

SM Let's look at the situation when bonds were issued uninsured and are traded on the secondary market Is there a way to still insure them, and if so then how and who would do that?

RS The answer is yes, there is a way There are funds of money that invest in municipal bonds and have ongoing agreements with insurance companies to provide AAA-rating on their portfolios The bond buyer would tell the insurance company that there is a block of 2 million dollars worth of bonds for let s say the city of Omsk or the city of Novosibirsk, that he wants to buy asking the insurance company whether this block of bonds a) qualifies for getting a higher rating and b) what the cost of insurance would be That whole process takes place as you described it in the secondary side, or after the offering It is a procedure that is designed to take an obligation that was uninsured when issued and make it insured when purchased I am not aware of any way of doing what you described as an individual purchaser As I understand that kind of arrangements only exists with a relatively small number of large institutional investors and insurance companies

SM What insurance mechanisms or schemes became the most popular in the West and could you describe them?

RS The general type of insurance that we have talked about so far is the type of insurance that is applied to essentially long-term bonds and is primarily oriented towards credit risk Again it is designed to take an A-rated credit or a high B-rated credit and make it into an AAA There is a related type of insurance that is not really called insurance, it is designed to make short-term or very-very short-term obligations marketable That type of insurance usually takes the form of Letter of Credit from a very large bank and is designed to permit some issuers to issue extremely short-term obligations They may have a 30-year bond issue but the bond issue may be set up so that it is re-priced every single day or every single week So this type of insurance combines a creditworthiness feature with a true liquidity feature so that the investor can present his bonds every single day for redemption if he does not like the new interest rate The bank letter of credit is designed to guarantee that the bank will accept the paper and pay for it if it cannot be resold at today s interest rate So that type of insurance really is credit plus liquidity And that is usually provided by largest banks

SM Do you know about any cases when an issuer would default on his obligations and the insurance company will come out to the market and bear the responsibility?

RS Yes but let me explain a little bit the way the insurance works In a long-term obligation if the issuer defaults on payment of the principal and interests that is typically designed to present situation called an acceleration At that point the entire obligation over the entire future life of it is accelerated and becomes immediately due The situation with insurance is somewhat different In the insurance situation the insurance company decides whether the default in question is an event that is supposed to trigger acceleration Generally the insurance company does not see it that way and that is because the insurance company has only obligated itself to do one thing to provide timely payment of principal and interest on the bonds The insurance company sees an event of default not as the trigger for an acceleration, but as the trigger for someone to get on an airplane, go out to the issuer and see what is wrong Because most payments of interests are spaced six months apart the insurance company sees an event of default as a business problem and regards the situation as one in which it must work with the obligor or the issuer to fix it what do they have to do? Do they have to raise rates, do they have to raise taxes, do they have to lower expenses, do they have to pick a new bank to be their trustee or to handle their funds, is there some one-time problem that prevented this particular interest payment from being paid was there a giant ice storm as has happened in the North-East of the United States and in Canada is there a drought is there some specific thing that can be worked with to fix the situation And this brings us back to your original question on how the insurance process works and the reason why it is founded on the concept of a silver credit plated with gold Insurance companies are looking for situations that are fundamentally sound so that they have a long-term comfort that whatever problems an issuer might face are transient and can be fixed

SM How important is the role of the insurance on the Western market and did it become a critical component of this market?

RS We have already discussed the percentage numbers - they are significant the West and probably will remain that way as long as the supply of insurance company appetite for municipal risk remains where it is because the supply of the municipal paper in America is slowly going down Each year since 1993 the outstanding volume has shrunk a little bit So I think the answer to your question is yes it probably will remain the feature of the American municipal finance for some time to come

SM Let s talk about the insurance business as it applies to Russia Does it have a future and what are the specific traits or features that would be characterizing this market here?

RS I think this is a very interesting question probably one of the most interesting one could ask about sub-federal debt in Russia Unfortunately I cannot give a clear and immediate answer because I am not comfortable yet that I know what the answer is In the first instance one has to ask who will capitalize an insurance company The experience in America was reasonably straight-forward the first insurers were capitalized by other insurance companies who wanted to get into a new business and saw municipal credit as an attractive place to invest money for risk purposes It is not obvious to me who would capitalize a Russian - insurance company right now It is conceivable that an insurance company might be capitalized by a non-private source But that is highly speculative and I am unaware of any plans to do anything like that

SM The insurance market in general is undeveloped in Russia but we can often witness a situation when a guarantor is a bank whereas the obligor is an affiliated company even a subsidiary Can you comment on such a scheme?

RS Well I am not familiar with many details of the Russian corporate scene but I can say that it is not at all uncommon in the west for a parent company or a holding company to guarantee the debt of a subsidiary

SM Assuming the insurance industry develops in Russia do you think it will increase the level of interest of Western investors towards the Russian municipal debt market? And, in general, is this market interesting for foreign investors?

RS Potentially yes currently though the whole idea is highly speculative and really beyond the horizon of what can be foreseen It is not something that is likely to happen immediately But it will happen and as you suggested, it could develop into a situation of interest to Western investors I can even imagine a situation where an insurer of Russian municipal debt will bear the greatest risk burden, and it is likely to be backed up by Western insurance money so that the insurance money most at risk will be the Russian domestic money, and the depth of insurance will be provided by a larger insurer possibly from the west Again however, this is the "dream of a winter night'

SM Could you give your insight on what steps should be made by Russian specialists or companies to develop the municipal bond insurance industry? Is it reasonable to copy western models?

RS I think it is going to be hard to copy western models because the fundamental premise of the western model is silver covered with gold And for the sort term for the next two years at least, the number of silver credits in Russia will be limited As an idea, it is something that is worth to be thought about however I do know for a fact that the Ministry of Finance is very committed to working with local governments to reduce their deficits and to increase the overall economic stability To some extent credit is the public face that is worn by the underlying economics of the situation So to the extent that the underlying economics of the local governments improves their credit will improve as well Another aspect that makes insurance attractive is the commitment of the Federal Commission for the Securities Market to full disclosure of all relevant materials and financial information by all varieties of public borrowers in Russia

SM Can we say that most municipal bond issues in Russia can be classified as copper'?

RS I have not personally investigated the finances of the current municipal bond issuers in Russia However other people have If you look at the ratings applied to Russian municipal obligations you really looking at a handful of rating entities In the first instance there are municipal bond issues that were done in the eurobond market and have been rated by international bond rating agencies at the approximate level of Ba2, which is just slightly below what is called investment grade in the West That is probably not silver It may not be copper , maybe it is brass Other ratings have been applied by for example Skate Press This is a highly regarded Russian financial reporting service and those ratings are generally even more negative than the Western ratings The Russian Consulting firm named the Urban Institute has developed a rationale for rating Russian municipalities and has in fact done the rating for Novgorod which puts the credit quality just about the same place as S&P or Moody's would Finally we are told by knowledgeable people that Interfax the huge Russian news organization will be developing a rating process for municipalities to complement its existing rating procedures for banks and insurance companies and these ratings will be starting to appear in the near future So there will be three indigenous Russian rating services in operation or are already in operation And it is quite possible that the development of a body of rated securities could provide the basis for a much larger industry in Russia

SM To conclude let me ask you about the World financial crisis and its impact on the Russian securities market and in particular the municipal debt market

RS I am not an expert in international finance and fund flows but I do know that when there is a crisis it tends to spread at least psychologically beyond the immediate focus of the crisis I have read that the Asian crisis has resulted in the net dis-investment of about 8 5 billion dollars in the Russian equity market There is no reason to believe that the Asian crisis situation is prevailing here and that dis-investment may simply be as probably a form of excess caution But I can tell you this risk money does not take vacations If it pulls back temporarily it will soon be looking for a new place to invest and Asia will probably not be that place for some time Let me turn the question to you if you were a manager of a large pool of investment capital wouldn't you want to look carefully at the country that has astonishing reserves of natural resources, universal literacy, higher literacy that in the United States or Canada, that has a tremendous scientific and technological infrastructure, including the space station 120 miles above us? I think, my point is that to the eye of this amateur the Asian financial crisis could end up favoring Russia because when you eliminate South-East Asia from your possibilities for investment, what is left? The brightest diamond in the diadem is right here We can also assume that the South-East Asian financial crisis will ultimately contribute to the development of the Russian municipal debt market because there is a great number of investors ready to invest in the social infrastructure elements - water heating, health care schools etc

Unfortunately I spent too little time in Russia, the total of 3 months during the last year But I keep on being amazed by the highest intellectual potential and professionalism of people I am meeting here I very much admire and appreciate the dedication and the determination of persons in government that clearly realize what efforts they are to make There are lots of people in this country who are ready to do their best to improve the image of Russia so that in the future it can again be called a super power

The analysis of the activity of UIFs

In January 1997 there were only 2 UIFs - Short-term Ruble Investment Fund (SRI) managed by Credit Swiss Moscow and GKO fund managed by Pallada Asset Management (PG)

All the funds that started selling units at that moment were concentrated on GKOs as securities, combining liquidity, reliability and high yield and being tax-exempt When by June-July GKO yields dropped relative to fast growth of Russia blue chips, more funds investing in stock appeared There were 4 of them by the month of May Credit Swiss Large Cap Shares (LCS) Fund, Pallada Corporate (PC) Fund, Piotr Stolypin (PS) Fund and Dobrynia Nikitich (DN) Fund

In June 1997 10 UIFs were selling their units in regular mode 3 Credit Swiss funds – SRI, Short-term Foreign Currency Investment Fund (SCI) and LCS, 2 Dialog funds – Ilia Muromets (IM) and DN, 2 Pallada funds – PG and PC, Pioneer First (P-1), Montes Auri Short-term Mutual Investment (SMI) Fund and Piotr Stolypin (PS), managed by the United Financial Group "Invest"

The total NAV of all 10 funds reached by the end of June 113 bln rubles (app $20 mln), which is not much Calculations show that with US $ 1 mln under management the management company can count on getting maximum of $50,000 per year (5% management fee is a legal requirement), which will never allow to break even because only advertising and printing costs will go far beyond this limit According to western experts opinions the minimum reasonable asset size is $ 25,000 – 30,000 Consequently, the main objective for managers will be to attract large amount of capital into UIFs To do that, it is necessary to inform the public and to regain investors' confidence and positive attitude towards UIFs

Below is the chart displaying NAV dynamics of all the UIFs during 1997 As we can see, the considerable growth was observed up to October 27, when the World financial system crashed The presented data covers the whole year since the beginning when there was only 6 funds up to the end of the year when there were 17 funds operating on the market

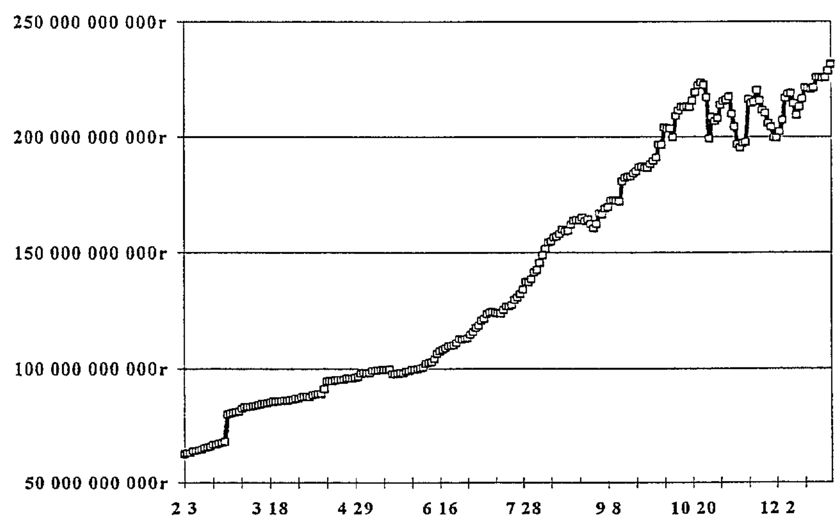

Fig 1 UIFs' NAV dynamics in 1997

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Below is the NAV data of open-end UIFs that terminated primary distribution before the end of 1997

Table 1 Open-end UIFs, data as of the beginning of 1998

Management company	Fund's name (full)	Fund's name (short)	NAV* as of 01 05 98 mln rbls
JSC Credit Swiss Unit Funds (Moscow)"	Bond fund	CS B	**33 165**
	Short-term foreign currency investments fund	CS SCF	**30 185**
	Large and medium cap shares fund	CS LCS	**55 112**
CJSC "Trioka-Dialog"	Ilia Muromets	IM	**2 152**
	Dobrynia Nikitich	DN	**26 015**
CJSC "Pallada Asset Management"	GKO fund	PG	**4 065**
	Corporate securities fund	PC	**3 408**
CJSC "Pioneer First IFMC"	Pioneer First	P-1	**3 171**
	Pioneer First – Liquid shares fund	P-2	**2 582**
CJSC "Montes Auri"	Short-term mutual investments	SMI MA	**9 904**
	Long-term mutual investments	LMI MA	**8 138**
CJSC "United Financial Group INVEST"	Piotr Stolypin	PS	**14 350**
	Borei	Borei	**3 070**
"MKB-Capital Ltd "	Montblanc	Montblanc	**6 881**
CJSC "Templeton"	Templeton	Templeton	**18 044**
		Total	**220 242**

The First interval fund "AVO-Dubna" was registered in March, 1997, started primary distribution on June 30 and terminated on October 28, 1997 "Petrol Fund of Reconstruction and Development" was registered later (at the end of September), but terminated the primary distribution 10 days earlier than "AVO-Dubna" Table 2 contains brief data about these funds

Table 2 Interval UIFs, data as of the beginning of 1998

Management company	Fund's name (full)	Fund's name (short)	Interval dates in 1998	NAV* as of 01 05 98 mln rbls
OJSC 'AVO-Capital'	AVO-Dubna	AVO	1-14 03 98	5 330
CJSC "Management-Center"	"Petrol fund of industrial reconstruction and development"	Neftianoy	5-20 04 98	22 650

The total NAV of 17 operating funds at the beginning of 1998 was equal to 248 mln New rubles Like during the whole year, largest assets were accumulated by "Credit Swiss" funds - 118 5 mln (8% of the total NAV of all Russian UIFs), the smallest - by "Pioneer" - 7 5 mln rbls (3 %)

It is clear that such a deplorable situation is to a great extend explained by the world financial crisis The RTS index dropped 108 points (25% of the value as of October 24) during 27 and 28 of October 1997 Consequently, the total NAV of corporate funds dropped 15 5 rubles overnight of 27 to 28 of October Credit Swiss LCS fund assets lost 11 mln rbls (17 % of October 27 value), DN - 3 74 mln (13 %), PC - 1 04 mln (12 %), PS – 225 mln (1 6 %)

One could expect a sudden increase of redemptions – unsophisticated investors usually start panic when fund's assets go down Hopefully, in case of our funds it did not happen

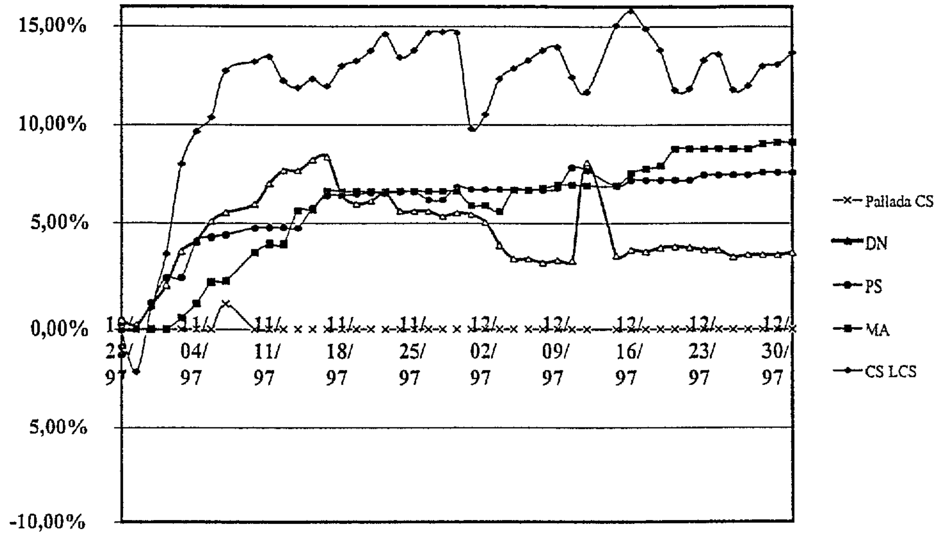

Fig 2 Relative change of number of units of corporate UIFs over the period from October 27 till the end of 1997

As you can see from Fig 2, in November-December 1997 there was no sudden decrease of number of units in such funds as DN, LCI, MA, PS, PC and CS LCS On the contrary, during the first ten days of November funds DN, PS, LCI and MA experienced unit number growth of 5 % in average, and CS LCS – 13 % Apparently, investors hurried up to buy units at a cheaper price, established in that period of time – between October 27 and November 14 assets of CS LCS fund lost 25% of their value

Government securities funds, however, were loosing clients, despite the sudden growth of yield on GKOs and OFZ in November (from 20% in October up to 30% at the end of November Number of units in IM and P-1 funds was dropping by 4-6% till the end of December, but 5 days before the New Year IM lost 12 % of units CS B fund managed to keep the number of units virtually unchanged over the whole period As for PG fund, the significant (-30%) redemptions at the end of November were followed by a large placement (+41 %), which resulted as of the end of the year in 11% growth Almost 10% of units were redeemed from SCI MA fund at the beginning of November, after which units started getting placed little by little, and the percentage of redemptions at the end of the year was 8% of the value as of October 27

As you can see from Fig 3, there are no common trend lines in the behavior of government securities funds investors

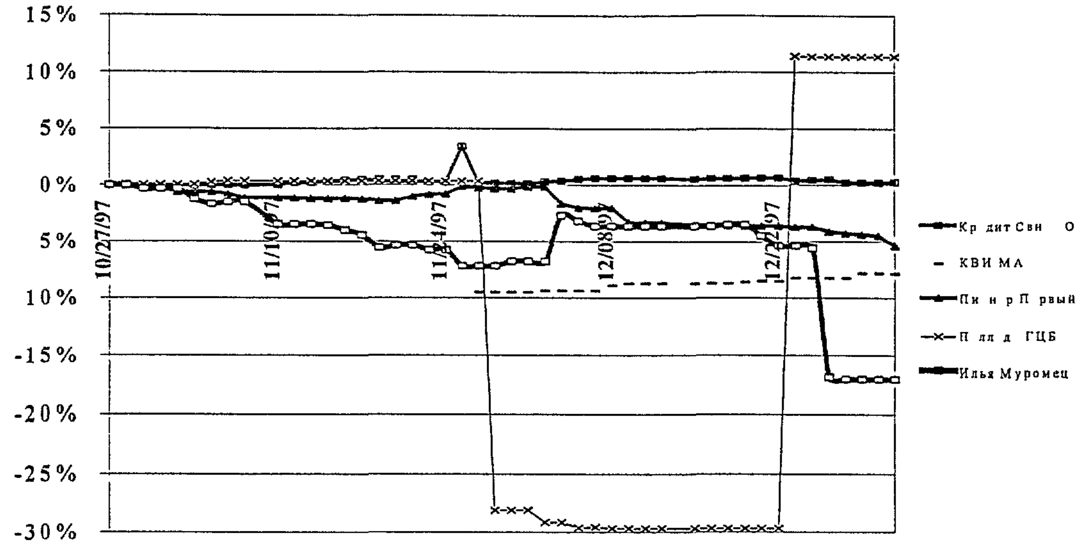

Fig 3 Relative change of number of units of government securities UIFs over the period from October 27 till the end of 1997

It is difficult to judge upon the performance of funds based on these charts because of the different unit price in different UIFs Thus, a P-1 unit cost at that time 5,000 old rubles, whereas a CS B unit was selling at 640,000 Consequently, redemption of 1,000 P-1 units (5,000 x 1,000 = 5,000,000) is equal to redemption of 8 (5,000,000 / 640,000 = 8) units of CS B I think it would be logical to base the comparison on some kind of «discounted» units of, let's say, 500,000 rubles of value

Table 3 Change of number of units of UIFs over the period from October 27 till the end of the year

Management company	Fund's short name	# of units in the register as of 27 10 97	# of units in the register as of 31 12 97	End of the year result	In discounted units	Total for all the funds of the company
Troika Dialog	IM	4446	3688	-758	-887	+906
	DN	51773	53660	+1887	1793	
Credit Swiss Unit Funds	CS B	51846	51987	141	180	+9923
	CS LCS	82206	90040	7834	9613	
	CS SCI	50358	50467	109	130	
Montes Auri	SCI	914468	842664	-71804	-1688	-239
	LCI	881565	970042	88477	1449	
Pallada Asset Management	PG	316752	352733	35981	828	828
	PC	4195	4195	0	0	
IFMC	P-1	614691	581469	-33222	-359	**
OFG INVEST	PS	255175	274507	19332	1991	**

** - other funds of these companies did not finished primary placement at that time

Table 3 shows that by the end of the year only Montes Auri funds showed negative balance of units the redemptions of SCI fund were just 239 «discounted» units more than placement volume of the LCI fund (or 119 5 mln old rubles of negative balance) Again, this evaluation is very approximate, since units were sold and redeemed at different dates, and the unit price was floating all over the analyzed period

Assessment of UIFs performance based on the NAV analysis is also pretty rough, because besides the sales-redemptions balance it also reflects changes in assets market value NAV changes of Russian UIFs over the examined period are shown in Table 4

Table 4 Change of NAV of UIFs over the period from October 27 till the end of the year

Management company	Fund s short name	NAV at 27 10 97 Mln rbls	NAV at 31 12 97 Mln rbls	End of the year result (mln rbls)
Troika-Dialog	IM DN	2599 29268	2155 25515	-444 -3753
Credit Swiss Unit Funds	CS B CS LCS CS SCI	33177 62813 30277	33263 55243 30195	+86 -7570 -82
Montes Auri	SCI LCI	10553 8433	9906 7943	-647 -490
Pallada Asset Management	PG PC	3739 4469	4067 3491	+328 -978
IFMC	P 1	3397	3158	-239
OFG INVEST	PS	14048	14180	+132

Yield on UIFs investments

The income of a UIF investor is generated as the difference between the buying price and the redemption price There are neither dividends not interests on units and the Manager is not allowed to promise to the investor whatever income in the future Consequently, *the key parameter to evaluate the yield in a specific moment in time is the actual growth of UIF assets over the specific period of time* This enables us to draw two conclusions that have practical value for investors

a) yield on UIF investments is subject to daily changes,
б) yield depends upon the period of time it is calculated for

Unit price growth data (see Table 1) shows that in the 2nd quarter of 1997 the maximum monthly average unit price growth was achieved by the fund IM - 3,91% Most other funds also have a very decent value from 2,5 to 3,4%

The unit price growth is indicative for *nominal* yield *To calculate effective, or net yield on investments in a specific fund it is necessary to account for premiums and discounts the management company charges to sales and redemptions* Here is an example

Let's assume the management company charges 3 % sales premium and 2 % redemption discount to the unit price An investor bought a unit on March 31 The unit price was 1,000,000 rubles Sales price then was 1,000,000 rbls x 1,03 = 1 030 000 rbls (unit price + premium)

During 3 months (March 31 – July 1) the unit price grew up to 1 1 mln rbls Consequently, the unit price growth was equal to 100,000 rbls , and the nominal yield on investments over the period - 100,000 rbls /1,000,000 rbls x 100% = 10%

On July 1st the investor decided to materialize the income and sold the unit back to the management company The real redemption price was 1 100 000 rbls x 0,98 = 1 078 000 rbls The net profit of the investor ended up being 1 078 000 rbls - 1 030 000 rbls = 48 000 rbls , and the net yield 48 000 rbls / 1 030 000 rbls x 100% = 4,66%

So the example shows

- Nominal yield over the quarter = 10%,
- Net yield for the investor over the quarter = 4,66% (two times less than the nominal yield)

These values can be easily calculated for longer periods Assuming that premiums and discounts are constant, and the unit price growth dynamics don't change, if we calculate the yield for the periods of 6 and 9 months respectively, we will get the following results

- Nominal yield for 6 months = 21%,
- Effective yield for 6 months = 15 13% (30% less than nominal),
- Nominal yield for 9 months = 33 1%,
- Effective yield for 9 months = 26 63% (20% less than nominal),

Conclusions

a) premiums and discounts may have significant impact on the effective yield on UIF investments,
б) lowering premiums and discounts has to become (and already starts being) one of the main tools of competing for clients among management companies,
в) the investor can only feel real advantages of investing in UIFs when money is invested for a relatively long period of time (6 months and more)

Nominal yields of open-end UIFs are shown in Table 5, together with best results achieved by the fund over the year and the date when it was achieved Unit price growth was calculated from the date of termination of primary placement

Table 5 Results achieved by UIFs by December 31, 1997

Management company	Fund's short name	Unit price growth, %	Date of the end of primary placement	Max unit price growth	Date of achievement of Max unit price growth
Troika Dialog	IM	15 6	31 03 97	16	24 10 97
	DN	-4 7	18 06 97	27	15 08 97
Credit Swiss Unit Funds	CS B	15 3	1 01 97	16	24 10 97
	CS LCS	9 06	29 01 97	52	8 10 97
	CS SCI	6 95	4 03 97	10 2	6 10 97
Montes Auri	SCI	17	18 04 97	17 4	5 11 97
	LCI	-18 1	17 09 97	5	22 10 97
Pallada Asset Management	PG	12 8	17 01 97	15 6	7 10 97
	PC	-16 7	13 06 97	27	15 08 97

6

IFMC	P 1 P 2	7 95 0 7	11 02 97 22 12 97	10 24	7 10 97
OFG INVEST	PS Borei	2 7 3 1	29 05 97 16 10 97	25 -	16 10 97 -
MKB-Capital Ltd	Montblanc	-0 16	19 12 97	-	-
CJSC «Templeton»	Templeton	1 7	21 11 97		-

The best results were achieved by funds investing in government securities, which is no surprise in a crisis situation on the stock market The champion became the fund SCI with the result 17 % (which is 58 % annualized) Then come IM and CS B, 15 6 % and 15 3 % respectively Corporate funds could not show positive results due to the sudden fall of stock quotations on the Russian market because of the stock market crisis, started in the South-East Asia

But the last two columns of Table 5 show that UIFs had better results during the year In particular, for corporate funds best results were in August and the beginning October, for government securities funds - in October

Fig 4 and 5 below show the dynamics of unit price growth in October Unit price changes were calculated based on the price at the beginning of the month

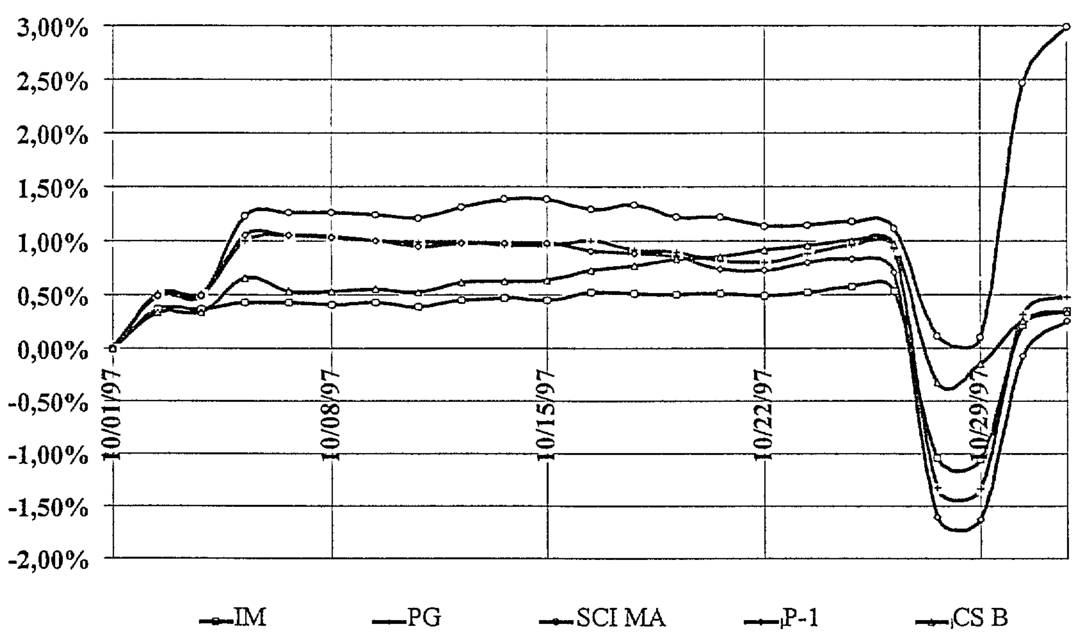

Fig 4 Relative change of unit price of government securities funds in October 1997 (in percent to the value as of the beginning of the month)

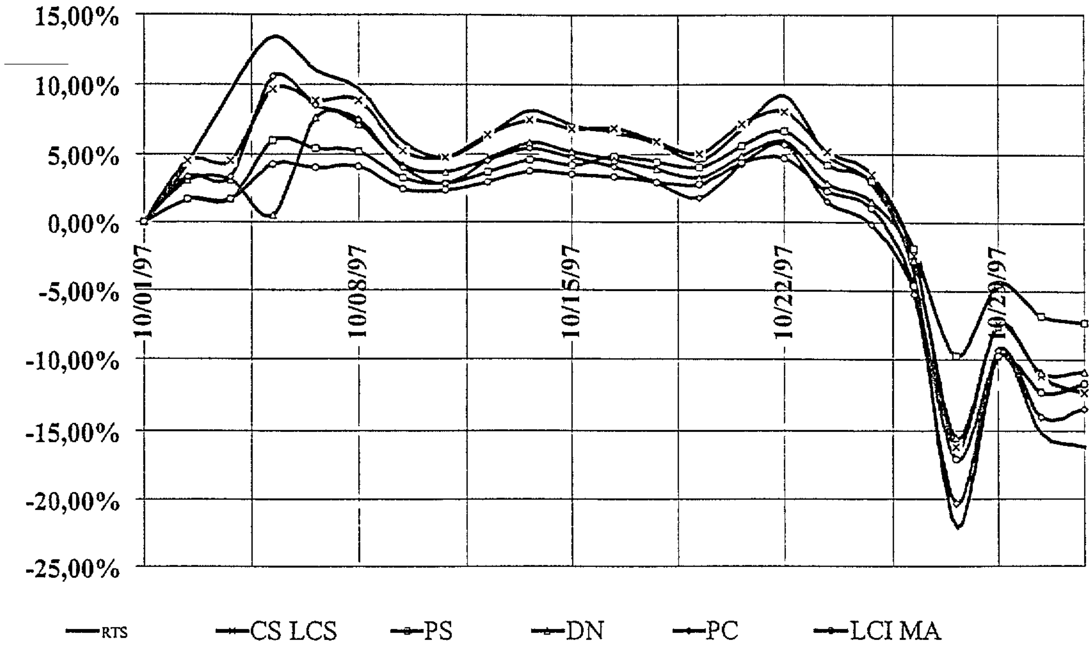

Fig 5 Relative change of unit price of corporate funds in October 1997 (in percent to the value as of the beginning of the month)

If we compare monthly growth of unit price, the most efficient period for government securities funds was in April and May Units gained 5-6 % in price per month, which was due to extremely high yields on GKOs and OFZs at that time, as well as to specific features of re-evaluation of funds portfolios This is shown in Fig 6 and 7

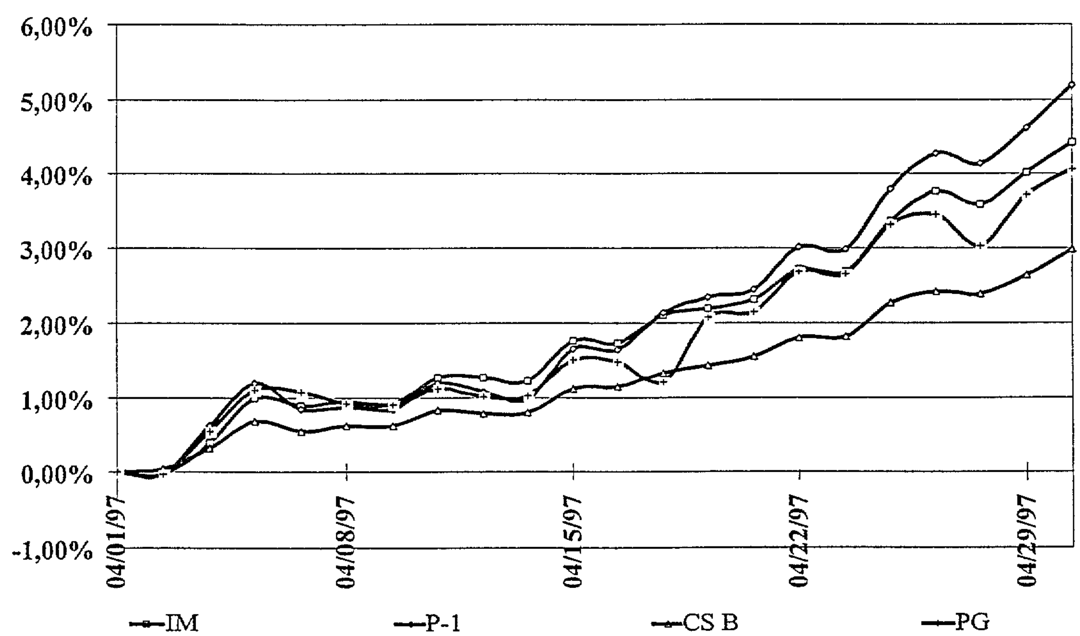

Fig 6 Relative change of unit price of government securities funds in April 1997 (in percent to the value as of the beginning of the month)

UIF managers evaluate GKOs and OFZs daily based on their current quotations on MICEX It is known that during a few days right after the auction quotations grow rapidly, then the growth slows down and right before maturity the price remains virtually stable So securities bought in April-May were ensuring good growth dynamics of GKO funds assets In April the maximum monthly assets growth was shown by the fund P-1 - 5 2 % , and in May - by IM (4 1%)

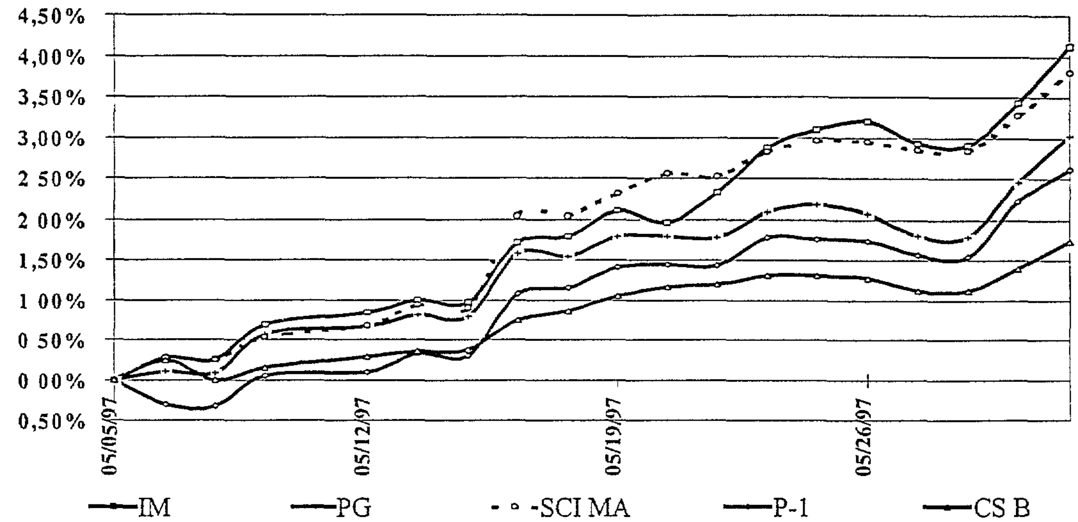

Fig 7 Relative change of unit price of government securities funds in May 1997 (in percent to the value as of the beginning of the month)

As for corporate funds, the most favorable period is surely July (see Fig 8) The unit price growth of CS LCS fund in this month was 26%, PC and DN funds also showed good results - 12 %

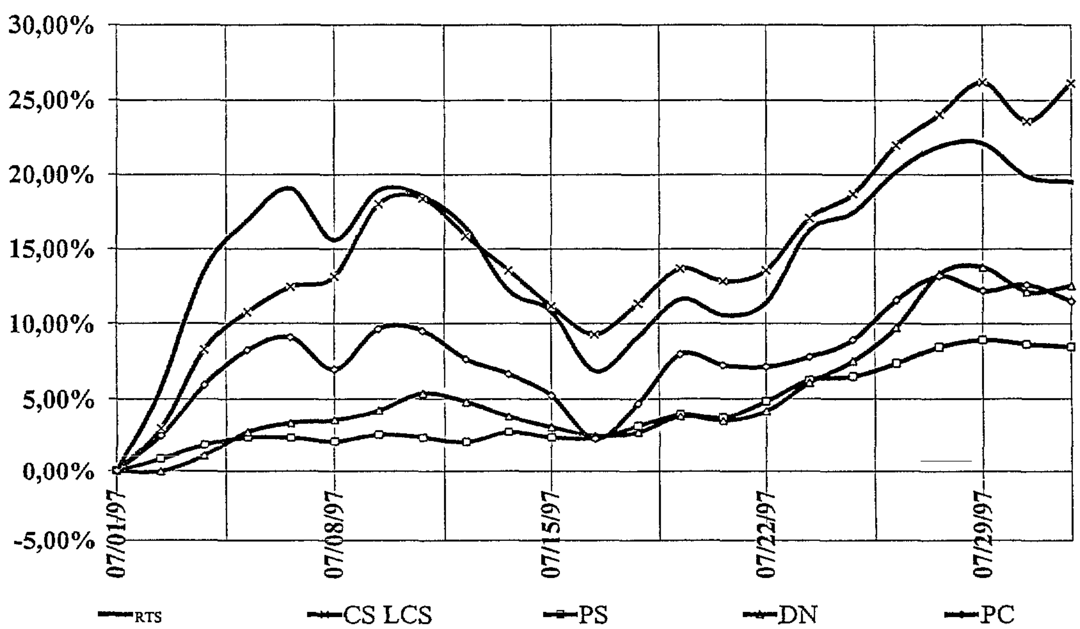

Fig 8 Relative change of unit price of corporate funds in July 1997 (in percent to the value as of the beginning of the month)

Fees charged to investors

When managers realized that attraction of additional clients is the key component of their future success, they started making changes to their contract terms First of all this applies to management fees and fund management expenses Fig 9 shows the dynamics of changes in these indicators over 1997 for both corporate and government securities funds

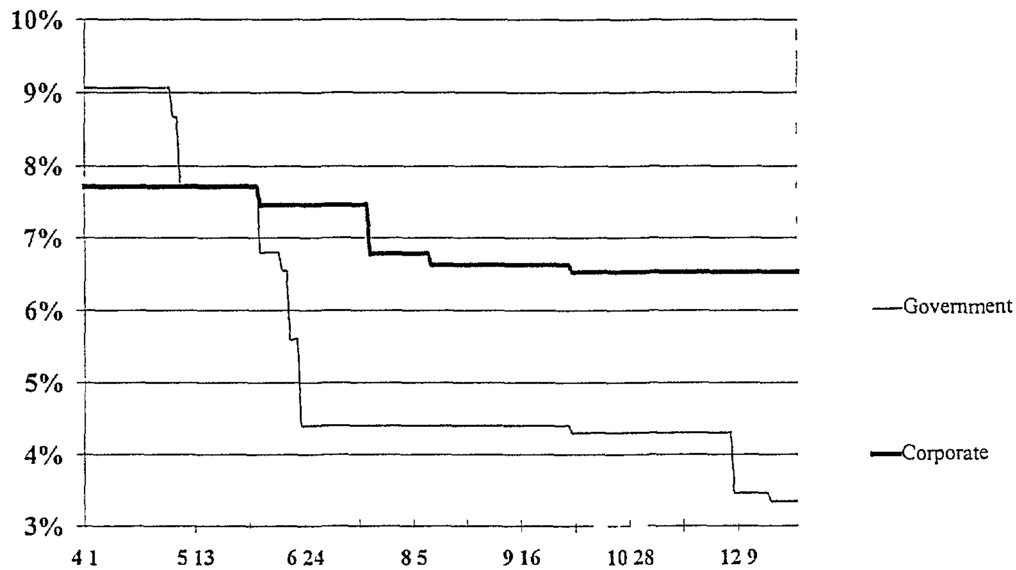

Fig 9 Changes of average management fees and expenses of corporate and government securities funds

As you can see from Fig 9, most managers lowered their fees already in July, moreover, by the end of the year government securities funds had much lower total fees (3 3 %), than corporate (6 5 %) Data for each fund, including premiums and discounts, is available in the Attachment

Apparently, the trend of lowering fees will stay With more funds there will be more competition There won't be, of course, very significant and sudden decrease of fees size, but manages will have to work hard on making their business profitable without repulsing investors by high commissions

Agents

Success of a UIF manager depends a lot upon an efficient agents network Today all the funds are located in Moscow, but they are getting to regions The first was "Pioneer" fund manager to open agent offices in St -Petersburg and Voronezh at the end of May, 1997 This management company plans to open up to 40 offices in different cities and towns of Russia in a few months Other management companies also expressed their interest in promoting UIFs to regions Obviously, the sooner the massive UIF expansion starts, the sooner managers will resolve their main problem – to accumulate assets, which is today literally the question of life for all the funds

Taxation

Speaking of net yield on investments, we have to take into account taxes investors have to pay on their income So, let's talk in brief about UIF taxation

Clarifications of UIF taxation are given in the Letter of the State Tax Agency № НП-2-01/80н of January 15, 1995 agreed with the Ministry of Finance and the FCSM

Income of individuals, generated from redemption of units is subject to income tax according to sub-section «t» of paragraph 1 of article 3 of the Federal Law № 1998-1 of December 7, 1991 «About Income Tax For Individuals» accounting for changes made by the Federal Law №159-ФЗ of December 31, 1997 «About Changes And Amendments To the Federal Law About Income Tax For Individuals» Individuals are given two choices while defining taxable income they can either get tax relief for income generated from selling property (including securities) which is then not to exceed 1000 minimal wages, or subtract from their total taxable income documented expenses for purchase of this property

In the first case when the company redeems units it charges income tax based on the current progressive scale on the actual difference between distribution and redemption price At the end of the year the investor files necessary documents to the tax authority, which makes adjustments and pays out the rebate The second variant is much more attractive for investors – purchase expenses for securities (including units) can be accounted at source of the income – i e the management company without applying 1000 minimal wages rule

The revenue of an institution – investor in UIF is generated at the moment of redemption and is determined as the difference between distribution and redemption price, being accounted in financial results of the institution

UIF revenues of non-resident institutions, in case they are not related to company's activities in Russia, are taxed according to Article 10 of the Federal Law «About Taxation Of Institutions' Revenues» at a 20 % rate The tax is withheld by the management company in the currency of payment, the taxable base is the total sum of revenue at each transfer of unit price According to point 5 1 9 of the Instruction of the State Tax Agency № 34 of June 17, 1995 «About taxation of revenues of non-resident institutions» the revenue from redemption of units should be determined as the difference between their redemption and purchase price

Before coming into force of the Federal Law «About Changes And Amendments To The Federal Law «About Taxation Of Revenues Of Institutions» № 13-ФЗ of January 10, 1997 revenues and incomes of UIF investors were tax-free on condition that all of the assets of the fund were invested in government securities and equally treated securities, revenues on which were free of income and revenue taxes

Starting from January 21, 1997 institutional UIF investors lost this tax relief since the moment when funds started buying taxable government and equally treated securities