

**Republic of Georgia  
End of Contract Report  
Capital Markets Development Program**

**Barents Group of KPMG Consulting, LLC**

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## I. Executive Summary

### **Goals/Objectives:**

Barents Group of KPMG Consulting, LLC, was contracted by the United State Agency for International Development (USAID) to provide technical assistance to the Government of Georgia (GOG) to develop their capital markets. The program commenced in Sep-97 with a final completion date of Oct-99. The completion date was subsequently modified to Dec-00.

The goal of the Georgian Capital Markets Development Program was to stimulate the growth of an emerging private economy in Georgia, increase the level of investment in Georgia (both domestic and foreign) and increase per capita productivity, leading to higher standards of living for all Georgians.

Objectives of the program were to develop an effective regulatory framework for the securities industry; provide a commercially viable securities trading mechanism, an independent share registry mechanism, and a central clearance, settlement and depository system; train market participants and inform the general public regarding the infrastructure being created; and promote corporate governance, shareholder participation, and compliance with National Securities Commission (NSC) regulations by the newly privatized companies.

The following is a brief summary of the results for each of the primary components of the Georgian Capital Markets Development Program.

### **National Securities Commission (NSC)**

The advisors worked closely with the Securities and Stock Exchange State Inspection Board (SIB), subsequently the National Securities Commission (NSC), to define its role in the capital markets in Georgia and to assist in the institutional development of the organization to fulfill its regulatory responsibilities. Commission staff received training and other development assistance throughout the project.

The advisors conducted a comprehensive review of all the laws and regulations that had an impact on the capital markets in Georgia, compiling an inventory of all applicable laws and creating a Capital Markets Library for use by the Commission. After reviewing these laws, the advisors provided policy advice to the Commission, recommended amendments to the appropriate laws and regulations to address deficiencies and assisted the Commission through each stage of the legislative adoption and amendment process.

When the initial review of the draft securities law completed under a previous assistance project revealed significant deficiencies, the advisors prepared a revised securities law to assist the GOG comply with the requirements of the World Bank's Structural Adjustment Credit II.

The revised Law on Securities Markets was passed on December 24, 1998 and in July of 1999, a Decree was signed by the President of Georgia, forming the independent NSC and establishing its roles, responsibilities, and funding. This included the "transitional" provision for two foreign commissioners to increase the credibility of the organization and assist in the initial

development of the independent agency. The Law on Securities Markets also defined the role of the NSC in licensing and overseeing market participants, Self-Regulatory Organizations (SROs), and Independent Securities Registrars.

The advisors also assisted the Commission in defining its role regarding the establishment and enforcement of accounting and auditing standards related to the financial reporting of publicly traded companies and helped the Commission establish a Market Monitoring Unit to monitor compliance with these standards and newly established regulations. This included assistance in establishing policies, procedures and systems to support public access to this information. When the World Bank/PWC project to establish share registries for public companies experienced delays, Barents was requested by USAID to assume responsibility for the completion of this project to reduce its impact on the development of the overall capital markets development efforts in Georgia.

### **Georgia Stock Exchange (GSE)**

The advisors initially conducted an analysis of the telecommunications capabilities in Georgia that identified deficiencies in the existing infrastructure that would have an impact on the design of the initial trading mechanism in Georgia. A tender process to identify potential candidates for assistance in the development of an Exchange was initiated through the development of a Request for Proposal (RFP). When the advisors identified and analyzed potential candidates for the tender process and found that none were likely to meet the preliminary criteria for the RFP, it developed a Working Group to explore different partnering arrangements between existing candidates. The initial tender process was delayed while issues related to the organization and structure of a Stock Exchange were debated during the review of the new Law on Securities Markets.

After these issues were resolved and several viable candidates began to emerge, the tender process was begun in November of 1998. The GSE was selected as the winner of the tender process on February 1, 1999. Barents formed an evaluation team to review trading and settlement systems in Moscow, Bishkek and Riga, and as a result, the Russian Trading System (RTS) Plaza software was selected for use by the GSE. The advisors worked with the RTS and GSE technical staff to install the new system.

The advisors provided assistance to the GSE in all aspects of organizational development, including assistance in revising and adopting its rules and operating procedures relating to trading, membership, disciplinary procedures and other conduct by members. The rules and operating procedures were included in the GSE's application to the Commission for a Stock Exchange license.

The Stock Exchange was licensed by the NSC on January 14, 2000 and was designated as a SRO by the NSC on January 19, 2000. Mock trading sessions were conducted prior to the first trading session on March 23, 2000 to help the NSC, the GSE and market participants develop more experience prior to the commencement of official trading. Since then, the GSE has been operational and conducting trading sessions without any significant disruptions. On September 15, 2000, the GSE was admitted as a member of the Federation of Euro-Asian Stock Exchanges (FEAS). As of November 30, 2000, the GSE had 37 member firms that employed 76 licensed brokers. Two hundred fifty-seven securities had been admitted for trading on the GSE.

The advisors developed a comprehensive business plan for the GSE that helped them recognize the importance of quality securities and market activity to accomplish the

organization's ultimate goal of self-sustainability. The advisors also provided assistance to the GSE in developing the capacity to conduct cash auctions of residual shares from the privatization process in Georgia, in anticipation of becoming more involved in that process when the political/economic environment improved.

### **Georgian Securities Central Depository (GSCD)**

A tender process to identify potential candidates for assistance in the development of a safe, reliable clearance and settlement mechanism was initiated through the development of a Request for Proposal (RFP). The review of potential candidates for the tender process determined that no viable candidates existed that would be prepared in time to coincide with the development schedule of the Exchange. Since a safe and reliable clearance and settlement mechanism is critical to the success of a trading mechanism, an alternative approach was developed to have the Exchange tender candidates submit a plan to develop a suitable clearance and settlement mechanism for Exchange transactions.

After the GSE was named the winner of the Exchange tender, the GSCD was formed on October 19, 1999 as a Limited Liability Company with initial share capital provided by the GSE. The Depository was licensed by the NSC on March 1, 2000 and was designated as a SRO.

Software was developed by the GSCD with support of Barents as an interim solution to be prepared for the launch of the GSE Trading System. Barents was encouraged by USAID to review solutions developed for other emerging markets and selected the Romanian Central Depository Software for implementation in Georgia. After numerous delays in the receipt of the source code and related background documentation, the advisors developed an interim solution to avoid delays in the scheduled implementation of the trading mechanism. The interim system for the GSCD was operational for the first trading session conducted on the GSE on March 23, 2000. Since then, the GSCD has been operational and handling clearance and settlement for Exchange transactions without significant disruptions.

The lack of reliable, consolidated ownership records was identified as an obstacle to the development of a reliable clearance and settlement mechanism in Georgia. The advisors worked with the World Bank/PWC project to develop independent share registrars to facilitate the consolidation process. Barents, at the request of USAID, eventually assumed full responsibility for this project, completing it in early 2000.

### **Training and Public Education**

An extensive training needs assessment (TNA) was conducted for each major constituent group (brokers, registrars, SIB/NSC Staff, and GSE Staff) and was reviewed with an Advisory Board formed to ensure the appropriate input and buy-in regarding the design and administration of the capital markets training initiatives. The advisors developed extensive training courses relating to brokerage operations and the investment fund industry that were used to develop the certification programs for the brokerage industry.

A Training Unit composed mainly of local staff was developed to prepare course materials in English and Georgian and to assist in the administration of the training programs. Pilot programs for the various courses and additional workshops were delivered to the NSC and SRO staff to meet the dual purpose of institutional development of the counterparts and to provide input to refine the courses prior to offering them to the target audiences. Instructor notes were prepared for the local instructors.

The courses were offered on five separate occasions. In addition to the required post training written examinations, pre-training examinations were conducted to serve as a baseline for evaluating the effectiveness of the courses. Based on the feedback from the follow-up “On-The-Job” consulting, the courses were well received and retention of the material by the participants was excellent (95% on a combined basis).

A separate course was also developed for market participants and the NSC/GSE staff in the use of the GSE Trading System. Market participants were required to complete the course and pass an examination prior to use of the trading system.

The advisors also developed a “Train-The Trainer” program to increase the number of courses taught by local instructors. The Train-the-Trainer program was conducted in February, 2000 with participants from the NSC, the GSE and Barents local staff. The Broker Dealer Operations and Investment Fund components of the training initiatives were combined with other courses (e.g., accounting, securities law, etc.) into an integrated Capital Markets Development program with USAID approval. In excess of 70% of the total courses offered by the Training Unit were taught by local instructors. All of the final sessions of the Capital Markets Development Program were delivered by local instructors.

Participant guides were developed and work shops conducted to introduce the new securities laws to business leaders and market participants, and to acquaint issuers with corporate governance requirements and shareholder rights. An accounting course was developed for the NSC and Exchange staff as a prerequisite to a required course on International Accounting Standards and conducted in July of 1999. A course was also developed to assist in the development of the Independent Registrars after Barents assumed the responsibility for this effort from the World Bank/PWC project. An extensive glossary of financial terms was prepared in conjunction with the preparation of the Participant Guides and Information Guides associated with the various training programs.

Journalists were invited to all of the workshops offered to financial intermediaries and other constituents. A “Press Workshop” was developed specifically for journalists. By the end of the project, a core group of journalists had developed into a “press club” with the skills and interests to focus on financial/economic issues. This group was instrumental in increasing public awareness of the progress of the various reform projects in Georgia.

In lieu of the classroom workshops planned for public education, a series of TV programs were developed in conjunction with a self-study guide to introduce the public to the capital markets and general issues relating to investment in securities. These programs were aired twice on Georgian television. Certain public education functions of the project were spun off to Overseas Strategic Consulting (OSC), who originally was a subcontractor on this project, when, under a separate contract, they assumed responsibility for coordinating the public education efforts across all of the primary economic reform projects in Georgia. A series of presentations for shareholders was conducted throughout Georgia by the NSC and OSC in November of 2000.

### **Other Activities**

The evaluation of potential candidates for the Exchange Tender Process led the advisors to conduct a study of potential companies for listing/trading on the Exchange. This led to a follow-up analysis of the privatization process in Georgia and the creation of a separate project to provide policy advice to the Ministry of State Property Management (MinSPM).

Recognizing the important role of professional associations in the development of fledgling industries in emerging markets, Barents was encouraged to support organizations that could support the capital markets development process in Georgia. The Georgian Securities Industry Association (GSIA), formerly known as the Broker's Guild, developed into a natural advocate for the capital markets development efforts in Georgia and made significant contributions to the development of the legal/regulatory framework and the Capital Markets Training Program. The GSIA was provided with policy advice, office space, and administrative support services to encourage its support of the development process. A comprehensive business plan was developed for the GSIA to assist them in securing additional funding to support its operations.

### **Current Market Conditions and Follow-up Required**

The market infrastructure (systems and legislation) is substantially in place. Although market activity increased significantly in the fall of 2000, it was not sufficient to allow the Exchange and Depository to fund operations from membership and transaction fees. Until market activity increases, the organizations will have to depend on external funding to maintain the appropriate infrastructure for the securities markets. The ability of the Exchange to attract market activity is restricted by the ability of the NSC to monitor and enforce regulations and by the general economic conditions in Georgia.

The existing institutions responsible for monitoring and enforcing securities market regulations, the NSC, GSE and GSCD, might not have sufficient resources to fulfill these responsibilities. Without effective monitoring and enforcement capabilities, it will be difficult to improve the trust and confidence of potential participants in the market mechanisms that have been developed and difficult for the Exchange to attract market activity.

The Memorandum of Understanding (MOU) signed between the MinSPM, the NSC, and the GSE regarding the use of the Exchange to facilitate privatization auctions is an indication that confidence in the established securities markets mechanisms is improving. If investor interest in admitted securities is limited, privatizations, initial public offerings and Exchange listings become even more critical to making quality products available to potential investors through the Exchange. It is important for the initial offerings to be successful to attract other possible participants. It appears that there might still be some lingering educational/awareness issues regarding the benefits of using the securities markets to raise capital. Economic conditions and the availability of other sources of capital to the potential issuers also have an impact on the ability of the Exchange to attract securities and market activity.

The most significant potential area for operational risk is the pre and post trade process of the GSE and GSCD. The existing process was designed to be safe and reliable to build trust with potential market participants, but it could create a bottleneck if trading activity increases significantly. The Romanian Central Depository software was installed and tested by the GSCD, but since there are some lingering concerns about its compatibility with the GSCD's current rules, process and interface with the Exchange system the interim system developed by the GSCD is still in use.

## **II. Background**

In 1997, Barents Group of KPMG Consulting, LLC. (Barents) was awarded a Task Order by the United States Agency for International Development (USAID) to provide technical assistance to the Government of Georgia, under the Georgian Capital Markets Development Program. The period of performance was three years beginning September 30, 1997 to October 31, 1999, with subsequent modifications extending the project until December 31, 2000.

The goals of the program were to stimulate the growth of an emerging private economy in Georgia, increase the level of investment in Georgia (both domestic and foreign) and increase per capita productivity, leading to higher standards of living for all Georgians.

In order to achieve these goals, the Task Order (and subsequent modifications) defined five specific objectives:

- to provide comprehensive development of the Government of Georgia's (GOG's) securities regulatory capacity by creating and/or reforming all of the needed legal and institutional components;
- to provide a commercially viable securities trading mechanism that is capable of trading several types of instruments, is open to all qualified brokers, has a high degree of systemic integrity and operates in a transparent fashion;
- to provide a commercially viable independent share registry mechanism and central clearance, settlement and depository system that are capable of serving all of the trading mechanisms in Georgia, have a high degree of systemic integrity and provide equal access to all qualified market intermediaries;
- to increase the level of knowledge of the market intermediaries, other members of the securities community, GOG officials and the general public through extensive training; and
- to promote corporate governance, shareholder participation and compliance with National Securities Commission (NSC) regulations by the newly privatized companies.

To accomplish these objectives, Barents provided resident advisors as well as numerous short-term advisors who were specialists in various fields related to the program. Many Georgian nationals also participated in this program. In addition, Barents subcontracted the public education portion of the work to the Overseas Strategic Consulting Group (OSC).

The following presents an overview of the program scope of work, the benchmarks established, and the results achieved. To provide more clarity to the reader, this information is provided by objective.

### **III. National Securities Commission**

#### **Objective/Scope of Work**

One objective of the program was to provide comprehensive development of GOG's securities regulatory capacity by creating and/or reforming all of the needed legal and institutional components. To accomplish this objective the following tasks were required:

- Perform a comprehensive survey of the laws extant as they apply to securities industry activities in Georgia, and assist the SIB in drafting additional securities laws to create a strong and efficient regulatory scheme governing all aspects of the securities markets.
- Assist the SIB in building the regulatory capacity Georgia needed to oversee its markets. In particular, assist it in becoming an independent agency, as agreed to by the GOG and assist in setting the structure and staffing of this agency.
- Provide policy guidance to the SIB in the following areas:
  - adopting regulations governing the issuance and trading of securities,
  - setting periodic disclosure requirements for issuers,
  - imposing and enforcing shareholder rights and other aspects of corporate governance,
  - receiving and making available to the public filings of financial statements and other disclosure,
  - setting licensing standards for market participants and overseeing the conversion of the privatization funds into investment funds regulated by the SIB,
- Work closely with the USAID contractor selected to assist Georgia in the area of accounting reform, in setting financial reporting practices that would meet the requirements of the western world. This included promoting the adoption and/or revision of accounting principles and auditing standards in order to make them acceptable to the foreign investment community and developing the means to enforce use of the established accounting principles and periodic independent audits.
- Work closely with the other USAID contractors participating in the economic reform process in Georgia. This was to include contractors involved in the area of accounting reform, fiscal reform, land reform, enterprise privatization, bank supervision and if applicable, pension reform so that each contractor would be able to leverage off work accomplished by the others.

#### **Tasks/Benchmarks**

The following is an outline of the primary tasks/benchmarks associated with assisting the SIB/NSC. A detailed discussion of the results associated with these tasks/benchmarks follows.

- Recommendations on the Role of the NSC in the financial markets
- Recommendations regarding NSC's organizational structure and institutional development
- Development of NSC operating procedures and requirements
- Development and implementation of regulations governing the structure and operations of the NSC
- Training of NSC staff regarding organization, structure and operations of the NSC
- Survey of Laws related to securities industry activities in Georgia
- Policy guidance on regulation of securities and other non-banking financial markets

- Oversight of Self-Regulatory Organizations (SRO's)
- Policy guidance on financial reporting and auditing standards
- Regulatory framework for creation and oversight of share registries
- Development and management of NSC Market Monitoring Unit
- Public access to records

### **Role of the NSC in the Financial Markets**

**Benchmark(s):** Recommendations on the Role of the NSC in the Financial Markets (Completed on June 3, 1998. Follow-up advice and assistance was provided throughout the project.)

Barents prepared a report on the potential role of the SIB in the capital markets and conducted a "Vision Seminar" in February of 1998, with the SIB, the Ministry of Finance (MOF), and other government officials to discuss the typical role of securities commissions in other securities markets to help them define the role of the SIB/NSC in Georgia. The importance of establishing an independent agency to oversee the securities markets was emphasized. Advisor Robert Smith, prepared a report on the proposed regulatory authority of the SIB (See "Review of Procedures for Licensing, Regulating and Overall Regulatory Authority of the SIB", by Robert Smith on June 3, 1998) and conducted a meeting with the SIB on June 9, 1998 to discuss its implications. Mr. Smith's findings were incorporated into a revised version of the Regulatory Work Plan. (See "Analysis of Laws Regulating the Georgian Securities Markets and Regulatory Work Plan," by Kertzman on July 23, 1998).

The roles and responsibilities of the NSC were more formally defined in the Law on Securities Markets, which was passed on December 24, 1998, and amended in July of 1999. This law included provisions to establish the NSC as an independent agency with the responsibility to oversee activities in the securities market. (See "Law on Securities Markets, Chapter 8, Supervision of the Securities Markets", July 1999).

### **NSC Organizational Structure and Institutional Development**

**Benchmark(s):** Recommendations Regarding Organizational Structure and Institutional Development (Completed on July 30, 1998. Follow-up advice and assistance was provided throughout the project.)

The advisors analyzed the existing structure of the SIB and made recommendations for changes based on the anticipated role of the Commission in the financial markets. The "Regulatory Work Plan" prepared by Advisor Kertzman provided a framework for the SIB operations, including the definition of its regulatory mission, division of responsibility and comprehensive regulatory authority. It was updated regularly during the first year of the project (See "Developing a Securities Market Regulator in Georgia," by Kertzman on July 30, 1998).

Advisor Jenny Willier prepared a transition plan for the Commission (See "SIB Transition To Independent Securities Exchange Commission – November 1998," on November 20, 1998). This plan included proposed projects/initiatives by organizational unit within the Commission to assist in the development of the capital markets in Georgia.

The NSC was formed as an independent agency in succession of the SIB in July of 1999. Amendments to the Law on Securities Markets provided for the establishment, funding,

composition and supervision and inspection powers of the NSC. This included the transitional provision for two foreign commissioners to be funded by the World Bank to increase the credibility of the organization and assist in the initial formation of the organization.

Barents continued to provide assistance throughout the various development phases of the SIB/NSC. Advisor Michael Rodriguez prepared a summary of the Commission Structure for the Commission in September of 1999 (See “Memorandum – Commission Structure” from Rodriguez to the Commission, dated September 15, 1999).

The advisors also assisted in the selection and hiring of the initial Commissioners to serve on the NSC, including the hiring of two foreign Commissioners to improve the credibility of the reform process in Georgia. The advisors helped the Commission define the roles and responsibilities of the foreign commissioners (See “Terms of Reference- Commissioners,” August 30, 1999). In March of 2000, the two foreign commissioners, Robert Singletary of the United States and Robert Parry of Australia, assumed their responsibilities with the three Georgian commissioners with assistance from the Barents Project Team.

### **NSC Operating Procedures and Requirements**

**Benchmark(s):** Operating procedures and routines such as reporting requirements and regular meetings for SIB/NSC staff. (Completed July 30, 1998. Follow-up assistance provided throughout the project).

After defining the roles of the Commission and making recommendations for the organizational structure and plans for institutional development, the advisors developed a detailed implementation plan, “Regulatory Work Plan and Building and Emerging Market Regulator,” which detailed the steps for the development of the Commission and the revision of the legal/regulatory framework for the securities markets in Georgia. This work plan was the basis for assistance to the Commission throughout the project.

The advisors instituted weekly meetings with the SIB to discuss organizational implementation plans and operational issues. Visiting advisors were invited to these meetings to provide guidance on specific issues for the SIB staff.

Advisor Jim Ryan prepared guidelines for licensing and monitoring of market participants, including the development of a qualifications examination and procedures for the administration of the exam in October of 1998.

Barents advisors also assisted in developing the regulations related to the administrative proceedings of the Commission in October of 1999 (See “Administrative Protocol (and Resolution) by the Commission of Violations of the Securities Law,” by Kartlos Koranashvili and Giorgi Dvalishvili on October 20, 1999).

In December of 1999, Advisor Rodriguez drafted the By-Laws of the Commission. The By-Laws included guidelines for conducting meetings of the Commission (See “Memorandum On Commission Meeting Rule,” by Rodriguez on December 3, 1999). Mr. Rodriguez provided additional guidance to the Commission regarding administrative proceedings of the NSC in February of 2000. (See “Memorandum – Proposed Instruction on the Administrative Proceedings of the Commission,” from Rodriguez to the Commission on February 14, 2000).

### **Regulations Governing the Structure and Operations of the NSC**

**Benchmark(s):** Drafting, proposal and implementation of regulations governing the structure and operations of the NSC. (Completed in July of 1999).

In February of 1998, the advisors assisted in drafting a law concerning the establishment of an independent securities commission in Georgia (See “Securities Market Commission,” February, 1998). In July of 1999, the NSC was formed in succession to the SIB. Amendments to the Law on Securities Markets provided for the establishment, funding, composition and supervision and inspection powers of the NSC (See “Law on Securities Markets, Chapter 8, Supervision of the Securities Markets,” July 1999). This included the transitional provision for two foreign commissioners to be funded by the World Bank to increase the credibility of the organization and assist in the initial transition of the organization to an independent agency. Additional transitional provisions were approved relating to the terms of the Commissioners, the appointment of two foreign Commissioners and the appointment of the Chairman of the Commission.

Presidential Decree Number 508 was issued on August 20, 1999, on “Additional Measures of Promoting Operation of the National Securities Commission of Georgia.” This decree addressed Commission salaries, extra salaries and issues relating to the transfer of property and office space for the Commission. The advisors also helped develop the temporary regulations for the transition from the SIB to the NSC (See “Law on Securities Markets, Chapter 10, Transitional Provisions”) and drafted the NSC By-Laws. As a result of these and other efforts, the Commission initiated its first regulation as an independent securities regulator, “Initial Capital for Brokerage Companies”, in October of 1999.

### **Training of NSC staff regarding Organization, Structure and Operations of the NSC**

**Benchmark(s):**

- Quarterly training sessions to the SIB/NSC staff regarding the organization, structure and operations of the SIB/NSC. (Completed. Ongoing throughout project. See examples below).
- Assess training needs of Ministries and/or professional labor categories associated with the issuance of securities and work with other contractors to assure training is provided in the most effective, efficient way. (Completed on April 19, 1999).

The advisors provided both formal and informal training programs to assist the Commission at various stages of its development. Initial programs were informal and were delivered through daily and weekly meetings where commission staff and advisors would discuss current issues facing the Commission. As advisors were brought in to assist with specific development issues, these informal sessions were augmented with seminars/workshops conducted by the resident advisors and visiting experts on specific topics. The following is a sampling of the workshops and presentations prepared for the purpose of training the Commission staff:

- “Corporate Disclosure,” by William Hazeltine on March 25, 1998
- “Regulation of Investment Funds,” by Stanley Judd on May 14, 1998
- “Share Registrar Operations and Regulation,” by Jean Spears on May 21, 1998
- “Corporate Governance,” by Jay Weinstein in May of 1998
- “Market Regulation, Surveillance, and Compliance,” by Robert Smith on June 2, 1998

- “Public Offerings,” by Debra Kertzman on August 11, 1998
- “Regulating Reporting Companies,” by Kertzman on August 18, 1998
- “Role and Structure of Securities Commissions,” in August of 1998
- “Comparisons of Latin American Securities Regulators” in August of 1998
- “Draft Rule for Initial Capital Requirements for Brokerage Companies,” by Don Buddenbohn in July of 1999
- “Draft Rule on Reports and Periodic Financial Statements for Brokerage Companies,” by Don Buddenbohn in July of 1999
- “Draft Rule on Capital Adequacy Requirements for Brokerage Companies,” by Don Buddenbohn in July of 1999
- “Draft Rule on Books and Records of Georgian Brokerage Companies,” by Don Buddenbohn in July of 1999
- “Internal Controls,” by James Ryan in October of 1999
- “Risk Management,” by James Ryan in October of 1999
- “Dividend and Interest Accounting, Reverse Purchase Agreements, and Statements of Cash Flow and Changes in Financial Condition,” by James Ryan in October of 1999.

The advisors also developed more formal programs for SIB/NSC staff based on a Training Needs Assessment (TNA) (See “Capital Markets Development Program – SIB Core Competencies and Performance Standards,” by Diana Osinski on April 19, 1999).

After it was determined that the staff of the NSC and GSE needed some background accounting training as a prerequisite for the planned course on International Accounting Standards, training materials for a Basic Accounting Course for the two organizations were developed by the advisors in conjunction with the Accounting Reform Project. The “Basics of Accounting” course was attended by NSC and GSE staff from July 14 – 31, 1999. After Barents assumed the responsibility for the Share Registry Project from the World Bank/PWC Project Team, the advisors also developed a workshop for Registrars that was conducted in January and February of 2000. (See “Registrar Workshop Industry Participant Guide,” August 1999). NSC staff was invited to attend these workshops.

The initial Capital Markets Development Program which was developed for market participants based on the TNA was offered to NSC and GSE staff to meet the dual purpose of institutional development and to refine the courses prior to delivery to the primary target audience. The Capital Markets Development Program attended by the NSC staff included the following courses:

- Basics of Accounting
- Securities Market Law and Amendments to the Law on Entrepreneurs Overview (Law Workshop)
- Overview of the Capital Markets Industry
- Operations of the Investment Industry
- Corporate Governance Principles and Shareholder Rights Overview (Issuers Workshop)

NSC staff was also invited to attend the course on the GSE Trading System developed for market participants and the other seminars and workshops developed in conjunction with the Training and Public Education Component of the project.

## **Survey of Laws related to Securities Industry Activities in Georgia**

### **Benchmark (s):**

- Comprehensive survey of the laws extant as they apply to securities industry activities in Georgia. (Completed in April 1998)
- Inventory of laws reviewed and a report setting out the results of the analysis. (Completed in April 1998).
- Compilation of a comprehensive library of the laws and regulations in force that affect the securities industry and other sectors of non-banking finance with copies, wherever possible, maintained in both English and Georgian. (Completed in July of 1998).
- Review of laws and identification of recommendations for additions and amendments. (Initially completed on July 2, 1998. Additional reviews were conducted throughout the project).

The thorough review of the draft securities law and other regulations related to the securities markets in Georgia, conducted by the advisors when the project began in February of 1998, identified some serious weaknesses in these laws. It was determined that revision of these laws was critical in order for Georgia to comply with the World Bank's Structural Adjustment Credit II requirements for continued assistance. Barents reprioritized its planned activities for the project to focus on the preparation of a new draft securities law that was prepared in February of 1998.

In April of 1998, the advisors finalized the inventory of laws and regulations affecting the Georgian Securities Markets and created the "Capital Markets Library." The Library included relevant laws of the NIS/Eastern Europe in order to provide the Commission with a broad framework to measure its development. The Library was turned over to the Commission when it moved to its new offices in the same building as the Ministry of Finance (MOF). (See "Catalog of Capital Markets Library"). Additional materials were added to the library throughout the project.

The advisors used the library to assist in the efforts to review all securities laws and related regulations and to begin providing the Commission with policy advice. Attention was focused on the Law on Securities Markets, Law on Entrepreneurs, the Tax Code of Georgia, and the Administrative Code of Georgia in order to address the most critical elements and allow the development of the capital markets in Georgia to continue while minimizing the risks of disruptions. The analysis and recommendations associated with these efforts were incorporated into the Regulatory Work Plan. (See "Analysis of Laws Regulating the Georgian Securities Markets and Regulatory Work Plan," by Kertzman on July 2, 1998).

In August of 1998, after completing a review of all of the relevant laws and regulations, Advisors Kertzman and Kevin Fogerty recommended changes to the following laws/regulations as part of a plan to create a "Capital Markets Package" to be submitted to the Parliament of Georgia:

- Law on Entrepreneurs
- Law on Normative Acts
- The Administrative Code
- The Criminal Code
- The Tax Code
- The Civil Code

- The MINSMP Regulation on Privatization Funds
- The Privatization Law
- The Commercial Bank Law
- The Bankruptcy Law
- Law on Bills
- Temporary Regulation on Municipal Securities
- Temporary Regulation on Share Registrars
- Law on Licensing
- Procedure of Personal and Institutional Licensing of the Organized Securities Markets.

### **Policy Guidance on Regulation of Securities and Other Non-Banking Financial Markets**

As mentioned previously, most of the suggestions for amendments to the laws/regulations related to the securities markets in Georgia were incorporated into the Law on Securities Markets. Specific references to the provisions in this law are listed next to the benchmarks below. Additional references to policy advice and draft laws related to these benchmarks are also included.

**Benchmark(s):** Policy guidance and draft securities laws on the following:

- offer and sale of securities (See Law on Securities Markets, Chapter 2 – Public Offering of Securities)
- registration of publicly traded companies (See Law on Securities Markets, Chapter 3 – Reporting Companies)
- promoting good corporate governance (See Law on Securities Markets, Article 16 – Responsibilities of Members of Reporting Company Management Bodies to Securities Holders)
- creating and enforcing shareholders rights (See Law on Securities Markets Article 16)
- requiring periodic disclosure by companies, including audited financial statements, qualitative information and narrative descriptions of operating results (See Law on Securities Markets, Chapter 3, Article 11 – Periodic Reporting Requirements)
- providing public access to information filed with the SIB (See Law on Securities Markets, Article 54 – Maintenance of Public Records and Publication of Commission Actions)
- qualifications and licensing of broker-dealers and their associated persons (See Law on Securities Markets, Chapter 5- Licensing, Articles 20-26)
- regulation of securities exchanges and other trading mechanisms (Law on Securities Markets, Chapter 5- Article 27 and Chapter 6 Articles 34-37)
- regulation of the clearance, settlement and depository functions (Law on Securities Markets, Chapter 5 – Article 28 and Chapter 6 - Articles 38 & 39)
- licensing and regulating investment funds (See Law on Investment Funds by Stanley Judd, June 1999)
- enforcing other provisions of the existing enterprise law and other laws under the jurisdiction of the SIB (See Law on Securities Markets, Chapter 9 – Sanctions Imposed for the Violations of the Legislation on Securities)
- recommending other changes to current securities and non-banking financial laws

As mentioned previously, the review of the draft laws developed under previous assistance projects found those laws to be inadequate to meet the World Bank requirements and

found a lack of consistency between related laws and regulations (e.g., Law on Entrepreneurs, Tax Code, Administrative Code, etc.). The advisors prepared a “Capital Markets Package” of revisions to various laws and regulations to help Parliament see the overall impact of these changes on the securities markets in Georgia. The advisors also prioritized work on changes that were likely to have the most immediate impact on the development of the markets and had a local consultant prepare an analysis of the process for drafting and amending legislation in Georgia, so that effective implementation assistance could be provided to the Commission at each stage of the process. (See “Procedures for Adopting and Amending Laws in Georgia,” by Kartlos Karanashvili on July 8, 1998).

Policy advice and recommendations for changes to relevant laws and regulations affecting the Georgian securities markets were provided throughout the project. In addition to the reviews that were incorporated into the Law on Securities Markets and other related laws and regulations, the advisors conducted numerous additional reviews of specific issues. The following is a sampling of some of these reviews conducted by the advisors:

#### ***Offer and Sale of Securities***

- “Proposed Rule on Tender Offers”, “Proposed Rule on Transactions in Public Securities,” and “Proposed Rule on Transfer of Public Securities which have not been Paid for in Full,” by Jay Weinstein in May of 2000.

#### ***Registration of Public Companies***

- “Rule on Definition of Securities “Held of Record” and “Reporting Company” “ in April 2000 to clarify those areas subject to the Law on Securities Markets.

#### ***Promoting Good Corporate Governance***

- “Proposed Proxy Rule” in April of 2000 to enhance corporate governance.

#### ***Creating and Enforcing Shareholder Rights***

- “Insider Securities Beneficial Ownership Reports to be filed with the Commission,” “Rule on Establishment of Record Dates for Shareholder Meetings and Payment of Dividends,” and “Proposed Rule on Disclosure of Substantial Acquisition of Equity Securities,” in April of 2000.

#### ***Requiring Periodic Disclosure by Companies***

- “Rule on Preparation and Filing of Current Reports by Reporting Companies”, “Rule on Preparation and Filing of Semi-Annual Reports by Reporting Companies,” and “Rule on Preparation and Filing of Annual Reports by Reporting Companies,” adopted by the NSC as part of Regulation #4 on January 21, 2000. The draft rules were prepared for the NSC by Advisor Rodriguez.
- “Regulation on Financial Statements of Companies,” by Rodriguez on September 30, 2000.

#### ***Qualifications and Licensing of Broker Dealers***

- “Proposed Rule on Minimum Capital Requirements for Brokerage Companies,” by Don Buddenbohn in June of 1998.

- “Report on Stock Brokers and Supervisory Officers Qualifications Examination,” and “Ethics Code for Financial Intermediaries,” by James Ryan in October of 1998.
- “The Proposal to Require a Supervisory Examination for Officers and Partners Functioning in a Supervisory Capacity at Banks and Investment Brokerage Companies,” by James Ryan on November 3, 1998.
- “The Instruction of the Georgia Stock Brokers Qualification Examination,” by James Ryan on November 6, 1998.
- “The Administration of the Stock Brokers Qualification Test,” by James Ryan on November 11, 1998.
- “Temporary Licensing Procedures of Brokers, Brokerage Companies and Stock Exchanges,” in February of 1999.
- “Draft Rule of Initial Capital Requirements for Brokerage Companies in Georgia,” “Capital Adequacy Requirements,” and “Draft Rule on Reports and Periodic Financial Statements of Brokerage Companies,” by Don Buddenbohn on March 30, 1999.
- “Draft Rule on Books and Records of Georgian Brokerage Companies,” by Don Buddenbohn on June 10, 1999.
- “Main Concepts of Securities Capital Requirements” and “Initial Capital for Brokerage Companies,” by James Ryan in October of 1999.
- “Forms for Issuance of Permanent Licenses for Brokerage Companies, Brokers, Stock Exchanges, and Securities Registrars to Replace Temporary Licenses,” in November of 1999.

#### ***Regulation of Securities Exchanges and Trading Mechanisms***

- See Next Section “Oversight of Self-Regulatory Organizations”.

#### ***Regulation of Clearance, Settlement and Depository Functions***

- See Next Section “Oversight of Self-Regulatory Organizations”.

#### ***Licensing and Regulating Investment Funds***

- “Law on Investment Funds and Collectively Managed and Commingled Account Arrangements,” by Stanley Judd on June 24, 1998
- “Draft Law of Georgia on Investment Funds,” by Stanley Judd on July 8, 1999.

#### ***Enforcing other provisions of the existing enterprise law and other laws under the jurisdiction of the Commission***

- “Memorandum On Proposed Instructions on Administrative Proceedings of the Commission,” by Rodriguez on February 14, 2000.
- “Memorandum On Administrative Sanctions for False or Misleading Statements in Reports Related to Brokerage Company Financial Reports, Brokerage Company Books and Records, Reports by Stock Exchanges, Central Depositories, Securities Registrars, Tender Offers, Acquisitions and Insider Securities Beneficial Ownership Reports required to be filed with the Commission,” by Rodriguez on February 24, 2000.
- “Strengthening the Enforcement Powers of the NSC of Georgia: An Advisory Report,” by Robert Strahota, Assistant Director, U.S. Securities and Exchange Commission. Advisor Rodriguez participated in the meetings conducted by Mr. Strahota and prepared comments on the Advisory Report on behalf of the Commission in October of 2000.

#### ***Recommending other changes to current securities and non-banking financial laws.***

As mentioned previously, the advisors incorporated most of the revisions to securities related laws and regulations into the Law on Securities Markets. Other significant changes were incorporated into amendments of the Law on Entrepreneurs, the Tax Code of Georgia and the Administrative Code of Georgia.

### ***Law on Securities Markets***

- “Amendments to the Law on Securities Markets” April 30, June 9, and July 20, 1999.

### ***Law on Entrepreneurs***

- “Analytical Matrix on Review of Law on Entrepreneurs,” and “Proposed Revisions to Law on Entrepreneurs,” by Jay Weinstein on May 25, 1998.
- “White Paper – Law on Entrepreneurs Policy Advice and Recommendations,” by Jay Weinstein on November 19, 1998.
- “Amendments to Law on Entrepreneurs” on June 9, 1999.
- “Amendments to Law on Entrepreneurs” in April of 2000.

### ***Tax Code of Georgia***

- “Taxation in Regard to Investment Funds,” by Stanley Judd on May 13, 1998
- “Amendments to Tax Code,” by Stanley Judd in June of 1999
- “Taxation of Dividends and Interest Received by Companies from Securities”, “Taxation of Capital Gains for Legal Persons”, “Taxation of Securities Operations under the Road Fund Tax”, and “Taxation of Securities Operations under the Economic Activity Tax” in November of 1999. This was a collective effort of the GSE, the Georgian Securities Industry Association (GSIA) and Barents.

### ***Administrative Code of Georgia***

- “Amendments to Administrative Code” in December of 1998
- “Administrative Code Deficiencies and Amendments,” by Rodriguez on February 14, 2000
- “Proposed Amendments to the Administrative Code of Georgia,” Kartlos Koranashvili and Giorgi Dvalishvili on February 16, 2000.

### **Oversight of Self-Regulatory Organizations (SRO’s)**

**Benchmark(s):** Policy guidance and draft securities laws on the following:

- Regulation of securities exchanges and other trading mechanisms, (Completed in July of 1999. See Law on Securities Markets, Chapter 5- Article 27 and Chapter 6 Articles 34-37)
- Regulation of the clearance, settlement and depository functions, (Completed in July of 1999. See Law on Securities Markets, Chapter 5 – Article 28 and Chapter 6 - Articles 38 & 39).

While analyzing the role of the Commission in capital markets, the advisors identified the potential role of Self-Regulatory Organizations (SROs) to assist the Commission in overseeing the activities of market participants. The advisors helped the Commission define its role in licensing and overseeing SROs (Exchanges and Depositories). This included advice on ownership structure, initial capital, licensing and reporting by SROs. Advisor Mike Kulczak, prepared a

presentation to discuss the roles of SRO's in securities markets to help the Commission define the role of SROs in the Georgian markets (See "Response to Legal Issues Raised at April 2, 1999 Meeting," by Michael Kulczak to Tengiz Akhobadze on April 7, 1999). The advisors also assisted the commission in establishing permanent and temporary licenses for SROs and helped the SROs develop the required documentation for the Commission (e.g., charter, by-laws, rules, etc.). The Law on Securities Markets, Chapter 6 Articles 41-43, addresses general issues regarding SRO designation. Articles 27, and 34-37 address licensing and oversight of a Stock Exchange and Articles 28, 38 and 39 address licensing and oversight of a Depository.

In December of 1999, Advisor Rodriguez drafted the By-Laws of the Commission. The By-Laws included guidelines for Commission oversight of SROs including the approval of Amendments to the Rules of SROs (See "Memorandum on NSC Rule for SRO Rule Amendments," by Rodriguez on December 3, 1999). Mr. Rodriguez also prepared guidance on the administrative sanctions associated with false or misleading statements in reports by Stock Exchanges and Depositories. (See "Memorandum On Administrative Sanctions for False or Misleading Statements in Reports Related to Brokerage Company Financial Reports, Brokerage Company Books and Records, Reports by Stock Exchanges, Central Depositories, Securities Registrars, Tender Offers, Acquisitions and Insider Securities Beneficial Ownership Reports required to be filed with the Commission," by Rodriguez on February 24, 2000).

On January 14, 2000, the NSC issued Decree No. 5 which granted Stock Exchange License Number 90001 to the GSE. On January 18, 2000, the NSC issued Decree No. 6 which designated the GSE as the first Self-Regulatory Organization (SRO) in Georgia. On March 1, 2000 the NSC issued License Number 80001 to the GSCD and designated the GSCD as an SRO.

### **Policy Guidance on Financial Reporting and Auditing Standards**

**Benchmark(s):** Assess the status and role of the accounting association(s) in the following areas

- setting financial reporting standards
- setting standards for audits of public companies
- providing education, training and professional development
- examinations and certification of accountants
- setting professional and ethical standards
- providing for disciplinary procedures for violations of ethical standards

(Completed on June 9, 1998). Advisor Don Buddenbohn worked with the Commission, the newly formed Federation of Accountants and the Accounting Reform project to determine the role of the Commission in establishing and enforcing standards related to financial reporting of publicly traded companies (See "Commission Role in Establishing and Regulating Compliance with Accounting Standards," by Don Buddenbohn on June 9, 1998). All parties agreed that the Commission would delegate the responsibility for establishing standards to the newly formed Federation of Accountants. These standards were to be based on International Accounting Standards and the Commission would monitor compliance through its review of documents required of reporting companies. The frequency and content of these reports/documents would be defined in the Law on Securities Markets, Law on Entrepreneurs and other rules adopted by the Commission. One of the Commissioners, Tengiz Akhobadze, was named to the Committee that was to oversee the adoption of International Accounting Standards in Georgia. The advisors provided additional policy advice and guidance on accounting related issues and coordinated their efforts with the Accounting Reform contractor throughout the project.

In addition to the provisions built into the Law on Securities Markets and the Law on Entrepreneurs, the NSC adopted Regulation #4 on January 21, 2000 which included the following rules: “Rule on Preparation and Filing of Current Reports by Reporting Companies”; “Rule on Preparation and Filing of Semi-Annual Reports by Reporting Companies,” and “Rule on Preparation and Filing of Annual Reports by Reporting Companies.” Advisor Rodriguez prepared the drafts of these rules. Mr. Rodriguez also prepared a “Regulation on Financial Statements of Companies,” on September 30, 2000.

### **Regulatory Framework for Creation and Oversight of Share Registries**

#### **Benchmark(s):**

- Draft regulations relating to the creation and oversight of share registries (Completed in November of 1998)
- Assist in the gathering of data in order to create definitive, consolidated shareholder records (Completed in April 2000).
- In conjunction with the NSC, conduct an audit and a systems review of all licensed registrars to assess the consistency of consolidated records. (Completed in April of 2000).
- Work with the broker dealer community to develop and provide shareholders with an extract of their statements of accounts in each respective company. (Completed in November of 2000 by the NSC with assistance from OSC).

The review of the market conditions in Georgia, quickly highlighted the importance of accurate consolidated records of ownership in publicly held securities. The advisors assisted the Commission in developing the regulatory framework for the creation and oversight of registrars including their licensing (See “Regulation on Securities Registrars and Maintenance of Securities Registrars,” submitted to the SIB in November of 1998 and Law on Securities Markets Articles 29 and 40).

In April of 1998, when delays in the World Bank/PWC project to develop independent registrars in Georgia were beginning to threaten the development of the trading and settlement mechanisms, Barents began working closely with the World Bank/PWC project team responsible for the creation of share registrars and the consolidation of shareholder records in Georgia. The advisors assisted the PWC team by reviewing the procedures and software for the shareholder record consolidation. In July of 1998, Barents absorbed the remainder of the PWC project team and assumed the responsibility for the consolidation of shareholder records, in order to ensure the successful completion of this critical task. The Consolidation Manual and Software were completed and distributed in November of 1998 by Advisor Jean Spears (See “Reference Manual on the Consolidation Process” on November 21, 1998 and the “Mechanics of the Consolidation Process,” on November 24, 1998).

Consolidators were recruited, trained and supported in the actual consolidation of shareholders records and later became licensed Independent Securities Registrars. Meetings were held with the Directors and Managers of the 394 Reporting Companies in Georgia with more than 100 shareholders located throughout the country to get them into the consolidation process and the willing enterprises were matched with the qualified registrars to facilitate the consolidation process.

The advisors also helped the SIB/NSC deal with transitional registration of registrars while conversion from the SIB to the NSC was taking place (See “Procedure of Licensing Activity of Independent Securities Registrars,” by Jean Spears on June 15, 1998 and “Temporary Regulations on Licensing of Independent Registrars,” passed by Parliament of Georgia in December of 1998). The advisors established a Certifications Commission to certify registrar employees so the registrars could apply for an NSC license. This Commission was composed of representatives of the SIB, the MINSPM and Barents (See “Certification of Securities Registers Maintainers,” by Robert Clark on January 25, 1999).

In October of 1999, audits of the registrars were conducted by the NSC with Barents assistance (See “Memo on Registrar Audit” by Robert Clark on November 9, 1999). In April of 2000, two additional audits of the registrar records were completed to ensure the accuracy and completeness of the consolidations. (See “Consolidation of Shareholders Records Final Report” by Advisor Clark, April 2000).

When the consolidation process was completed in April 2000, all but 18 of the original 394 Reporting Companies were accounted for in the overall consolidation process and details of the refusals, re-contacts and unable-to-be-located enterprises making up the remaining 18 were documented and reported to the NSC for the appropriate follow-up actions.

### **Development and Management of NSC Market Monitoring Unit**

#### **Benchmark(s):**

- Establish procedures for collecting, tracking and analyzing financial, statistical and trading information (Completed in August of 1998).
- Develop and install a database system for collecting and tracking data. (Completed in June of 1999).
- Develop a framework for producing periodic public reports on the trends, issues and problems in the securities industry (Completed. See “Silk Road” by Connie Guglielmi in August of 1998)
- Develop compliance examination guidelines and techniques, as well as related training materials (Completed in February of 2000).
- Train local professionals for substantive roles in the SIB/NSC. (Initially completed in July of 1999. Supervision and assistance was provided throughout the project).

In conjunction with defining the organizational structure of the Commission, the advisors assisted in the development of the Market Monitoring Unit (MMU) of the SIB/NSC. This included a process for collecting, tracking and analyzing participant data and the design and population of the regulatory database (See “Proposed Database Requirements for SIB” by Advisor Wall on April 2, 1998 and “Development of a Market Monitoring Unit at the SIB,” by Kertzman on August 25, 1998). This also included the development of a framework for producing periodic reports on the trends, issues and problems in the securities industry (See “Silk Road” by Connie Guglielmi in August of 1998). The advisors developed estimates for the required hardware and software, procured the equipment for the Commission and assisted in the population of the initial database (See “Database of Historical Information on the Georgian Securities Markets” by Don Buddenbohn on September 10, 1998 and “Market Regulation Database” in June of 1999).

The advisors hired the initial staff of the MMU (two attorneys and one accountant) in July of 1999 and managed the unit's development and activities on behalf of the Commission, including the development of compliance examination guidelines and techniques (See "Memorandum on Compliance Checklist" by Advisor Kulczak on February 14, 2000). This unit was transferred to the Commission when the foreign commissioners came on board in the spring of 2000. As was the case with other Commission staff, members of the MMU were invited to attend training programs (e.g., GSE Trading System Course) to help them develop the skills necessary to fulfill their responsibilities.

### **Public Access to Records**

#### **Benchmark(s):**

- Written policy advice regarding public access to information filed with the SIB/NSC. (Completed. See Law on Securities Markets, Article 54 – Maintenance of Public Records and Publication of Commission Actions).
- Develop a system for maintaining public records and providing access for the general public. (Completed in June of 1999).

In conjunction with the development of the database for the Market Monitoring Unit, the advisors helped the Commission establish policies and procedures for retaining records and providing public access to certain information (See "Database of Historical Information on the Georgian Securities Markets" by Don Buddenbohn on September 10, 1998 and "Market Regulation Database" in June of 1999). This included access to certain information online via a website maintained by Barents and provisions for a public records access at the SIB/NSC offices.

## **IV. Georgia Stock Exchange**

### **Objectives/Scope of Work**

The objective of this component of the project was to create a commercially viable securities trading mechanism that would be capable of trading several types of instruments, is open to all qualified brokers, has a high degree of systemic integrity and operates in a transparent fashion. To accomplish this objective, the following tasks were required:

- assist in the development of a mechanism for securities trading, including an assessment of the current status of the eight exchanges in Georgia and, in conjunction with the SIB, conducting a tender competition to determine a recipient for further assistance,
- working with the selected exchange, review the available trading systems, recommend a selection to USAID and install the selected system (including the hardware, software, and, if necessary, the communication network),
- assist the selected exchange in adopting or revising its rules and operating procedures relating to trading, membership, disciplinary procedures and other conduct by members, and
- assist the selected exchange in the development of a business plan.

### **Background**

When the project commenced, there were 8 exchanges in Georgia, in varying states of operations and trading various assets. The Tbilisi Interbank Currency Exchange (“TICEX”) was by far the most active exchange mechanism in Georgia. Although its operations were limited to currency trading (U.S. dollars, Deutsche marks and Russian rubles), there were plans to trade government securities, stocks and certificates of deposit. TICEX’s members were the National Bank of Georgia (NBG) and 14 commercial banks. Each held 6.67% ownership.

The Caucasian Exchange (“CAEX”), although inactive at the time, was Georgia’s leading exchange in the early 1990’s. Established in March 1991, it was reportedly the first joint stock company in Georgia. By March 1993, volume on the CAEX was \$150,000 per day. The price of one share of CAEX’s common stock rose to \$320 (from \$70 in mid 1992). Over 800 members were registered with the Exchange. According to CAEX, the volume of deposit transfers processed through its settlement bank, the Caucasian Bank, equaled the volume of deposit transfers processed through all of the other 150 banks in the country. While the reasons were unclear, the government shut the CAEX down by passing several restrictions on its operations. The CAEX had been inactive since the end of 1993.

The Tbilisi Exchange (“TE”) was also inactive. It had the potential to become a significant force in the Georgian capital markets, since it was founded by the 18 largest banks in Georgia. Collectively, its member banks held 90% of the bank deposits in Georgia.

### **Tasks/Benchmarks**

The following are the primary tasks/benchmarks associated with the establishment of a mechanism for securities trading in Georgia:

- Assessment of Georgian Communications Infrastructure
- Assessment of Potential Tender Candidates
- Development of Tender Process Parameters
- Conduct Tender Process
- Prepare Volume Estimates and System Capacity Requirements
- Evaluate Hardware and Software Packages
- Procure, Install and Test the Trading System
- Assist in the Development of the Exchange Organizational Structure
- Assist in Developing Plans, Procedures and Regulations Relating to Daily Operations
- Assist in Preparing a Manual of Organizational and Operating Policies, Rules and Procedures.
- Definition of Self-Regulatory Responsibilities
- Develop a Business Plan
- Develop capacity to conduct cash auctions of residuals shares from privatization process

#### **Assessment of Georgian Communications Infrastructure**

**Benchmark(s):** Investigation of the status of the communications network extant in Georgia as it relates to communication requirements for trading systems. (Completed on January 30, 1998).

The first task completed on the project was an analysis of the telecommunications infrastructure in Georgia. Advisor Richard Cowles completed a report titled, "Georgian Communications Infrastructure: Implications for the Capital Markets" on January 30, 1998. This was included with the February 1998-Implementation Plan and Progress Report. This analysis found the Georgian communications infrastructure to be in need of significant improvements and found severe deficiencies in this infrastructure that precluded consideration of certain structures (e.g., remote access to the trading system) in the initial development phase of the trading mechanism in Georgia.

#### **Assessment of Potential Tender Candidates**

**Benchmark(s):** Conduct summary review of the exchanges that can be expected to submit proposals. (Completed in March of 1998).

Barents published a Letter of Interest (LOI) in three national newspapers, The New Generation, the Georgian Business Weekly and the Georgian Times to solicit interest in the tender process to identify potential candidates for assistance in the development of an Exchange in Georgia. Barents received six responses to the LOI. Responses were received from the following institutions in March of 1998:

- Caucasian Stock Exchange (CSX)
- Tbilisi Exchange
- Tbilisi Inter-bank Currency Exchange (TICEX)
- Tbilisi International Exchange for Grain and Oil Products
- United Global Technologies, Co.

■ Conjecture Research Center, Ltd.

Barents initial review of these candidates found that none of them met the anticipated criteria for the tender proposal (See “Quarterly Report- April 1, 1998, page 7). At the time of the review, several of the existing exchanges were “for-profit” companies and several were partially owned by the Government. Barents eventually recommended the concept of a member-owned, not-for profit entity to ensure autonomy and the appropriate focus on the development of a cost effective trading mechanism. This particular topic was the subject of much debate during the review of the new Law on Securities Markets. The advisors eventually developed a working group of representatives of two of the potential candidates (TICEX and CSX) in July of 1998 to discuss alternatives/partnerships that could lead to the development of viable candidates for the tender.

As a result of the investigation into the viability of the potential candidates of the tender process, the advisors conducted some additional research into the lack of activity on the existing organized Exchanges. This process led to the identification of a “gray market” in the securities of public companies and also pointed out the need to analyze the companies with potential for being admitted to trading on the Exchange.

The advisors conducted an analysis of Joint Stock Companies and State Enterprises and ranked them in terms of potential for Exchange trading (See “State Holdings of Enterprises in Georgia” by Advisor Cowles, May 26, 1998 and “Enterprise Study Concluding Report” by Advisor Cowles in October 1998). The concluding report identified 87 enterprises for potential admission and highlighted the 58 with the greatest potential.

### **Development of Tender Process Parameters**

**Benchmark(s):** Prepare a Request for Proposal (RFP). (Completed on November 12, 1998)

The advisors used the Exchange Working Group mentioned previously to help develop the parameters for the tender proposal. These were defined in the Request for Proposal: Republic of Georgia Capital Market Development Program that was submitted to USAID for approval prior to its publication on November 16, 1999. The basic requirements for an Exchange were incorporated into the revised Law on Securities Markets.

Since a safe and reliable clearance and settlement mechanism is critical to the success of a trading mechanism and since no viable candidates existed for the tender process for building a Central Depository, it was decided to add a clearing and settlement component to the RFP for the Exchange. The lack of independent registrars and consolidated shareholder records created an environment where it was extremely unlikely that an independent organization could be developed in time for the scheduled launch of the Stock Exchange.

### **Conduct Tender Process**

**Benchmark(s):** Solicit responses to RFP and prepare recommendations for final selection (Completed on February 1, 1999).

The Request For Proposal (RFP) was released on November 16, 1998 with a letter of invitation to six potential participants. A clarification meeting was held with four potential

candidates on November 25, 1998 to answer questions about the RFP requirements and the anticipated assistance program (See “Minutes of the Bidders Clarification Session,” on November 25, 1998).

The advisors conducted the “Bidder Opening Conference” on January 20, 1999 and a follow-up “Stock Exchange Bidders Conference” was conducted on January 29, 1999 to query each tender respondent on certain aspects of their proposals.

The advisors received two responses to the RFP, reviewed these responses and ranked them based on the agreed upon acceptance criteria and presented its recommendations to USAID on February 1, 1999 in the form of a memorandum from Advisor David Wall (See Memorandum to USAID, “Stock Exchange Tender - Recommendation” by Advisor Wall on February 1, 1999). On February 19, 1999 USAID representative, Robert Singletary, announced the selection of the GSE as the winner of the tender process at a press conference from the USAID Tbilisi Mission Office. Results of the tender process were published in the local news media on March 19, 1999.

Note. The initial tender process was delayed because of the debate regarding the organization and structure of a stock exchange in conjunction with the review of the Law on Securities Markets and the lack of a viable candidate after the preliminary assessment of existing Exchanges was conducted. USAID agreed to delay the tender process until these issues were resolved.

### **Prepare Volume Estimates and System Capacity Requirements**

#### **Benchmark(s):**

- Volume Estimates for Trading Systems (Completed in January of 1999).
- Capacity Requirements for Systems and Communications Network (Completed in August of 1999).

Technical requirements for the trading system were developed by the Exchange with the assistance of Rati Skhirtladze. Advisors Wall and John Willsea, helped the GSE refine the volume estimates from its winning response to the RFP and use these estimates to develop the preliminary capacity requirements for the new systems (See “GSE Response to RFP” in January of 1999 and “Memorandum - Statement of Work Update” by John Willsea on August 13, 1999). A follow-up study of the communications infrastructure in Georgia was also conducted. This study identified the reluctance of broker dealers to absorb the incremental telecommunications costs associated with remote access to the trading system. It was determined that the initial structure would incorporate trading terminals at the Exchange for each member and that remote access would be reviewed periodically as the telecommunications infrastructure in Georgia improved.

### **Evaluate Hardware and Software Packages**

**Benchmark(s):** Review potential hardware and software packages and prepare recommendations. (Completed in April of 1999).

Barents created a Review and Selection Group of Exchange Staff and the advisors to organize trips to Moscow, Bishkek and Riga in March of 1999 to evaluate stock exchange trading and settlement systems developed under other USAID projects (See “Trading System Review and Selection Group”, by Advisor Wall, March 1999). USAID encouraged this to increase the

leverage from its investment in other emerging markets and also to reduce the development cycle for establishing the trading mechanism in Georgia.

In April of 1999, the RTS Plaza system was chosen by the Selection Group and in May and June of 1999, demonstrations of the systems were conducted for USAID and the NSC in Tbilisi. The RTS Plaza software developed for use in Russia was determined to be the most viable candidate due to its flexibility/scalability and strong performance record. The RTS plaza was a proven platform, was scalable to fit the unique needs of the Georgian trading environment and the developers of the RTS Plaza had the ability to provide real-time technical support to the GSE.

### **Procure, Install and Test the Trading System**

#### **Benchmark(s):**

- Procure (Completed in July of 1999).
- Install (Completed in October of 1999).
- Test (Completed in March of 2000).

The procurement of the primary file server, workstations and related hardware and software for the trading system was approved by USAID in July of 1999. The equipment was subsequently delivered on September 27, 1999 and installed in October of 1999. (See “Procurement Approval Verification Worksheet”).

The RTS plaza source code was delivered in September of 1999 and installed in October of 1999. USAID established a licensing agreement with RTS that would allow them to assign the license to the GSE at the end of the project.

After the RTS Plaza software was selected, the advisors assisted the GSE, with input from the SIB/NSC, in developing design specifications for modifications to the software (See “Proposed Modifications to RTS Plaza for the Georgian Stock Exchange (“GSE”), September 17, 1999). This included provisions to establish unique requirements for the Exchange. These included: 100% pre-deposit of funds and securities in the Central Depository; Firm Bid/Offers; Anonymity of Trades; and Automatic Clearing and Settlement through the Depository.

Barents helped the Exchange develop a multiphase approach to these modifications to facilitate testing of the system and integration with the Depository function that was being developed simultaneously. The advisors developed a compliance checklist and a training program for the NSC, GSE staff and market participants to ensure that systems implementation would go smoothly and all relevant parties would be ready when official trading began. Barents hired local technical staff to work with the RTS technical staff to ensure that the Exchange would have experienced technical staff to support the system after it was operational.

Due to the instability and cost of the telecommunications infrastructure in Georgia, it was decided to provide access to the trading system to members through dedicated workstations at the Exchange facilities.

The advisors worked with the GSE and RTS technical staff to test hardware and software. The advisors also developed a training course to train GSE, NSC, and market participants in the use of the system. Successfully completing the course and the associated examination was a pre-requisite for the use of the trading system. Mock trading sessions were

conducted prior to official trading so that users would feel comfortable with the functionality of the trading system. Securities were phased in gradually to avoid potential problems and to refine the system. The initial trading session of the GSE was conducted on March 23, 2000. The GSE has been conducting two sessions per week since this initial session with no significant disruptions to trading. Equipment related to the operation of the trading system was transferred to the GSE from Barents with USAID approval upon completion of the project (See “Equipment Turnover Report”).

### **Assist in the Development of the Exchange Organizational Structure**

#### **Benchmark(s):**

- Legal status (Completed. See “Law on Securities Markets, Article 27 – Licensing of a Stock Exchange” and “Georgian Stock Exchange Charter” as adopted by the General Meeting of Shareholders on December 5, 1999).
- Membership qualifications (Completed. See “Georgian Stock Exchange Charter” and “Rules on Georgian Stock Exchange Owner-Members” as adopted by the General Meeting of Shareholders on December 22, 1999).
- Services offered by the Exchange (Completed. See “Georgian Stock Exchange Charter”)
- Securities eligible for trading (Completed. See “Rules on Admission of Securities to the Trading System of the Georgian Stock Exchange and Listing,” as adopted by the General Meeting of Shareholders on December 22, 1999).
- Costs and fees (Completed. See “Rules on Owner-Members and Rules on Admission and Listing of Securities”).
- Code of ethics (Completed. See “Code of Ethics of the Georgian Stock Exchange” as adopted by the General Meeting of Shareholders on December 22, 1999).

After the review of the initial tender candidates identified potential weaknesses in the existing candidates, the advisors established a Stock Exchange Working Group to discuss alternatives and potential partnering agreements. This working group was instrumental in establishing the parameters for the RFP and in identifying issues to be addressed regarding the structure and operations of the Exchanges as defined in the Law on Securities Markets. The advisors recommended the legal, ownership and organizational structure for the Exchange and its potential role as a Self-Regulatory Organization (SRO). Advisor Lois Cohen, helped the Exchange prepare its application and related documents (e.g., Membership Rules, Code of Ethics, etc) for an Exchange license and designation as an SRO.

As a result of the efforts of the Stock Exchange Working Group and the debate on the organization and structure of an exchange related to the review of the new Law on Securities Markets, the basic organizational structure of the Exchange was established and outlined in the original tender proposal of the GSE. The GSE was registered as a not-for-profit joint stock company and would be owned and operated by its members/shareholders. Membership qualifications for brokerage firms were established in the revised Law on Securities Markets. Additional membership rules were drafted by the GSE with assistance from the advisors and were submitted with its application for a Stock Exchange License in September of 1999. Securities eligible for trading on the Exchange were defined in the “Rules on Admission of Securities to the Trading System of the Georgian Stock Exchange and Listing” which were also submitted to the NSC for approval with the license application. The code of ethics for brokers was drafted by advisor James Ryan, and was formerly approved by the Meeting of Shareholders of the Exchange on December 22, 1999. (Current versions of these and other rules are available on the GSE website at [www.gse.ge](http://www.gse.ge)).

All owner/members of the Exchange were required to contribute to the initial capitalization of the Exchange through the purchase of shares. Nominal membership and transaction fees were established to defer some of the operating costs of the GSE after the trading system was operational (See “Rules on Georgian Stock Exchange Owner-Members” as adopted by the General Meeting of Shareholders on December 22, 1999). Fees for listing on the exchange were also established (See “Rules on Admission of Securities to the Trading System of the Georgian Stock Exchange and Listing,” as adopted by the General Meeting of Shareholders on December 22, 1999).

In September of 1999, the GSE submitted its license application to the NSC. On January 14, 2000 the NSC granted the GSE an Exchange license and on January 19, 2000, the GSE was designated as an SRO.

### **Assist in Developing Plans, Procedures and Regulations relating to Daily Operations**

The completion of the following benchmarks associated with this task were incorporated into the GSE Charter and the various rules that were required for the GSE to become a licensed Exchange.

#### **Benchmark(s):**

- Staffing requirements
- Listing requirements and tiering
- Policies, systems and procedures for receipt of orders
- Trading rules
- Linkages between institutional and retail trading markets
- Trade reporting
- Off-market trading rules
- Methods of price discovery
- Policies, systems and procedures for protecting the confidential information of members and their customers.
- Risk management controls the Exchange should implement to protect the facility and its participants
- Rules to address buy ins and sell outs
- Reporting to members
- Communications with customers of members
- Disaster recovery plans and recovery testing
- Information and communications linkages with members
- Communication interfaces with market data information systems
- Communication interfaces with the SIB

The advisors helped the Exchange staff develop detailed plans for daily operations through the initial development stage and for when regular operations were established. Advisor Cohen, (July 1999) conducted a detailed review of all of the primary rules and regulations of the Exchange and suggested revisions prior to submitting the license request to the NSC.

Advisor Cohen completed the following documents on behalf of the exchange on July 29, 1999 to be included in the GSE’s license application:

- GSE Code of Ethics

- GSE Code of Procedure
- GSE Trading Rules
- GSE Code of Arbitration and Originating Provisions for the Establishment of an Arbitration Council.

The Draft Rule on Georgian Stock Exchange Owner Members was completed on August 6, 1999.

The advisors also prepared a compliance checklist to be used prior to the initial trading sessions to ensure that all participants were prepared to commence trading operations. As mentioned previously, Barents staff was instrumental in developing the rules and operational procedures required by the NSC for a license and for SRO designation. The advisors also helped the Exchange develop implementation strategies (e.g., gradual increases in securities admitted for trading) to reduce the risk of problems during the initial development phase.

#### **Assist in Preparing a Manual of Organizational and Operating Policies, Rules and Procedures.**

**Benchmark(s):** Assist the Exchange in preparing a manual that contains all organizational and operating policies, rules and procedures to be distributed to the membership and made available to regulators. (Completed. See GSE Website at “www.gse.ge” for a current version of the Rules and Regulations of the GSE).

The relevant operating policies, rules and procedures of the GSE were incorporated into the rules and regulations required by the NSC for licensing and SRO designation. In addition to preparing these in English and Georgian for distribution to its members, the advisors assisted the Exchange in developing a website that would provide access to this information to all interested parties. This information was initially posted on the Barents website and was transferred to the GSE website when it was completed (See GSE website at “www.gse.ge”).

#### **Definition of Self-Regulatory Responsibilities**

**Benchmark(s):** Assist the Exchange in determining whether and to what extent it should serve as a self-regulatory organization. (Completed in July of 1999. See Law on Securities Markets, Chapter 5 – Article 27 and Chapter 6 Articles 34-37).

As mentioned previously, the advisors worked closely with the Commission and market participants to define the role of SROs in the development and operations of the securities markets in Georgia. Based on these discussions, provisions were built into the Law on Securities Markets defining the NSC role in licensing and oversight of SRO’s and the obligations of SROs. After defining these roles and responsibilities, the advisors provided assistance to the Exchange staff in assuming these responsibilities.

On May 21, 1999, Advisor Kulczak consulted with the GSE and NSC regarding the typical roles and responsibilities of SROs in emerging and developed markets. Mr. Kulczak made a presentation to representatives of the Brokers Guild of Georgia (GSIA) on the functions of SROs within the securities industry.

Prior to the commencement of trading on the Exchange, the advisors developed a compliance checklist in February 2000 to ensure that all participants were aware of their responsibilities and prepared for the first sessions.

In March of 2000, Advisor Rodriguez prepared the GSE Sanction Guidelines to address the GSE's responsibilities for monitoring compliance of its members with its rules as well as those established by the Commission.

In September of 2000, Advisor Ryan prepared the following series of modules and workshops for the GSE regarding fulfillment of the supervisory responsibilities as an SRO:

- GSE Supervision Procedures
- Sales Practices
- Customer Complaints
- Communications with the Public
- Managed Accounts

In October of 2000, Mr. Ryan completed the following additional modules and presentations to the GSE:

- Interview Modules (For Conducting Examinations)
- Checklist Modules
- Letter from Exchange to Members on Supervision and Trading Guidelines.

### **Develop a Business Plan**

**Benchmark(s):** Develop a time phased business plan for the first two years of operation. (Completed. See "Georgian Stock Exchange Business Plan," by Matt Zimmermann in August 2000.)

Advisor Matt Zimmermann assisted the Exchange in the development of a comprehensive business plan in August of 2000. The business plan included a mission statement, market plan, operations plan and financial plan to help the organization identify the links between these functional areas and to clarify its development strategies/priorities. A financial model was developed that could be used to modify financial planning assumptions and experiment with different pricing and volume scenarios. This also included assistance in preparing revised volume and staffing forecasts. The business plan was discussed with the local USAID mission and the USAID Evaluation Team. This exercise helped the organization see the dependence of the Exchange on market activity to accomplish its ultimate goal of self-sustainability. This caused them to refocus their strategies on steps to bring product to the market and ensure that all activity in public companies is appropriately processed through the exchange.

A consolidated budget for the GSE and GSCD was developed based on the categories defined in the financial plan to assist the Exchange and Depository in estimating follow-up assistance requirements upon completion of the Barents project.

### **Develop capacity to conduct cash auctions of residuals shares from privatization process**

**Benchmark(s):** Develop the capacity to conduct cash auctions of residual shares remaining from the privatization process. (Completed in October of 1998).

Residual shares from the privatization process are a potential source of product for trading on the Exchange. It is important for the Exchange to be able to clearly demonstrate to the appropriate government officials and company managers that the Exchange can help them efficiently use this process.

The advisors provided recommendations to the MINSPM on the procedures for conducting cash auctions for residual shares in August of 1998 (See “Residual Share Auction Operations and Procedures Proposal – October 1998).

Barents assisted the Exchange staff in developing a plan for cash auctions for sale of residual shares from the privatization process. The advisors analyzed joint stock companies with partial government ownership to identify candidates. Advisor Enzo Maravito prepared recommendations for improvements to the privatization process in Georgia. (This led to development of recommendations to improve the privatization process and led to the spin-off of a separate project). Revised plans to conduct auctions were developed to be consistent with the selected trading system to minimize the cost associated with modifying the system. Recommended changes to privatization rules were developed but implementation was delayed due to political and other barriers outside the control of project. These were reintroduced in the fall of 2000 prior to the completion of the project when market conditions and the political environment were more favorable. Changes to the trading system have been delayed pending approval of the rules changes to avoid premature investment in changes to the system.

## V. Georgia Securities Central Depository

### Objective/Scope of Work

The objective of this component of the project was to provide a commercially viable central clearance, settlement and depository system that is capable of serving all of the trading mechanisms in Georgia, has a high degree of systemic integrity and provides equal access to all qualified market intermediaries. To accomplish this objective, the following tasks were required:

- provide assistance in the creation and development of a centralized clearance, settlement and depository system including conducting a tender competition to determine the entity to receive further assistance.
- work with the selected entity to review available systems, recommend a selection to USAID and install the selected system (including hardware, software and, if necessary, the communications network).
- assist the depository in adopting rules and operating procedures relating to clearance, settlement and depository activities, financial responsibility, membership, disciplinary procedures and other conduct by members.
- assist the Depository in developing a business plan.

### Background

When the project commenced, there were no independent share registries in Georgia and there was no centralized share registrar or similar integrated depository/registry. Instead, shareholder records were fragmented and had not been consolidated or compared to obtain an integrated understanding of share ownership.

At the time, the Law on Entrepreneurs required shareholder records to be kept by the institution that sold the shares. Records of share sales to employees and to other private parties through closed subscriptions were maintained by the enterprises themselves. Records of share sales by the MINSPM via the voucher program were recorded by the Ministry. The GOG planned to conduct cash auctions of the shares in enterprises that were not completely sold via vouchers. If the cash auctions did not result in clearing the entire ownership, then sales of residual shares would have to take place through an exchange or otherwise. Accordingly, there were four possible sections of the shareholder records: (1) the log of the initial closed subscriptions and gifts to employees and other persons; (2) the results of the voucher program; (3) the results of the cash auctions; and (4) the results of sales of any residual shares through the exchange or otherwise. Until the ownership records were consolidated, verified and finalized there could be no systemic integrity to trading these securities.

In addition, the Law on Entrepreneurs required each joint stock company to establish and maintain the definitive record of share ownership. This requirement precluded the adoption of either an independent share registry or central securities depository approach to shareholder record keeping. Until this requirement was removed: (1) the clearance and settlement system would have to create a communications link with each enterprise, a costly exercise that also

raised technology compatibility issues; (2) the opportunity for corruption would increase dramatically; and (3) the time period for settlement would be uncertain, inconsistent and lengthy.

Another legal issue related to the rights of the enterprise vis a vis a shareholder wishing to sell his/her shares. The Joint Stock Company law required a shareholder to obtain the consent of the enterprise before transferring his/her shares. It is unclear whether the law also granted a right of first refusal to the enterprise or any other group of shareholders. This concept, used in the U.S. to protect closely held companies from unwanted persons joining the privately held shareholder group, was clearly incompatible with the concept of public trading in securities that occurs without the involvement or approval of the company.

There was no centralized clearance and settlement system that served all of the exchanges. The TICEX cleared and settled its trades and those done off-exchange. Each of the other exchanges ran their own back offices if and when they were active. There was no depository and no practice of holding securities in "street name". It was not even clear that the concept of nominee ownership existed under Georgian law at the time.

The communications systems in Georgia were also in need of improvement. USAID was conducting a technology upgrade project for the benefit of the National Bank of Georgia (NBG). USAID had installed the SWIFT system at the NBG for international money flows and was installing an intrabank payments (or wire) system for the commercial banks. These efforts had important ramifications for the development of a suitable clearance and settlement mechanism for the trading of securities in Georgia.

### **Tasks/Benchmarks**

The following is an outline of the primary tasks/benchmarks associated with the establishment of a mechanism for clearance and settlement of securities transactions. A detailed discussion of the specific results associated with these tasks/benchmarks follows:

- Assessment of Potential Tender Candidates
- Development of Tender Process Parameters
- Conduct Tender Process
- Prepare Volume Estimates and System Capacity Requirements
- Evaluate Hardware and Software Packages
- Procure, Install and Test the System
- Assist in the Development of the Depository Organizational Structure
- Assistance in Developing Plans, Procedures and Regulations Relating to Daily Operations
- Assist in Preparing a Manual of Organizational and Operating Policies, Rules and Procedures
- Definition of Self-Regulatory Responsibilities
- Develop a Business Plan
- Develop Capacity to Conduct Cash Auctions of Residuals Shares from the Privatization Process

### **Assessment of Potential Tender Candidates**

**Benchmark(s):** Conduct a summary review of the various clearance, settlement and depository operations that can be expected to submit proposals for the purpose of doing preliminary due diligence for judging the proposals. (Completed in February of 1999).

Analysis of the potential candidates for the tender proposal found that no existing organization in Georgia, including the potential Exchange candidates, was operating an appropriate depository function when the project commenced (See Quarterly Report Number 5 – January 1, 1999 to March 31, 1999, page 10). As a result, Barents requested participants in the tender process for the Exchange to submit a plan for the creation and operation of a clearance and settlement mechanism for Exchange transactions. Barents also found that the lack of reliable consolidated ownership records was a potential obstacle to the development of an effective clearance and settlement mechanism. The completion of the World Bank/PWC project to develop registrars became critical to the development of the Exchange and Depository. Barents worked with PWC to help them make progress and ended up assuming responsibility for this project.

### **Development of Tender Process Parameters**

**Benchmark(s):** Prepare a Request for Proposal (RFP) (Completed on November 12, 1998. Combined with Tender Process for the Stock Exchange).

This task was combined with the tender process for the Exchange when it was determined that no viable candidates existed for a separate tender process. Given the importance of a safe, reliable clearance and settlement mechanism to the successful implementation of the Exchange trading mechanism, linking the two initiatives reduced the implementation and operational risks and offered potential cost savings due to the synergies between the two functions. The advisors conducted seminars to discuss potential structures for the clearance, settlement and payment functions in Georgia that were used to develop the plans of the Exchange tender participants to develop clearance and settlement mechanisms.

Advisor Gene Callan presented three primary models for a Central Securities Depository to the participants of a Stock Exchange Seminar held in Batumi on September 2 and 3, 1998. (See “Central Depository Models – Strategy and Vision Seminar- August 1998” by Gene Callan). The discussion of these models helped identify issues that needed to be addressed in the formulation of the clearance and settlement mechanism for Georgia. The requirements for the operation and oversight of a Central Depository were also defined in the revised Law on Securities Markets.

### **Conduct Tender Process**

**Benchmark(s):** Solicit responses to RFP and prepare recommendations for final selection. (Completed on February 1, 1999. Combined with Tender Process for the Stock Exchange).

As mentioned previously, the tender process for the Exchange and Depository was combined when it was determined that a viable candidate for the Depository tender was unlikely to emerge in a timely manner. This change in approach was reviewed with and approved by USAID.

### **Prepare Volume Estimates and System Capacity Requirements**

**Benchmark(s):**

- Volume Estimates for Systems (Completed in November of 1999).

- Capacity Requirements for Systems and Communications Network. (Completed in November of 1999).

Since the Depository was being built to provide a clearance and settlement mechanism for the Exchange, the advisors helped the Depository use the volume estimates for the Exchange to develop the volume estimates and capacity requirements for the Depository system.

As part of the process to build the interim clearance and settlement system, updated volume estimates and capacity requirements for the clearance and settlement system were prepared by Advisor Jones (See “Operating Procedures and Users Guide for Depository Accounting System,” by Advisor Jones in November of 1999).

### **Evaluate Hardware and Software Packages**

**Benchmark(s):** Review potential hardware and software packages and prepare recommendations. (Completed in June of 1999).

As mentioned in the review of the results of the development of the trading mechanism in Georgia, the advisors created a “Review and Selection Group” of Exchange staff and the advisors to organize trips to Moscow, Bishkek and Riga in March of 1999 to evaluate stock exchange trading and settlement systems developed under other USAID projects. (See “Trading System Review and Selection Group”, by Advisor Wall, March 1999). This team also visited Bucharest, Romania in May of 1999 to evaluate the Romanian Central Depository software. USAID encouraged this to leverage its investment in other emerging markets and to reduce the development cycle for establishing the trading and settlement mechanisms in Georgia. Unfortunately, delays were experienced getting access to the software and an interim solution had to be developed in order to complete the implementation of a clearance and settlement mechanism in conjunction with the implementation of the trading mechanism.

### **Procure, Install and Test the System**

**Benchmark(s):**

- Procure (Completed in November of 1999.)
- Install (Completed in February of 2000).
- Test (Completed in March of 2000).

To prevent delays in development of an adequate clearance and settlement mechanism in conjunction with the commencement of trading on the Exchange, the advisors developed a plan to build an interim clearance and settlement solution for the Depository. The advisors worked with Depository and Exchange staff to design a system based on the unique requirements for settlement of GSE transactions. The software to support the interim solution was developed by the advisors with the assistance of GSCD staff and local programmers to ensure that the GSCD staff would be familiar with the operation of the system when it was completed. The advisors developed a detailed implementation plan to minimize risks and ensure the integrity of the process. A compliance checklist was developed to ensure a smooth transition.

In August of 1999, the source code for the Romanian Central Depository Software was received but the documentation defining installation procedures was not available. Additional

documentation was eventually received, but it was decided to continue the implementation of the interim solution.

After building the interim system, the advisors helped the GSCD technical staff test the system and prepare for its launch in conjunction with the launch of the GSE Trading System. (See “Operational Readiness Checklist,” by Jones on February 23, 2000 and “Georgian Centralized Depository Accounting System Functional Checklist” by Jones in February of 2000.

In October of 2000, GSCD technical staff conducted a follow-up assessment of the Romanian Central Depository Software. When the project was completed, there were still some concerns about the suitability of this software for use by the GSCD.

In October/November of 2000, Barents received the new server for the Stock Exchange that allowed the transfer of the existing Stock Exchange server for use by the Depository (See “Equipment Turnover Report”). This completed the installation of all of the required equipment for the Depository.

### **Assist in Development of Organizational Structure**

#### **Benchmark(s):**

- Legal status (Completed. See “Law on Securities Markets, Article 28 – Licensing of a Central Securities Depository” and “Georgian Securities Central Depository Charter”).
- Membership qualifications (Completed. See “GSCD Membership Rules,” by Jones in November of 1999).
- Services offered by the Depository (Completed. See “Rules on Operations and Services for the Depository,” by Jones in November of 1999).
- Securities eligible for trading (See “Rules for Admission of Securities for Trading on the Exchange and Listing”)
- Costs and fees (Completed. See “Operating Procedures and Users Guide for Brokers,” by Jones in February of 2000).
- Code of ethics (Completed. See “GSCD Code of Ethics,” by Jones in November of 1999).

In conjunction with the review/discussion of alternative approaches to clearance and settlement to support the anticipated trading mechanisms in Georgia, the advisors helped the GSCD develop its organizational structure and implementation plan (See “GSCD Organizational Structure,” by Jones in October of 1999). This plan included the use of existing Exchange staff to cover critical functions of the Depository to minimize the initial investment in infrastructure without significantly increasing the operational risks. The advisors assisted the Exchange in determining the legal entity and ownership structure for the Depository and helped the Depository prepare the application and related documents for licensing and SRO designation with the NSC.

### **Assistance in Developing Plans, Procedures and Regulations Relating to Daily Operations**

The completion of the following benchmarks associated with this task were incorporated into the GSCD Charter and the various rules and procedures manuals that were required for the GSCD to become a licensed Depository.

#### **Benchmark(s):**

- Staffing requirements
- Policies, systems and procedures for receipt of trade information

- Policies, systems and procedures for the receipt, transfer and withdrawals of securities
- Arrangements with the settlement bank
- Policies, systems and procedures for safeguarding and protecting securities and funds
- Policies, systems and procedures for protecting the confidential information of participants and their customers
- DVP settlement
- Risk management controls the CSD should implement to protect the facility and its participants.
- Financial responsibilities requirements imposed on members
- Rules to address failures to receive and deliver
- Guarantee fund structure, rules and operations
- Rule 17f-5 status
- Compliance with G30 Recommendations
- Policies systems and procedures for downloading consolidated share records.
- Reporting to members
- Communications with customers of members
- Disaster recovery plans and recovery testing
- Communication linkages with members
- Communication interfaces with market data information systems
- Communication interfaces with the SIB

In conjunction with the development of the interim software solution for the clearance and settlement mechanisms necessary for trading on the Exchange, the advisors helped the Depository develop a detailed operations plan. This also included a detailed compliance checklist to ensure all parties were prepared when Exchange trading was begun. Advisors worked closely with counterparts during all the phases of the development and operations process and helped identify solutions and implement changes throughout the process (See “Rules on Operations and Services for the Depository” and “Operating Procedures and Users Guide for the Depository Accounting System” by Jones in November 1999). Revised versions of the various rules and codes were provided to NSC in April of 2000. Operating procedures were revised in June of 2000 to improve the process as a result of experience during initial trading sessions of the Stock Exchange.

**Assist in Preparing a Manual of Organizational and Operating Policies, Rules and Procedures.**

**Benchmark(s):** Assist the Depository in preparing a manual that contains all organizational and operating policies, rules and procedures to be distributed to the membership and made available to regulators. (Completed in March of 2000).

Most of the relevant rules and procedures were incorporated into the rules and regulations required by the NSC for licensing and SRO designation. In November of 1999, Advisor Jones prepared the following documents in conjunction with the development of the GSCD:

- Membership Rules
- The Code of Ethics
- Code of Procedures
- Rules for Settlement of Disputes

An operational readiness checklist was also prepared (See “Operational Readiness Checklist for GSCD in Advance of GSE Trading,” by Jones in February of 2000). A detailed operations manual was prepared for the Depository in English and Georgian for distribution to its members in March of 2000 (See “Brokers Guide for Operations and Procedures,” distributed in Georgian on March 8, 2000).

### **Definition of Self-Regulatory Responsibilities**

**Benchmark(s):** Assist the Depository in determining whether and to what extent it should serve as a self-regulatory organization. (Completed. See “Law on Securities Markets, Article 28 – Licensing of a Central Securities Depository and Articles 41, 42 and 43”)

As mentioned previously, the advisors worked closely with the Commission and market participants to define the role of SROs in the development and operations of the securities markets in Georgia. Based on these discussions, provisions were built into the Law on Securities Markets defining the NSC role in licensing and oversight of SRO’s and the obligations of SROs. After defining these roles and responsibilities, the advisors helped provide the Depository and Exchange staff in assuming these responsibilities. On March 1, 2000, the NSC granted license # 80001 to the GSCD to operate a Central Securities Depository and designated the GSCD as a SRO.

### **Develop a Business Plan**

**Benchmark(s):** Develop a time phased business plan for the first two years of operation. (Completed in August of 2000).

A comprehensive business plan, including a mission statement, market plan, operations plan and financial plan was developed with the GSCD management with emphasis on integrating these plans and developing strategies to facilitate the goal of reaching financial viability as soon as possible (See “GSCD Business Plan,” by Matt Zimmermann in August of 2000). A financial model was developed to analyze the impact of different fee structures and volume assumptions on the financial viability of the organization. A consolidated budget for the GSCD and GSE was developed to assist in preparing a proposal for continued assistance after completion of the Barents project.

### **Develop capacity to conduct cash auctions of residuals shares from privatization process**

**Benchmark(s):** Develop the capacity to conduct cash auctions of residual shares remaining from the privatization process. (Completed in conjunction with Exchange process to conduct cash auctions. See GSE section of this report).

The advisors assisted the Depository and Exchange staff in developing a plan for cash auctions for sale of residual shares from the privatization process. The advisors analyzed joint stock companies with partial government ownership to identify candidates. The plans to conduct auctions were developed to be consistent with the selected depository and trading system to minimize the cost associated with modifying the system. Recommended changes to privatization rules were developed but implementation was delayed due to political and other barriers outside the control of project. These were reintroduced in the fall of 2000 prior to the completion of the project when market conditions and the political environment appeared to be more favorable. Changes to the depository and trading system have been delayed pending approval of the rules changes to avoid premature investment in changes to the system.

## **VI. Training and Public Education**

### **Objectives/Scope of Work**

The objective of the Training and Public Education component of the Capital Markets Development Project was to increase the level of knowledge of market intermediaries, other members of the securities community, GOG officials and the general public through extensive training and to promote corporate governance, shareholder participation and compliance with SIB regulations by the newly privatized companies. The overall goal of this activity was to:

- (1) increase the level of knowledge of the professional market participants so that they could be integrated fully, quickly and effectively into the market system;
- (2) familiarize the appropriate GOG officials with the design and operation of the system thereby increasing its political acceptance;
- (3) educate issuers regarding their obligations under the securities laws thereby promoting compliance and better disclosure of information to shareholders; and
- (4) educate the general public thereby increasing their participation in investment.

In order to carry out this objective the following tasks were required:

- create a training unit comprised of Georgian nationals that would assist in conducting training courses to the private sector and regulatory counterparts.
- prepare written course materials for each module offered.
- Administer written examinations and provide follow-up “On-The-Job” consulting for participants of certain training programs.

### **Tasks/Benchmarks**

Benchmarks for the Training and Public Education component of the Capital Markets Development Project were broken down into the following primary components. A detailed discussion regarding completion of the deliverables related to these benchmarks follows the outline.

#### **Training for professional market participants**

- Broker-Dealer operations
- Investment Funds

#### **Governmental briefing sessions and relations**

- Briefing sessions for GOG officials
- Education of financial press

#### **Training for the securities community on securities laws and regulations**

- Securities laws and regulations workshops for legal and business communities
- Information guides describing securities laws and their function

### **Training for issuers**

- Workshops for the issuer community on corporate governance and shareholder rights
- Information guides for officers and directors of publicly held enterprises

### **Public education**

- Workshops for the general public to explain the capital markets and concepts of investing
- Educational packets regarding investing and providing consumer protection information
- Public relations assistance to the NSC/SIB, GSE and GSCD.

## **Training for Professional Market Participants**

### **Benchmark(s):**

#### Broker-Dealer Operations

- Ten (10) training modules for broker dealers. Each of the modules should be offered on at least three separate occasions. (Completed on November 29, 2000).
- Follow-up on the job training for at least 50% of the broker dealer attendees. (Completed on August 31, 2000).

#### Investment Funds

- Five (5) training modules for investment funds. Each of the modules should be offered on at least three separate occasions. (Completed on December 20, 2000)
- Follow-up on the job training for at least 50% of the broker dealer attendees. (Completed on August 31, 2000).

Advisor Diana Osinski, a training consultant, conducted a comprehensive Training Needs Assessment (TNA) to determine the specific needs of the capital markets participants in Georgia. The TNA was completed in December of 1998 (See "Capital Market Development Program Training Needs Assessment," December 16, 1998). The advisors involved the various key constituent groups (NSC, GSE, and Georgian Securities Industry Association (GSIA)) in the development process by creating a Training Advisory Board to review the TNA and offer guidance on the administration of the program. It was determined that the existing environment for the investment funds at the time of the development of the training programs, precluded the need for offering a separate course. Therefore, these materials were incorporated into an integrated Capital Markets Development Program with USAID approval. The Capital Markets Development Program included the required fifteen (15) training modules/days on a combined basis (See Memorandum "Task Order Variance" from Diana Osinski to David Wall on April 21, 1999).

The Capital Markets Development Program integrated the two training programs required for market participants with the Law Workshop, Issuers Workshop and Basics of Accounting Course. The overall program included the following courses and workshops:

- Basics of Accounting
- Securities Market Law and Amendments to the Law on Entrepreneurs Overview (Law Workshop)
- Overview of the Capital Market Industry
- Operations of the Investment Industry
- Corporate Governance Principles and Shareholder Rights Overview (Issuers Workshop).

Note. The original contract required videos to be made of each course module that would be distributed to the counterparts for future use. Given the dynamic nature of the capital markets development efforts in Georgia and the need to modify training materials to keep pace with these changes, it was determined that the videos would not be a cost effective means for follow-up training exercises. This was discussed with and agreed upon by USAID (See “Task Order Variance” from Diana Osinski to Wall on February 17, 2000).

### **Overview of the Capital Markets Industry**

As part of the Capital Markets Development Program, this course was delivered first to the NSC and SRO staff to meet the institutional development goals of the project and to use their feedback to refine the program prior to offering it to market participants. The program was offered on four other occasions and the follow-up “On-The-Job” consulting was conducted for at least 50% of the attendees for the three required offerings of the programs. Since the fifth offering of the course was not required and was conducted close to the end of the project, follow-up OTJ was not conducted. Follow-up OTJ consulting was conducted for 57% (55 of 96) of the participants for the first four offerings of the course. Feedback from these sessions indicated that the training programs were well-received by the market participants and that the retention rates of course material were excellent (94.7% on average). (See “Overview of the Capital Market Industry Course – Results of the Follow-up Consulting (As of November 30, 2000) “). Certificates of completion were provided to all participants who took the final examination as required. A coding scheme was developed for use in the certification program based on the examination results for market participants.

#	City	Audience	Start Date	End Date	Participants	Course Rating
1	Tbilisi	NSC/GSE Staff	9/13/99	10/27/99	30	85.9%
2	“ “	Brokers	11/01/99	11/15/99	30	89.6%
3	“ “	NSC/GSE Staff & Journalists	03/09/00	03/24/00	18	87.6%
4	“ “	Brokers	03/30/00	04/14/00	18	90.0%
5	“ “	Brokers	11/13/00	11/29/00	28	90.3%

### **Operations of the Investment Industry (Investment Funds)**

Since the fifth offering of the course was not required and was conducted close to the end of the project, follow-up OTJ was not conducted for that session. Follow-up OTJ consulting was conducted for 53% (55 of 104) of the participants for the first four offerings of the course. Feedback from these sessions indicated that the training programs were well-received by the market participants and that the retention rates of course material were excellent (95.6% on average). (See “Operations of the Investment Industry Course – Results of the Follow-up Consulting (As of November 30, 2000) “

#	City	Audience	Start Date	End Date	Participants	Course Rating
1	Tbilisi	NSC/GSE Staff	9/30/99	10/28/99	27	77.8%
2	“ “	Brokers	11/17/99	12/10/99	29	86.5%
3	“ “	NSC/GSE Staff & Journalists	03/30/00	04/15/00	18	90.3%
4	“ “	Brokers	05/11/00	06/02/00	30	84.9%

5	“ “	Brokers	12/01/00	12/20/00	27	84.9%
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### **Governmental Briefing Sessions and Relations**

**Benchmark(s):** Provide regular, periodic briefings to the appropriate GOG officials, designed to keep them up to date on all progress in the capital market development areas as well as plans for the future. These briefings will be used as a vehicle to solicit input and approval of the GOG officials. (Completed. This was done throughout the project).

The advisors spent considerable effort to develop relationships with the appropriate GOG officials and help keep them informed and supportive of the reform process. Special seminars were created and select officials were invited to attend workshops prepared for other participant groups.

The following is a sampling of some of the presentations and seminars conducted to keep the appropriate GOG, regional and local officials informed of the progress of the capital market development process in Georgia.

Symposiums on Listing Requirements for Joint Stock Companies were conducted for local government and business leaders in December of 1998 in Tbilisi and Kakheti.

Presentations for local government and business leaders to encourage listing on the Exchange were conducted in February of 1999 in the following locations:

- Samtske/Javkheti
- Telavi/Khaketi
- Rustavi
- Mtsketa

A seminar was conducted for government officials and business leaders in Guduari on February 26 and 27, 2000 in advance of the first trading session of the Georgian Stock Exchange.

### **Education of Financial Press**

**Benchmark(s):**

- Conduct at least one “press club” event specifically for financial journalists. (Completed).
- Invite journalists to the seminars for financial intermediaries as well as for enterprise directors and officers. (Completed. See Summaries for other Training Programs and Workshops described in this section).

The completion of Overseas Strategic Consulting’s (OSC’s) agreement with the Civil Society on the Air in Georgia led to the development of a core group of journalists into a functioning “press club” with the skills and interests to focus on financial/economic issues on a broader level. This group was instrumental in increasing public awareness of the progress of the various reform projects in Georgia. OSC also sponsored a variety of presentations and trips to develop the independent journalists in Georgia.

Journalists were invited to all of the workshops offered to financial intermediaries and other constituents. Separate sessions of the Securities Law and Issuer Workshops were offered to journalists and a Press Workshop related to capital markets development subjects was developed specifically for journalists. This workshop was conducted for fourteen journalists by Advisors Brian Bell and Jim Chester from March 27-29, 2000 (See “Overview of the Securities Market, Related Legislation, Intermediaries and Investing Workshop”, March 2000).

### **Training for the Securities Community on Securities Laws and Regulations**

#### **Benchmark(s):**

- Ten (10) workshops for the legal and business communities designed to explain the new securities laws and regulations. (Completed on March 28, 2000).
- Updated information guides describing securities laws and their function for appropriate members of the securities industry, legal community, chambers of commerce and other appropriate business associations, as well as the public. (Completed. Initial participant guide for workshops was completed in September of 1999. A revised version was completed in July of 2000).

Participant guides were developed to introduce the new securities laws and regulations to the legal and business communities through a series of workshops. Twelve (12) workshops were conducted to present this information. The workshops were also used to get feedback and input from the participants and develop ideas for additional changes/amendments. The final version of the Information Guide was completed in July of 2000 (See “Securities Markets and the Law Information Guide,” July 2000).

#### **Securities Markets and the Law**

#	City	Audience	Start Date	End Date	Number of Participants	Course Rating
1	Tbilisi	NSC/GSE Staff	09/28/99	09/29/99	27	89.3%
2	“ “	Journalists	10/04/99	10/05/99	16	94.9%
3	“ “	Ministries	10/07/99	10/08/99	8	95.8%
4	“ “	Brokers	10/11/99	10/12/99	27	92.0%
5	“ “	Lawyers	10/14/99	10/15/99	6	80.0%
6	“ “	Bankers	10/18/99	10/19/99	12	91.7%
7	“ “	Students	10/21/99	10/22/99	21	94.9%
8	“ “	NSC/GSE Staff & Journalists	03/06/00	03/07/00	18	92.2%
9	“ “	Lawyers	03/20/00	03/21/00	5	96.7%
10	“ “	Brokers	03/27/00	03/28/00	32	94.4%
11	“ “	Brokers	09/11/00	09/12/00	8	100.0%
12	“ “	Brokers	09/14/00	09/15/00	18	93.0%

### **Training for Issuers**

#### **Benchmark(s):**

- Twenty (20) workshops for the issuer community designed to explain corporate governance requirements and shareholder rights. (Completed on July 20, 2000).

- Follow-up on the job training for at least 50% of the attendees. (Completed on August 31, 2000).
- Information guides for officers and directors of publicly held enterprises (Completed in January of 2000. A revised version was prepared in April of 2000 and provided to OSC to support the development of the public awareness programs).

Participant guides were developed to explain the changes to the Law on Securities and the Law on Entrepreneurs and their impacts on the reporting and other corporate governance requirements associated with being a public reporting company (See “Corporate Governance and Shareholder Rights” by Advisor Brian Bell on July 17, 1999 and “Corporate Governance Principles and Shareholder Rights Overview – Participant Manual” dated January 2000). The guides emphasized the importance of protecting shareholder rights to gain access to capital through the securities markets. Twenty-two (22) workshops were conducted for various audiences and the follow-up on-the-job training was conducted for 50% of the attendees of the workshops conducted in Tbilisi. In addition to the required workshops summarized below, various presentations and symposiums were conducted throughout the project to inform the issuer community and solicit their input. For example, a symposium on listing requirements was conducted on September 22, 1998. (See “Listing Requirements for Joint Stock Companies for Participation on the Stock Exchange,”).

Feedback from the follow-up OTJ consulting sessions indicated that the training programs were well-received by the participants and that the retention rates of course material were excellent (98.4%). (See “Corporate Governance Principles and Shareholders Rights Workshop – Results of the Follow-up Consulting (As of November 30, 2000) “

Corporate Governance Principles and Shareholder Rights

#	City	Audience	Start Date	End Date	Number of Participants	Course Rating
1	Tbilisi	NSC/GSE Staff	01/31/00	02/02/00	23	83.3%
2	“ “	Brokers	02/09/00	02/11/00	32	87.9%
3	“ “	Journalists	02/16/00	02/18/00	13	90.5%
4	“ “	Ministries	02/22/00	02/24/00	11	85.7%
5	“ “	Students	02/28/00	03/01/00	24	92.3%
6	“ “	Lawyers	03/08/00	03/10/00	12	96.3%
7	“ “	Enterprises	03/22/00	03/24/00	11	96.7%
8	“ “	Enterprises	03/29/00	03/31/00	7	94.4%
9	“ “	Enterprises	04/04/00	04/06/00	18	86.1%
10	“ “	NSC/GSE Staff & Journalists	04/24/00	04/26/00	16	96.4%
11	“ “	Enterprises	05/22/00	05/24/00	5	100.0%
12	“ “	Brokers	05/24/00	05/26/00	30	88.5%
13	“ “	Enterprises	05/29/00	05/31/00	11	90.7%
14	“ “	Banks	06/13/00	06/15/00	6	88.9%
15	“ “	NGO’s	06/20/00	06/22/00	12	90.9%
16	Telavi	Enterprises	06/27/00	06/29/00	12	94.4%
17	Kutaisi	Enterprises	07/04/00	07/06/00	21	94.2%
18	Rustavi	Enterprises	07/06/00	07/08/00	7	100.0%
19	Batumi	Enterprises	07/11/00	07/13/00	16	88.9%
20	Poti	Enterprises	07/18/00	07/20/00	6	100.0

21	Tbilisi	Brokers	09/14/00	09/18/00	8	97.2%
22	Tbilisi	Brokers	09/19/00	09/21/00	17	91.0%

### **Public Education**

#### **Benchmark(s):**

- Ten (10) workshops for the general public to explain the capital markets and concepts of investing
- Updated educational packets similar to the consumer education program of the U.S. Securities and Exchange Commission regarding investing and providing consumer protection information. (Completed. A self study guide was developed in conjunction with the development of the TV Programs).
- Public relations assistance to NSC/SIB, GSE and GSCD. (Completed. Barents sub-contractor, OSC, assumed responsibility for public relations/education for all economic reform projects in 1999. A separate contract was established for this assistance in 2000).

After conducting some preliminary research, it was determined that a series of TV programs would be a more effective means to deliver training to the general public. The TV programs were aired twice on Georgian National Television prior to the commencement of trading on the GSE in March of 2000. Self-study guides were developed to be used in conjunction with the broadcast of these programs. (See "Overview of Capital Markets and Investment Concepts Self Study Guide (English and Georgian)," April 2000).

## VII. Other Activities

### Tasks/Benchmarks

Several additional tasks/benchmarks were included in the original Task Order and subsequent modifications to support the overall capital markets development efforts in Georgia. The additional tasks/benchmarks were:

- Providing strategic advice to the MinSPM regarding the privatization process
- Developing a Shareholder Rights Association
- Promoting Associations
- Supporting the Georgian Securities Industry Association (GSIA)
- Assist the GSIA in developing a business plan

### Privatization

**Benchmark(s):** Provide strategic advice to the MINSPM regarding the privatization process. (Completed in July of 1999).

The analysis of potential tender candidates for the creation of the Exchange trading mechanism led the advisors to conduct an analysis of Joint Stock Companies and State Enterprises and ranked them in terms of potential for Exchange trading (See “State Holdings of Enterprises in Georgia” by Advisor Cowles, May 26, 1998 and “Enterprise Study Concluding Report” by Advisor Cowles in October 1998). The concluding report identified 87 enterprises for potential admission and highlighted the 58 with the greatest potential.

Recognizing the importance of quality listings for the Exchange, Advisor Maravita conducted follow-up studies of enterprises that were fully or partially owned by the government. Mr. Maravita provided policy advice for the MINSPM to improve the privatization process in Georgia (See “Suggested Improvements for the Privatization Process,” by Enzo Maravita on February 12, 1999 and “List of Registered Joint Stock Companies in which the State Owns Control Block of Shares,” by Enzo Maravita in July of 1999). A separate project was created in August of 1999 to provide additional support to the MINSPM.

### Shareholder Rights Association

**Benchmark(s):** Work to develop a shareholder rights association with a view towards promotion of corporate governance standards. (Not Applicable. Promotion of corporate governance and shareholder rights was provided through existing organizations).

Given the economic/market conditions in Georgia and the limited availability of support from donor agencies, the creation of an additional association was impractical. It was decided to use other natural advocates of shareholder rights (e.g., the NSC, the GSE and the Georgian Securities Industry Association (GSIA) to help champion this cause. In October and November

of 2000, the NSC conducted a series of presentations throughout Georgia with the assistance of OSC to promote shareholder rights.

### **Promote Associations**

**Benchmark(s):** Promote associations (i.e. Georgian Securities Industry Association “GSIA”), NGO’s and private sector entities advocating openness, transparency and accountability, in support of the capital market in particular and the market economy in general. (Completed. Provided throughout the project).

Barents efforts were focused on the support of the GSIA, since other NGO’s and private sector associations were supported by other economic reform projects in Georgia. Efforts were coordinated with the other reform projects when objectives overlapped.

### **Support of Georgian Securities Industry Association (GSIA)**

**Benchmark(s):** Assist the GSIA in member support and advocacy. (Completed. Assistance was provided to the GSIA throughout the project).

The GSIA was routinely included in discussions regarding key issues related to the capital markets development efforts in Georgia. Representatives of the GSIA commented on the various rules and regulations (e.g., Law on Securities Markets, Law on Entrepreneurs, Tax Code, Administrative Code, etc.) and participated in the Training Advisory Board that provided support to the Capital Markets Training Program. In return, Barents provided policy advice, office space and administrative support services to encourage its involvement.

### **GSIA Business Plan**

**Benchmark(s):** Assist the GSIA in development of a business plan with a view towards becoming a viable self-sustaining NGO. (Completed in July of 2000).

A comprehensive business plan was prepared for the Georgian Securities Industry Association (GSIA) by Advisor Matt Zimmermann, in July of 2000 (See “GSIA Business Plan,” by Matt Zimmermann in July of 2000). The business plan included a mission statement, market plan, operations plan and financial plan to help the organization clarify its development strategies and priorities. A financial model was developed that could be used to modify financial planning assumptions and experiment with different pricing and volume scenarios. The plan and model emphasized the importance of an integration of plans across functional areas. GSIA management used a modified version of the plan to assist them in securing a grant to cover the Securities Market Publication.

## **VIII. Current Market Conditions and Follow-up Required**

The following is a brief assessment of the current state of the securities markets in Georgia. Suggestions related to establishing priorities for future assistance are also included.

### **Current Market Conditions:**

The market infrastructure (systems and legislation) is substantially in place. Although market activity increased significantly in the fall of 2000, it was not sufficient to allow the Exchange and Depository to fund operations from membership and transaction fees. Until market activity increases, the organizations will have to depend on external funding to maintain the appropriate infrastructure for the securities markets. The ability of the Exchange to attract market activity is restricted by the ability of the NSC to monitor and enforce regulations and by the general economic conditions in Georgia.

The existing institutions responsible for monitoring and enforcing securities market regulations, the NSC, GSE and GSCD, might not have sufficient resources to fulfill these responsibilities. Without effective monitoring and enforcement capabilities, it will be difficult to improve the trust and confidence of potential investors and difficult for the Exchange to attract market activity.

The MOU signed between the MINSPM, the NSC, and the GSE regarding the use of the Exchange to facilitate privatization auctions is an indication that confidence in the established securities markets mechanisms is improving. If investor interest in admitted securities is limited, privatizations, initial public offerings and Exchange listings become even more critical to making quality products available to potential investors. It is important for the initial offerings to be successful to create a positive impression on other possible participants. It appears that there might still be some lingering educational/awareness issues regarding the benefits of using the securities markets to raise capital. Economic conditions and the availability of other sources of capital to potential issuers also have an impact on the ability of the Exchange to offer quality securities.

The most significant potential area for operational risk is the pre and post trade process of the GSE and GSCD. The existing process was designed to be safe and reliable to build trust with potential market participants, but it could create a bottleneck if trading activity increases significantly. The Romanian Central Depository software was installed and tested by the GSCD, but since there are some lingering concerns about its compatibility with the GSCD's current rules, process and interface with the Exchange system the interim system developed by the GSCD is still in use.

### **Next Steps/Priorities**

Since the commercial viability of the Exchange and Depository is dependent on market activity, it is imperative to reduce/remove all obstacles to legitimate trading activity. The following is a list of potential priorities for ongoing assistance to these organizations:

Process:

- Ensure the pre and post trade processes can support increased levels of market activity. It will be important to complete the evaluation of the feasibility of installing the software from the Romanian Depository. It will also be important to implement the other process improvements under consideration to improve the efficiency of the overall trading process. If transaction fees and other costs are too high or if the overall trading, clearance and settlement process is too slow, participants will have more incentives to avoid the market, if alternatives exist.
- Review the disaster recovery, back-up and contingency plans for the Exchange and Depository. These were included in the daily operation procedures of the organizations, but should be periodically reviewed/expanded.

Regulatory:

- Ensure sufficient resources exist at the NSC and/or the SRO's (Exchange and Depository) to monitor and enforce rules. The efforts associated with developing the legal framework have limited value if the resources do not exist to monitor and enforce them. This is supported by the findings of the team from Washington, DC that reviewed the inspection and enforcement capabilities of the NSC. Since funding is limited it is important to coordinate efforts between the organizations to improve prioritization and avoid duplication of effort.
- Enforce Corporate Governance and Shareholder Rights regulations, especially Disclosure and Financial Reporting Requirements (including compliance with International Accounting Standards). If the companies associated with the securities admitted for trading do not comply with these requirements it is unlikely that investors other than company insiders will feel comfortable committing capital to investments in the securities of these companies.
- Admit remaining securities for trading and enforce rules regarding processing transactions in Admitted Securities through the Exchange. The significant amount of OTC trading that occurred during the first five months of 2000, could be an indication that the existing rules are not being followed. It will be easier to monitor activity if it is all occurring in one place. It might also be easier for the NSC to monitor this activity, if a consolidated registry were created.

Business Development (Marketing/Public Relations):

- Provide follow-up training to market participants regarding marketing/business development to improve their ability to attract customers. This could be done in conjunction with a program to have the broker-dealer community assist with the privatization program, similar to the program that was used successfully in Armenia.
- Differentiate the securities available for trading on the Exchange. If the Exchange cannot use the Listing process to differentiate the more developed securities, consider separate segments for admitted securities.
- Continue to improve Public Awareness of the Securities Markets and the related protections provided to investors under the law. Although there are limited resources available to invest in the market currently, it will be important for investors to understand the potential benefits of investing in the securities markets.
- Continue to improve the Public Access to Securities Market Data and Information. Equal access to information will increase the confidence of potential investors. Currently, insiders and the larger players with the financial resources to gather information have a significant advantage over other potential participants.

- Provide additional follow-up training and/or educational/awareness programs regarding the benefits of using the securities markets to raise capital. These programs should be focused on company directors/managers and other influencers in the capital formation process (e.g., government officials).
- Secure an initial Exchange Listing, IPO, Privatization Auction and Municipal Bond. Assuming economic conditions become more favorable, it will be important to point out the benefits of raising capital via the securities markets to attract companies to the Exchange. Since the current process remains untested, it will be important to demonstrate initial success stories to attract others to use the markets.

### **Structure/Management of Future Assistance**

The best way to ensure the optimum level of investment in development and operating costs of securities markets institutions is to require market participants to pay for them. This requires them to balance the investment against their ability to generate reasonable profits. Since the securities market participants in Georgia did not have sufficient financial resources to supply the capital for the required infrastructure, it was necessary for them to receive the capital from external sources. This creates a dependence on external funding that can be difficult to break. The following are some recommendations to facilitate the transition of the Exchange and Depository to commercially viable entities:

- Provide direct funding for the remaining infrastructure items identified during the Project Close-Out process. The most important issue to address is the efficiency of the pre/post trade process. Once the infrastructure is completely in place, it becomes easier to hold the GSE and GSCD accountable for their ability to attract activity to the market.
- Provide direct funding for supplemental resources to monitor and enforce rules. Some resources exist at the NSC, but they might not be sufficient. Once rules are monitored and enforced it will be easier to hold the GSE and GSCD accountable for becoming commercially viable. This funding could be gradually reduced as market activity improves the ability of market participants to fund the necessary activities.
- Provide direct funding to support existing operating costs until obstacles to attracting market activity are removed. Since the ability of market participants to fund operating costs is also dependent on economic conditions, it might be necessary to fund operating costs until sufficient improvements in economic conditions occur. The initial tender proposal awarded to the GSE did not anticipate positive cash flow until the middle of the second year of operations even with a more optimistic set of forecasts for market participants and market activity.
- Provide direct funding for additional specific training, public relations and marketing programs for the organizations. Many of the programs completed during the development phase of the organizations should be augmented with follow-up programs to further improve the trust, confidence, awareness and understanding of the securities markets in Georgia. Benchmarks should be established to evaluate the effectiveness of these programs.
- Link future funding to key market indicators and completion of major milestones by the entities. Targets should be set for the gradual reduction of assistance as market activity improves the profitability of market participants. The organizations should be required to demonstrate the ability to collect an increasing portion of the funding from the participants as a condition for receiving future funding. Future funding should also be contingent upon the completion of agreed upon milestones (e.g. admission of all Reporting Companies for trading) to provide additional incentive for the organizations to complete the activities under their control.