The Pragma Corporation

Access to Credit Initiative

Fifth Quarterly Report

For the Period

October 1, 2005 – December 31, 2005

For the

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

GENERAL INFORMATION

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KYIV, UKRAINE

Table of Contents

A. PROJECT OVERVIEW

- I. PROJECT DESCRIPTION
- II. SIGNIFICANT EVENTS AND ACHIEVEMENTS
- III. PROJECT EXECUTIVE SUMMARY
- IV. PROJECT STAFFING
- V. ADMINISTRATIVE ISSUES

B. MORTGAGE

C. MUNICIPAL FINANCE

D. LEASING

E. CREDIT BUREAU

F. GENDER

ATTACHMENTS

A. PROJECT OVERVIEW

I. PROJECT DESCRIPTION

ATCI is tasked with developing the primary and secondary mortgage market with its associated infrastructure; increased capacity for the leasing industry including the development of certified leasing professionals; the ability for municipalities and utilities to use debt instruments to modernize vital infrastructure, and a credit bureau to facilitate the growth of credit for mortgages- and other retail lending. While the credit bureau component is subordinated to the mortgage component, it is being treated as a stand alone for purposes of implementation. The preliminary work plan was presented and accepted by USAID in November 2004.

In response to changing requirements for technical assistance, and a changing political landscape, the work plan is being reviewed quarterly for necessary adjustments. The CTO and COP are working closely to coordinate all technical assistance including defining expected outcomes for each planned activity and the results thereof.

ATCI is cooperating with numerous counterparts and expects to sign a series of formal protocols in addition to those already signed. These Protocols are expected to govern mutual activity as well as manage expectations during the course of the project.

The priorities of the Project for this period are noted by component in the boxes below.

The project update for this quarterly report will correspond to the activities set forth in the action plan described below and reported by component.

II. SIGNIFICANT EVENTS AND ACHIEVEMENTS

- PASSAGE OF THE MORTGAGE LAW
- MEETING WITH FIRST DEPUTY MINISTER OF FINANCE MAKSIUTA TAKES PLACE
- DELIVERED MORTGAGE CONFERENCE ON STATE OF MORTGAGE MARKET DEVELOPMENT IN UKRAINE – A STRATEGY FOR THE FUTURE.
- FIRST AND SECOND MODULES OF CML COURSE II COMPLETED
- SECOND REGIONAL MORTGAGE SEMINAR TO SSMSC DELIVERED

- CONFIDENTIALITY LETTER SIGNED WITH UKRAGAZ BANK.
- COMPLETED ASSESSMENT OF MORTGAGE (TERM-LIFE) INSURANCE IN UKRAINE
- PERFORMED LEAD MANAGER ROLE FOR IVANO-FRANKIVSK'S PILOT BOND ISSUE
- SECURED S&P CREDIT RATING FOR IVANO-FRANKIVSK
- COMPLETED AND DELIVERED BOND CAPACITY ASSESSMENT TO CHERKASSY.
- COMPLETED REPORT ON *Recent Changes In The Fiscal Environment Of Local Budgets In Ukraine And Their Impact On Appraising City Creditworthiness*
- MINISTRY OF FINANCE AGREES TO SPONSOR WORKSHOP ON CREATING A MUNICIPAL FINANCE FACILITY.
- CONCLUDED AGREEMENT WITH AMAKO AND BEGAN PROVSION OF ADVISORY SERVICES TO ASSIST IN ESTABLISHING UKRAINE'S FIRST CAPTIVE LESSOR OF AGRICULTURAL MACHINERY
- BEGAN DEVELOPMENT OF THE CONTENT STUDY GUIDE FOR THE CERTIFIED
- LEASE PROFESSIONAL (CLP) PROGRAM
- ATCI DRAFTS RFP FOR FIRST NATIONAL BUREAU OF CREDIT HISTORIES (FNBCH)
- CREDITINFO, D&B, KKB, CHUFA, AND TRANSUNION/CRIF. RESPOND TO TENDER
- CABINET OF MINISTERS AUTHORIZES MINISTRY OF JUSTICE TO LICENSE AND REGULATE CREDIT BUREAUS
- ATCI COMPLETES FIRST ANNUAL TEAM BUILDING RETREAT
- COP COMPLETES PRIVATE EQUITY MEMO FOR OEG OFFICE DIRECTOR GARY LINDEN

III. PROJECT EXECUTIVE SUMMARY

This Report provides details on the events and activities summarized below, as well as other events and activities regarding the USAID Access to Credit Initiative, as implemented by consultants for The Pragma Corporation (the Project), for the period from October 1, 2005 through December 31, 2005. The report is comprised of four components: Mortgage, Municipal Finance, Leasing and Credit Bureau. Each component section of the report will

have a summary with specific activity tasks identified and the status of each task with appropriate commentary, relevant attachments, and reference to administrative issues, if any.

Mortgage

For the mortgage component, this quarter can be characterized experienced as seminal with passage of the mortgage bond law in late December. ATCI worked with The World Bank and CLC to secure changes to the law that would ensure compliance with world standards of practice and set the stage for development of Ukraine's secondary mortgage market.

Separately, ATCI in cooperation with SMI and the Ministry of Finance prepared a delivered a major conference on development of the mortgage market in Ukraine for senior GOU leadership. The purpose was to frame policy choices that would determine future direction of the market development. The conference was organized at the request of First Deputy Minister of Finance Maksiuta and the First Deputy Chairman of the State Mortgage Institution (SMI), Sergiy Svyetko. Mr. Maksiuta met with ATCI during the course of planning to approve the agenda and organizational details.

As part of ATCI's continuing cooperation with the SSMSC that impacts the registration of any future securities issuance, ATCI agreed to deliver three seminars on the fundamentals of mortgage lending in three locations throughout Ukraine determined by the SSMSC. The first of these was delivered in Livov. Sixteen SSMSC staff members attended from eight regions.

ATCI continued its development of the primary mortgage in league with SMI and UNIA completing the second CML module of Course II. CML candidates receiving the training are from local financial institutions and the SMI.

Besides providing support to the SMI in its development as a liquidity facility, ATCI has been cooperating with three financial institutions UkrSibbank, Ukrsotsbank, and UkrGasBank to develop pilot mortgage bonds. Letters of confidentiality have been prepared for each bank for their review. To date, UkrGasBank has signed the agreement. Discussions with all banks have centered on alternative legal structures for issuance and have involved diagnostics regarding the complexion of their portfolios.

ATCI's third direction of activity in mortgage is development of associated market infrastructure. This includes the insurance market offering mortgage term – life insurance at affordable rates. To determine what emphasis should put on product development, ATCI commissioned an assessment of mortgage products offered by the insurance industry.

Municipal Finance

Intensive work on Ivano-Frankivsk's first bond generated Ministry of Finance approval, and enabled ATCI to develop expertise in preparation of SSMSC documents, an Investment Memorandum, and a competitive tender for underwriting services. ATCI produced detailed underwriter tender documents, SSMSC registration documents, draft Investment Memorandum, and received final Ministry of Finance approval for the borrowing in late December. The Standard & Poor's credit rating added real value to the city's bond preparations, and also provided staff analysts with an international-standard for comparison of their own work. ATCI also helped the city secure an innovative form of MinFin approval that

did not expire in 2005. At the end of the quarter, the City appeared to be on track for bond issuance in the first quarter of 2006.

ATCI withdrew temporarily from developing Cherkasy's bond, as the city's creditworthiness declined rapidly during 2005. Analysis revealed city to be in serious financial difficulty as of October 2005. ATCI advised the mayor that "we believe that the city does not currently have sufficient financial capacity to issue a UAH 5 million bond with the large margin of safety that the Access to Credit Initiative requires for pilot municipal bond cities."

Dr. Thirsk completed an analysis of how creditworthiness is affected by Ukraine's volatile intergovernmental finance system, and how we can identify creditworthy cities even in the volatile environment. As a result, ATCI has improved its methodology for evaluating the creditworthiness of cities.

Lastly, The Ministry of finance agreed to sponsor a January 27 workshop on establishing a municipal finance workshop. ATCI recruited nine speakers, drafted a preliminary agenda, secured a venue, and contacted the Ministry of Construction, Architecture and Housing and Communal Economy about acting as a co-sponsor.

Leasing

A service engagement *(Attachment 6)* was concluded with Amako Ukraine Ltd., a distributor of agricultural machinery in Ukraine. ATCI worked with senior management of Amako and its parent company American Machinery Company to facilitate their decision to establish its own finance company in Ukraine. Under the agreement, ATCI began working on the business plan for the finance company, which is to be completed in the next quarter. ATCI will provide further assistance to Amako in establishing the finance company, which is expected to occur in the second half of 2006. As Ukraine's first captive-lessor focused on the financing of agricultural equipment, its success or failure is likely to either encourage or discourage other sellers and producers of agricultural machinery to establish their own finance companies.

ATCI began the development of the Content Study-Guide for the CLP Program including participation by a few industry participants (Content Study-Guide table of Contents included as *Attachment 7*). Unfortunately, due to the illness of Ukrleasing Association's President, our main partner for the CLP Program, the association was mainly inactive for the quarter. This stalled progress with regard to finalizing roles and expectations with regard to the development and subsequent administering of the program. Things are expected to normalize in the next quarter and ATCI will engage the association in finalizing the plan for the program as well as their participation in its development.

Credit Bureau

At the request of FNBCH, ATCI drafted the RFP, which is the key tender document to engage a professional international credit bureau operator. This tender document was developed in compliance with international standards and best international practice.

Respondents to the tender document are expected to provide a separate business proposal on the information system delivery, specifications and servicing. Pricing Information with respect to the business proposal shall include the respondent's best estimate of costs and expenses and fees required of the FNBCB.

Tender bidders are also expected to specify a business model for the proposed credit bureau structure that would deal with information on natural persons and legal entities, as well as details of its implementation procedure (minimum required functionality and its extension options).

The RFP document was successfully distributed among the major credit bureau operators and subsequently tender proposals were submitted by the following companies: CREDITINFO, D&B, KKB, SCHUFA, AND TRANSUNION/CRIF. It is expected that as a result of this tender FNBCH will select a professional international partner whose input will be essential for securing successful credit bureau operation.

Development of credit bureau business plan and preparation of RFP for the engagement of profession international partner were the key highlights of cooperation between ATCI and AUB (which is one of FNBCH founders) as outlined in the Protocol on Cooperation. After the completion of these two major tasks, FNBCH again confirmed in writing its interest in cooperation with ATCI and on October 14, 2005 submitted to ATCI a letter requesting further assistance in the development of its credit bureau. This letter outlined areas of cooperation where ATCI input can secure maximum positive impact.

Lastly, the Cabinet of Ministers of Ukraine issued a Resolution in which it assigned the Ministry of Justice of Ukraine to serve as the authorized body responsible for licensing and regulation of credit bureau operations.

Gender

In Livov, twenty-two women of fifty-five participants (40%) participated in training that conveyed international standards of practice for the leasing industry. ATCI expects them to assert leadership within their respective businesses in matters related to the industry.

Other

The Director of OEG requested that ATCI prepare a brief analysis of state of the private equity market in Ukraine. It was delivered the day of the request.

ATCI completed its first team building retreat during the quarter. Project objectives and results for the year were presented to and reviewed by all staff; this was followed by staff participation in team building exercises that involved all staff.

IV. PROJECT STAFFING

The following personnel were engaged in project activities this quarter:

- David Lucterhand, Chief of Party
- Richard Genz, Senior Advisor, Municipal
- Rich Caproni, Senior Advisor, Leasing
- Javier Piedra, Senior Advisor, Credit Bureau
- Jim Aziz, Senior Advisor, Credit Bureau

- Bob Homans, Senior Advisor, Leasing
- Jim Butler, Senior Advisor, Mortgage
- Olexander Kopeikin, Advisor, Mortgage
- Natalia Rogozhina, Advisor, Mortgage
- Philip Fine, Advisor, Mortgage
- Steve Moody, Senior Advisor, Mortgage
- Sally Merrill, Senior Advisor, Mortgage
- Zhanat Kurmanov, Head of State Accumulation Pension Fund
- Ilya Goncharov, Director, Deutsche Bank Securities
- Elena Klepikova, Senior Operations Manager, International Finance Corporation, Moscow
- Achim Duebel, Consultant, Finpolconsult
- Palle Ulstrup, CEO, Attorney-at-Law, The Danish Association of Chartered Estate Agents
- Simon Walley, Head of Economic Affairs, European Mortgage Association
- Grigoriy Marchenko, President, Halyk Bank of Kazakhstan
- Wolfgang Kaelberer, Head of Brussels Office , Association of German Pfandbrief Banks

V. ADMINISTRATIVE ISSUES

NONE

B. MORTGAGE

I. COMPONENT DESCRIPTION

This Report provides details on the events and activities relating to the Mortgage Component of the USAID Access to Credit Initiative, as implemented by The Pragma Corporation, during the period from October 1, 2005 through December 31, 2005.

The primary purpose of the ATCI is to develop the primary and secondary mortgage market with its associated infrastructure. Primary market development involves legal review and addressing legislative deficiencies, the use of standardized documentation for underwriting and loan servicing, certification of personnel for mortgage lenders that results in a CML designation; technical assistance to financial institutions engaged in mortgage lending, and assessment of titling and all related processes. Development of the secondary market involves assistance to the newly formed state Mortgage Institution to become operational, development of national mortgage insurance as well as private, term life, and the structuring of mortgage-backed bonds with the appropriate legal environment for issuance. Associated market infrastructure involves appraisers, registration centers, real estate sales practitioners, and appropriate regulation.

While the credit bureau component is subordinated to the mortgage component, it is being treated as a stand alone for purposes of implementation.

II. SIGNIFICANT EVENTS

- PASSAGE OF THE MORTGAGE LAW
- MEETING WITH FIRST DEPUTY MINISTER OF FINANCE MAKSIUTA TAKES PLACE
- DELIVERED MORTGAGE CONFERENCE ON STATE OF MORTGAGE MARKET DEVELOPMENT IN UKRAINE – A STRATEGY FOR THE FUTURE.
- FIRST AND SECOND MODULES OF CML COURSE II COMPLETED
- SECOND REGIONAL MORTGAGE SEMINAR TO SSMSC DELIVERED
- CONFIDENTIALITY LETTER SIGNED WITH UKRAGAZ BANK.
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III. EXECUTIVE SUMMARY

For the mortgage component, this quarter can be characterized experienced as seminal with passage of the mortgage bond law in late December. ATCI worked with The World Bank and CLC to secure changes to the law that would ensure compliance with world standards of practice and set the stage for development of Ukraine's secondary mortgage market.

Separately, ATCI in cooperation with SMI and the Ministry of Finance prepared a delivered a major conference on development of the mortgage market in Ukraine for senior GOU leadership. The purpose was to frame policy choices that would determine future direction of the market development. The conference was organized at the request of First Deputy Minister of Finance Maksiuta and the First Deputy Chairman of the State Mortgage Institution (SMI), Sergiy Svyatko. Mr. Maksiuta met with ATCI during the course of planning to approve the agenda *(Attachment 1)* and organizational details.

Planning for the conference *The State of the Mortgage Market Today – A Strategy for the Future* was extensive and covered two days of activity with numerous topics related to market development *(Attachment 1).* A key area of discussion was the role subsidies play in the development of affordable housing. ATCI dedicated several presentations and a workshop to covey to policy makers that using subsidies to reduce interest rates is bad policy and has failed to produce the desired long-term results anywhere it has been tried. Also, definition of how the liquidity facility should function and its need for GOU capital was fully vetted. Registered participants (372) included senior officials from cabinet ministries, the Rada, regional governments, the NBU, banks, trade associations, market practitioners and media. Approximately 274 persons stayed for both days including the roundtables. Nineteen speakers made presentations or participated in workshops as panelists. That the mortgage bond law was not expected to pass during this session of the Rada is one measure of success. Another will be if the GOU determines that the use of subsidies is a poor policy and decides against using them. Lastly, one final measure will be if the SMI conducts its business as a true liquidity facility.

As part of ATCI's continuing cooperation with the SSMSC that impacts the registration of any future securities issuance, ATCI agreed to deliver three seminars on the fundamentals of mortgage lending in three locations throughout Ukraine determined by the SSMSC. The second of these was delivered Kiev. Nineteen SSMSC staff members attended from ten regions.

ATCI continued its development of the primary mortgage in league with SMI and UNIA completing the first and second CML modules of Course II. The fifteen CML candidates receiving the training are from local financial institutions and the SMI.

While the most significant event in terms of developing the secondary market was passage of the Mortgage Bond law, ATCI has been providing support to the SMI in its development as a liquidity facility, and cooperating with three financial institutions UkrSibbank, Ukrsotsbank, and UkrGasBank to develop pilot mortgage bonds. Letters of confidentiality have been prepared for each bank for their review. To date, UkrGasBank has signed the agreement. Discussions with all banks have centered on alternative legal structures for issuance and have involved diagnostics

regarding the complexion of their portfolios. In anticipation of the passage of the law "On Mortgage Bonds," ATCI senior advisors began developing mortgage portfolio reporting procedures and interviewing three potential bank/issuers. Accurate and timely mortgage pool reporting is the mainstay of "covered bonds" and, given that mortgage pools can contain thousands of individual mortgages, the reporting process must both very simple and highly automated.

In fact, the first criterion for qualifying a potential issuer is the degree of automation of its loan portfolio. The initial discussions with UkrSibbank, Ukrsotsbank and UkrGazBank revolved about the ability of the banks' software to extract specific information from loan ledgers and, subsequently, to generate specific reports on the condition of the mortgage pools. The "Report on the Condition of Mortgage Coverage" summarizes the key attributes of the mortgage pool: number of mortgages in the pool, current outstanding balance (value) of the pool, weighted average interest rate, weighted average term, and the percentage of residential (as opposed to commercial) mortgages. The issuer will make this report quarterly to the Trustee will in turn instruct the issue's auditor to verify or refute the issuer's claims.

Of course, for mortgage pools with thousands of mortgages (Ukrsotsbank's dollar-denominated mortgage pool contains more than five thousand mortgages), the auditor cannot examine every mortgage. Instead, the auditor randomly samples the pool; the size of the random sample is determined using specific statistical techniques involving two delimiters—precision intervals and confidence intervals. Using 95% confidence intervals (two standard deviations), it is possible to reduce the representative sample size to fewer than two hundred mortgages.

However, the auditor does not actually "audit" or "review" the representative sample; the auditor performs an "agreed-upon procedure," specifically designed to determine if the sample (and therefore the entire mortgage pool) conforms with the requirement in the law. For example, the procedure will check that all loans in the sample are standard (i.e., performing) assets, that the Loan to Value Ratio (LTV) does not exceed 75% and that commercial mortgages do not represent more than 15% of total mortgages. Such an agreed-upon procedure is considerably less time-consuming and expensive than an audit or a review.

From initial discussions, it appears that software at both Ukrsibbank and Ukrsotsbank will be able to sort the loan portfolios by required fields and generate the required reports. Ukrgazbank will have to conduct a test of its software.

ATCI's third direction of activity in mortgage is development of associated market infrastructure. This includes the insurance market offering mortgage term – life insurance at affordable rates. To determine what emphasis should put on product development, ATCI commissioned an assessment
(Attachment 2) of mortgage products offered by the insurance industry. Products are available though not mandatory. Many banks expressed reservations about requiring such insurance stating that the premium costs added to already high interest rate costs that resulted in many mortgages being pre-paid.

IV. ADMINISTRATIVE ISSUES

ATCI's role in shaping the final rules and regulations the SSMSC will draft for the implementation of the Mortgage Bond Law.

V. DESCRIPTION AND STATUS OF TASKS

Task 1. Mortgage - Certified Mortgage Lender Program

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **IUE review of training materials for applicability to Ukraine**	• WORK COMMENCED IN COOPERATION WITH THE UNIA AND SMI TO REVISE CML COURSEWORK FOR DELIVERY IN UKRAINE.
• **Selection of candidates for CML training**	• IN COOPERATION WITH UNIA AND SMI, ATCI SELECTED THE BANKS AND OTHER INSTITUTIONS FOR STAFF TRAINING.
• **Develop and administer CML training**	• COURSE MODIFICATION FOR DELIVERY IN UKRAINE IS COMPLETED AND READY FOR DELIVERY
• **Deliver two complete CML courses**	• DURING THE QUARTER, CML COURSES II MODULES 1 AND 2 WERE DELIVERED. FIFTEEN PERSONS ARE PARTICIPATING
• **Assess rural lending, titling registration, appraisal of profitable agricultural production units**	• THIS ACTIVITY IS EXPECTED TO BEGIN AFTER THE LAND LAW IS PASSED

Task 2. Mortgage - Assistance to Banks

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Standardize rules and procedures for retail mortgage lending**	• ATCI, EBED, UNIA, AND SMI HAVE ALL AGREED TO SET ONE STANDARD FOR MBS ISSUANCE. SOME BANKS ARE CHAFING AT USING THEM FOR COMPETITIVE REASONS. NONETHELESS, MORTGAGE BONDS WILL REQUIRE UNIFORM STANDARDS FOR ISSUANCE. ONCE PORTFOLIO ANALYSIS IS UNDERWAY, ATCI WILL BE ABLE TO DETERMINE THE EXTENT TO WHICH COMMON STANDARDS ARE BEING USED THROUGHOUT THE INDUSTRY.
• **Select candidate banks for receipt of on –site technical assistance**	• THE SAME BANKS THAT HAVE STAFF PARTICIPATE IN CML TRAINING WILL BE THE SAME WHO RECEIVE ON SITE TECHNICAL ASSISTANCE
• **Provide on – site technical assistance**	• THIS IS NOW UNDERWAY AT SEVERAL BANKS WHOSE STAFF HAVE ACHIEVED CML DESIGNATION

Task 3. Mortgage - Home Loan Guarantee

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Analyze market for existing mortgage insurance practices**	• THIS ASSESSMENT WAS COMPLETED DURING THE FOURTH QUARTER.
• **Assess legal and regulatory framework**	• ASSESSMENT IS CONTINGENT ON ATCI IDENTIFYING A CHAMPION .FOR TH E GUARANTEE FUND INSIDE THE GOU.
• **Complete Feasibility Study**	• THIS WILL COMMENCE AFTER COMPLETION OF THE ASSESSSMENT.
• **Complete Business Plan**	• THIS WILL FOLLOW THE FEASIBILITY STUDY
• **Assist in operational set-up of guarantee facility**	• NOTHING DONE THIS QUARTER
• **Provide on-site technical assistance to facility**	• NOTHING DONE THIS QUARTER
• **Promote the use of mortgage insurance**	• ATCI IS LOOKING FOR A SPONSOR TO DISCUSS THE ROLE OF A STATE MORTGAGE GUARANTEE FUND. DISCUSSIONS REGARDING THE USE OF PRIVATE MI WITH BANKS, UNMA AND THE NMB ARE ONGOING. ATCI CONTINUES TO PROMOTE THE IDEA WITH THE SMI.

Task 4. Mortgage - Life Insurance Products

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Analyze insurance and mortgage markets for existing products**	• ATCI COMPLETED AN ANALYSIS OF RELATED MORTGAGE INSURANCE PRODUCTS AS WELL AS THE INSTITUTIONS OFFERING THEM. SEVERAL COMPANIES ARE OFFERING MORTGAGE TERM-LIFE INSURANCE PRODUCTS. HOEWEVER, THE ASSESSMENT DETERMINED THAT BANKS ARE NOT REQUIRING THESE POLICIES BECAUSE THEY ADD TO THE COST OF THE MORTGAGE.
• **Assess legal and regulatory framework**	• NO ACTION TAKEN THIS QUARTER
• **Assess existing actuarial data**	• NO ACTION TAKEN THIS QUARTER
• **Select candidate insurers**	• ASSESSMENT PHASE IS UNDERWAY
• **Develop term sheet and rate structure**	• NO ACTION TAKEN THIS QUARTER
• **Draft Product policy**	• NO ACTION TAKEN THIS QUARTER
• **Conduct Road Show with mortgage lending banks and financial institutions**	• NO ACTION TAKEN THIS QUARTER

Task 5. Mortgage - Appraisers/Brokers Associations

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Assessment of UTO and other organizations**	• SOW PREAPRED FOR ASSESSMENT BY IRPF.
• **Facilitate development and use of unified methodology**	• NO ACTION TAKEN THIS QUARTER
• **Work with UAREP**	• NO ACTION TAKEN THIS QUARTER
• **Study tours to U.S.**	• NO ACTION TAKEN THIS QUARTER
• **Design, establish and sustain the transaction and price database**	• NO ACTION TAKEN THIS QUARTER

Task 6. Mortgage - Mortgage Backed Securities

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Establish Legal Working Group to assess legal and regulatory basis**	• ATCI PARTICIPATED IN WORKING GROUPS WITH UNIA AND CLC.TO AFFECT PASSAGE OF THE MORTGAGE BOND LAW. ATCI EXPXPECTS TO PARTICIPATE WITH UNIA AND THE SSMSC IN DRAFTING THE IMPLEMENTING RULES AND REGULATIONS.
• **Select Candidate Issuer**	• ATCI IS WORKING WITH UKRAGASBANK AND UKRASIBBANK.MOST PORTFOLIOS ARE DOLLAR DENOMINATED. MORTGAGES DENOMINATED IN LOCAL CURENCY ARE IMPORTANT TO MITIGATE CURRENCY RISK IN DOMESTIC ISSUANCE. THIS IS NOT THE CASE FOR INTERNATIONAL ISSUANCE. LETTERS OF CONFIDIENTIALITY HAVE BEEN GIVEN TO EACH BANK AND TO DATE; ATCI HAS EXECTUED AN AGREEMENT WITH UKRGASBANK. CURRENT ACTIVITY INVOLVES PORTFOLIO ANALYSIS TO DETERIMINE THE QUALITY OF MORTGAGE COLLATERAL AND SUITABILITY FOR ISSUANCE.
• **Draft investment memorandum**	• NOTHING DONE THIS QUARTER. FURTHER ACTION IS PREDICATED ON SELECTION OF PILOT CANDIDATES AND COMPLETION OF IMPLEMENTING RULES AND REGULATIONS.
• **Identify potential investors**	• THE COP HAS MET WITH POTENTIAL INSTITUTIONAL INVESTORS TO DESCRIBE THE POTENTIAL OF MORTGAGE BONDS AND TO GAGE INVESTMENT INTEREST. LIFE INSURANCE COMPANIES AND ASSET MANAGERS OF PRIVATE PENSION FUNDS APPEAR TO BE LIKELY INVESTORS BUT PFTS IS THE LIKELY MECHANISM FOR DISTRIBUTION • SMI HAS INVESTED AS PILOTS IN SOME WHOLE MORTGAGES PRECEDENT TO ANY SECURITIZED ISSUE.
• **Price and Place Issue**	• NO ACTION TAKEN THIS QUARTER

LIST OF ATTACHMENTS

ATTACHMENT 1 Mortgage Conference Agenda
ATTACHMENT 2 Mortgage Insurance Assessment

C. MUNICIPAL FINANCE

I. COMPONENT DESCRIPTION

The bond program of the Access to Credit Initiative helps cities and communal service enterprises issue long-term bonds for essential infrastructure. Intensive assistance from the program's team of Ukrainian and international experts in finance, accounting, and law will enable at least five municipalities or communal enterprises to issue bonds. The pilot bonds will demonstrate practices that creditworthy issuers employ to win investor confidence, such as transparent accounts, full disclosure, and financing capital projects that "pay for themselves" with cost savings. A training program will communicate the lessons learned from pilot bonds to city officials nationwide.

Pilot bonds will disclose legal and regulatory obstacles to bond issuance. The program's Legal Task Force on Municipal Issuance will develop solutions and advocate for their enactment. Stable, predictable central government transfers to municipalities, greater fiscal autonomy for cities, and full-cost recovery tariffs for utility companies will be key goals of the Legal Task Force. The Task Force will meet regularly throughout the five-year project, and will receive expert support on legal research and advocacy from the Commercial Law Center.

Key counterpart organizations supporting the bond program are the Association of Ukrainian Cities and the State Committee of Ukraine on Housing and Communal Economy.

II. SIGNIFICANT EVENTS AND ACHIEVEMENTS

- PERFORMED LEAD MANAGER ROLE FOR IVANO-FRANKIVSK'S PILOT BOND ISSUE
- SECURED S&P CREDIT RATING FOR IVANO-FRANKIVSK
- COMPLETED AND DELIVERED BOND CAPACITY ASSESSMENT TO CHERKASSY.
- COMPLETED DRAFT BOND CAPACITY ASSESSMENTS OF KOROSTEN AND BERDYANSK
- COMPLETED REPORT ON *Recent Changes In The Fiscal Environment Of Local Budgets In Ukraine And Their Impact On Appraising City Creditworthiness*
- DEVELOPED A BASIC REVENUE/EXPENDITURE FORCAST METHODOLOGY
- PRESENTED THREE DETAILED BRIEFINGS FOR ATCI STAFF ON INTER-GOVERNMENTAL FINANCE

- MINISTRY OF FINANCE AGREES TO SPONSOR WORKSHOP ON CREATING A MUNICIPAL FINANCE FACILITY.

III. EXECUTIVE SUMMARY

As development of a pooled finance facility became an additional, prominent objective, the municipal bond component effectively became the municipal finance component.

Intensive work on Ivano-Frankivsk's first bond generated Ministry of Finance approval, and enabled ATCI to develop expertise in preparation of SSMSC documents, an Investment Memorandum, and a competitive tender for underwriting services. This included several trips to the city and meetings with city staff at our offices in Kyiv. ATCI produced detailed underwriter tender documents, SSMSC registration documents, draft Investment Memorandum, and received final Ministry of Finance approval for the borrowing in late December. The Standard & Poor's credit rating added real value to the city's bond preparations, and also provided our analysts with an international-standard for comparison of their own work. ATCI also helped the city secure an innovative form of MinFin approval that did not expire in 2005. At the end of the quarter, the City appeared to be on track for bond issuance in the first quarter of 2006.

We withdrew temporarily from developing Cherkasy's bond, as the city's creditworthiness declined rapidly during 2005. Analysis revealed city to be in serious financial difficulty as of October 2005. ATCI advised the mayor that "we believe that the city does not currently have sufficient financial capacity to issue a UAH 5 million bond with the large margin of safety that the Access to Credit Initiative requires for pilot municipal bond cities." ATCI offered to meet with city officials in to discuss how our findings could be used as a blueprint to increase creditworthiness. Our goal is to assist Cherkasy with a bond when its finances can safely ensure repayment. (The city issued a UAH 5 million bond in December.)

Other effort entailed monitoring successive drafts of MinFin's proposed Law on Local Borrowings, including substantial changes from one to the next. The draft Law had not been approved by the Cabinet of Ministers as of the end of the quarter.

Dr. Thirsk helped members of the municipal team to understand how creditworthiness is affected by Ukraine's volatile intergovernmental finance system, and how we can identify creditworthy cities even in the volatile environment. In briefings, he explained the theory of the system and the practice, which differ in many respects.

With the objective of achieving better financial reporting, we met with the President of Ukrainian Association of Certified Accountants and Auditors to discuss the possibility of developing voluntary financial reporting standards to make city financial condition readily understandable to investors.

Lastly, in preparation for the January 27 workshop on establishing a municipal finance workshop, we recruited nine speakers, drafted a preliminary agenda, secured a venue, and

contacted the Ministry of Construction, Architecture and Housing and Communal Economy about acting as a co-sponsor.

Plan of Action

1. Finalize Bond Capacity Assessments for Korasten and Berdyansk.
2. Work intensively with Ivano-Frankivsk to issue its first bond in 2006 and list the bond on PFTS.
3. Generate GOU support for a municipal finance facility and begin task force meetings, including expert input with options paper.
4. Re-visit Cherkasy for possible 2006 bond issuance.
5. Continue to seek creditworthy communal service enterprises for bond issuance.
6. Identify new cities for pilot bond support, and contact them after March elections.

IV. ADMINISTRATIVE ISSUES

1. Complete preparation of municipal finance conference; determine whether Ministry of Construction, Architecture, Housing and Communal Services will also be a co-sponsor

2. ATCI issued a letter of deficiency to Olga Romanuk regarding her professional performance in several areas. She responded in writing to each deficiency. Both the Senior Advisor for Municipal Finance and ATCI's Chief of Party reviewed her response. Subsequently, Stepan Makovyak was assigned to cover Berdyansk and given the added responsibility of re-doing the Berdyansk bond capacity assessment previously assigned to Olga. The ATCI Chief of Party, after analyzing Olga's response and after receiving a recommendation from the Senior advisor for Municipal Finance, decided to request Olga's resignation.

V. DESCRIPTION AND STATUS OF TASKS

Task 1. Municipal Finance – Constraints to Bond issuance

Defined Activity	PROGRESS MADE DURING QUARTER/PROPOSED FUTURE ACTIONS
• **Monitor GOU intergov't finance practices for credit risks**	• DR. WAYNE THIRSK COMPLETED REPORT: *RECENT CHANGES IN THE FISCAL ENVIRONMENT OF LOCAL BUDGETS IN UKRAINE AND THEIR IMPACT ON APPRAISING CITY CREDITWORTHINESS.* DR. THIRSK CONDUCTED THREE BRIEFINGS FOR ATCI STAFF EXPLAINING THE INTERGOVERNMENTAL FINANCE SYSTEM THAT IS THE LIFELINE FOR MUNICIPAL FINANCE IN UKRAINE.
• **Participate in Drafting on Law on Local Borrowing**	• ATTORNEY SERHIY YURHELEVICH MONITORED CHANGES IN TWO NEW DRAFTS OF THE LAW ON LOCAL BORROWING. WE ARRANGED A TWO-DAY JANUARY VISIT BY INTERNATIONAL MUNICIPAL FINANCE LEGAL EXPERT, MICHAEL A. DEANGELIS.

Task 2. Municipal Finance – Prepare for a Pilot Issue

Defined Activity	PROGRESS MADE DURING QUARTER/PROPOSED FUTURE ACTIONS
• **Initiation of pilot**	• DELIVERED FINAL BOND CAPACITY ASSESSMENT FOR CHERKASY AND ADVISED CITY THAT ATCI WOULD DEFER INVOLVEMENT ON CITY BOND ISSUE UNTIL CITY FINANCES STABILIZE AND SURPLUS IS RESTORED. COMPLETED DRAFTS OF TWO MORE BOND CAPACITY ASSESSMENTS, BERDYANSK AND KOROSTEN. DEVELOPED BASIC REVENUE AND EXPENSE FORECAST METHODOLOGY.

Task 3. Municipal Finance – Issuance

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Implementation**	• HELPED IVANO-FRANKIVSK SECURE FINAL APPROVAL FROM MINFIN FOR THE CITY'S FIRST BOND ISSUE. PREPARED DETAILED TENDER DOCUMENT WHICH THE CITY ISSUED FOR COMPETITIVE SELECTION OF UNDERWRITER. PREPARED DRAFT SSMSC SUBMISSION AND DRAFT INVESTMENT MEMORANDUM. STANDARD & POOR'S PREPARED INTERNATIONAL AND DOMESTIC CREDIT RATING FOR THE CITY, PAID FOR BY ATCI. CITY'S INTERNATIONAL RATING B+ CONFIRMED ATCI'S POSITIVE ASSESSMENT OF CREDITWORTHINESS.

Task 4. Municipal Issuance – Legislation and Dissemination

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Workshops and public education**	• SECURED MINFIN AGREEMENT TO SPONSOR A WORKSHOP ON ESTABLISHING A MUNICIPAL BOND BANK ON JANUARY 27. RECRUITED NINE INTERNATIONAL EXPERTS.

LIST OF ATTACHMENTS

ATTACHMENT 3 Wayne Thirsk. *Recent Changes In The Fiscal Environment Of Local Budgets In Ukraine And Their Impact On Appraising City Creditworthiness.*

ATTACHMENT 4 ATCI Recommendations for Tender to be Used by Cities Selecting Bond Underwriter.

D. LEASING

I. COMPONENT DESCRIPTION

This report details events and activities relating to the Leasing Component of the USAID Access to Credit Initiative, implemented by the Pragma Corporation, during the period from October 1 through December 31, 2005.

The primary purpose of the Leasing Component is not only to create a supportive environment for modern financial leasing but to provide specific technical, advisory, and training assistance in order to increase access to credit throughout Ukraine. Leasing is an efficient alternative to bank financing.

ATCI will aim to strengthen existing leasing companies. Capacity building will consist of training and consulting for lessors, lessees, farmers, regulators, and other interested parties, such as vendors and banks. In addition, ATCI will seek potential foreign and local investors as well as conduct public awareness efforts.

Moreover, the Leasing Component will develop the cadre of leasing professionals by introducing the Certified Leasing Professional Program (CLPP), a designation for market participants so that they may attain world standards of practice.

ATCI will continue to support and/or develop the proper legislative and regulatory framework to support the leasing industry and facilitate the entry of foreign capital into the leasing sector.

II. SIGNIFICANT EVENTS

- PROVIDED ADVISORY SERVICES TO UKRAINE'S FIRST SMALL-TICKET LESSOR TO IMPROVE THEIR BUSINESS STRATEGY AND PREPARE APPROPRIATE PROPOSALS FOR POTENTIAL FUNDING SOURCES

- CONCLUDED AGREEMENT WITH AMAKO AND BEGAN PROVSION OF ADVISORY SERVICES TO ASSIST IN ESTABLISHING UKRAINE'S FIRST CAPTIVE LESSOR OF AGRICULTURAL MACHINERY

- ATTENDED LEASEUROPE CONFERENCE WITH FOUR LEASING COMPANIES TO ENCOURAGE ENTRANCE OR INVESTMENT INTO THE UKRAINIAN LEASING MARKET BY EUROPEAN BANKS AND LEASING COMPANIES;

- DELIVERED EDUCATIONAL SEMINAR FOR LESSEES, EQUIPMENT VENDORS, AND OTHER INDUSTRY PARTICIPANTS IN LVIV

- BEGAN DEVELOPMENT OF THE CONTENT STUDY GUIDE FOR THE CERTIFIED LEASE PROFESSIONAL (CLP) PROGRAM

III. EXECUTIVE SUMMARY

In this quarter, ATCI focused on the capacity building of market participants through delivering advisory services and training, attracting investors and banks to Ukraine's leasing market, and developing the market infrastructure.

ATCI concluded an agreement (See Attachment 6) to provide consulting services to LeaseIT, Ukraine's first small-ticket lessor (average transaction size of 3,000 USD). ATCI helped LeaseIT refine key aspects of their operations and business strategy as well as created financial models and proposals for LeaseIT to provide to funding sources of both equity and debt financing. The project will continue to provide assistance to LeaseIT to improve its pricing strategies and secure appropriate financing through the first half of 2006. LeaseIT's success or failure is likely to have a significant impact on the pace with which a small-ticket leasing market in Ukraine develops.

A second consulting service engagement (Attachment 7) was concluded with Amako Ukraine Ltd., a distributor of agricultural machinery in Ukraine. ATCI worked with senior management of Amako and its parent company American Machinery Company to facilitate their decision to establish its own finance company in Ukraine. Under the agreement, ATCI began working on the business plan for the finance company, which is to be completed in the next quarter. ATCI will provide further assistance to Amako in establishing the finance company, which is expected to occur in the second half of 2006. As Ukraine's first captive-lessor focused on the financing of agricultural equipment, its success or failure is likely to either encourage or discourage other sellers and producers of agricultural machinery to establish their own finance companies.

Additional advisory services focused on three main types of activity: a) assisting leasing companies to access financing sources including equity financing, credit lines, and post-import financing from agencies such as US ExIm Bank; b) working with leasing companies in establishing relationships with equipment vendors and developing financial products tailored to the needs of these vendors' customers; and c) providing ad hoc advisory services on tax, legal, and credit issues, typically on a transactional basis.

ATCI began the development of the Content Study-Guide for the CLP Program including participation by a few industry participants (Content Study-Guide table of Contents included as Attachment 8). Unfortunately, due to the illness of Ukrleasing Association's President, our main partner for the CLP Program, the association was mainly inactive for the quarter. This prohibited progress with regard to finalizing roles and expectations with regard to the development and subsequent administering of the program. Things are expected to normalize in the next quarter and ATCI will engage the association in finalizing the plan for the program as well as their participation in its development.

ATCI has partnered with USAID's Farmer-to-Farmer (FtF) Program, administered by the Citizens Network for Foreign Affairs (CNFA), to develop a series of three training / consulting assignments for Ukrainian lessors to assist them in developing and implementing an agricultural leasing program based on International best practices. The first of three assignments will be conducted next quarter. The descriptions of the FtF volunteer assignments may be found in Attachment 9.

ATCI delivered its training seminar, "Leasing Practice in Ukraine," for equipment vendors, potential lessees, banks and government officials in Lviv. (Seminar Invite and Agenda in Attachment 10). ATCI will continue to deliver such educational seminars for market participants, in additional regions of Ukraine.

ATCI provided technical assistance to the new leasing association, The Ukrainian Union of Lessors (UUL), in establishing its development strategy and increasing its membership. ATCI also accompanied four founding members of UUL and paid for the travel of the association's Executive Director to attend Leaseurope's annual conference in early October. ATCI worked with UUL to develop and distribute a CD containing information on Ukraine's leasing industry to conference participants.

The goal of the trip was to establish contacts and attract interest by European banks and leasing companies in Ukraine's leasing industry, one of the project's key objectives. ATCI has maintained relationships and provided relevant market data to continue encouraging some of Europe's largest banks and lessors to enter the Ukrainian market. Subsequently three of them have established plans to enter the Ukrainian market, (Bank Austria - Creditanstaldt Leasing, Raiffeisen Leasing, and Societe Generale Equipment Finance). ATCI will continue to contact and provide relevant information to potential market entrants in order to encourage them to enter the market.

ATCI worked with other TA projects and industry associations to hold three round-tables focused on tax and legal reforms to facilitate industry growth in order to gather support among industry stakeholders and relevant government officials. These events resulted in significant press (TV and print) coverage and resulted in initiatives on behalf of members of Parliament and the Cabinet of Ministers to introduce reforms. ATCI worked together with IFC to deliver a seminar for journalists on the benefits of leasing and the necessary steps for the development in Lviv.

ATCI worked with the Ministry of Economy, which prompted them to initiate a, "Government Program for the Development of the Leasing Industry for 2006-2010."ATCI has been included in the working group under the Cabinet of Ministers of Ukraine to develop the document and present it for approval at the CabMin level. ATCI also provided a series of proposals to the Ministry of Finance on tax policies, (Letter from USAID and attachments included in Attachment 11), that have been effective in facilitating the growth of the leasing industry and investment in fixed assets in other countries. ATCI will continue working with all above named parties to facilitate the creation of a more favorable tax and legal environment for the development of Ukraine's leasing industry.

IV. ADMINISTRATIVE ISSUES

The President of Ukrleasing Association, the project's main partner for the CLP Program, was ill and the association was mainly inactive for the quarter. Progress, therefore, was delayed in finalizing roles and expectations with regard to the development and subsequent administering of the program. Things are expected to normalize during the next quarter and ATCI will engage the association in finalizing the plan for the program as well as their participation in its development.

V. DESCRIPTION AND STATUS OF TASKS

Task 1. Financial Leasing – Building Participant Capacity

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Development of CLP Program for Ukraine**	▪ COMMENCED DEVELOPMENT OF CLP PROGRAM CONTENT STUDY-GUIDE, INVOLVING PARTICIPATION FROM INDUSTRY PARTICIPANTS. ▪ THE NEXT QUARTER WILL FOCUS ON THE DEVELOPMENT OF CLP PROGRAM CONTENT STUDY-GUIDE AND TRAINING MODULES AND SOLIDIFYING ROLES AND EXPECTATIONS WITH UKRLEASING ASSOCIATION REGARDING THE FUTURE ADMINISTRATION OF THE PROGRAM.
• **Develop and deliver training seminars for industry participants**	▪ DEVELOPED AND DELIVERED AN EDUCATIONAL SEMINAR (IN LVIV) ON 'LEASING PRACTICE IN UKRAINE,' FOR INDUSTRY STAKEHOLDERS SUCH AS POTENTIAL LESSEES, VENDORS, GOVERNMENT OFFICIALS AND BANKS. PARTICIPANTS INCLUDED 22 WOMEN. ▪ PARTNERED WITH USAID'S FARMER-TO-FARMER PROGRAM TO DEVELOP A SERIES OF TRAINING AND CONSULTING ASSIGNMENTS FOR UKRAINIAN LESSORS ON LEASING OF AGRICULTURAL MACHINERY. THE FIRST OF THREE ASSIGNMENTS WILL TAKE PLACE NEXT QUARTER.

Task 2. Financial Leasing – Information Network

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Work with key industry stakeholders to agree upon necessary reforms to create a favorable legal, tax and regulatory environment for leasing in Ukraine**	▪ ATCI PROVIDED TECHNICAL ASSISTANCE TO THE UKRAINIAN UNION OF INDUSTRIALISTS AND ENTREPRENEURS IN THEIR EFFORTS TO DEVELOP A DRAFT LAW THAT WOULD IMPROVE THE LEGAL AND TAX ENVIRONMENT FOR LEASING IN UKRAINE. ▪ ATCI WORKED WITH THE MINISTRY OF ECONOMY AND PARTICIPATED IN A ROUND-TABLE TO ENCOURAGE THE ESTABLISHMENT OF A 'GOVERNMENT PROGRAM TO DEVELOP UKRAINE'S LEASING INDUSTRY FOR 2006-2010." IN THE NEXT QUARTER, ATCI WILL PARTICIPATE AS A MEMBER OF THE WORKING GROUP FORMED UNDER THE CABINET OF MINISTERS TO FINALIZE THE DOCUMENT AND PRESENT IT FOR APPROVAL. ▪ ATCI WILL CONTINUE TO WORK WITH INDUSTRY STAKEHOLDERS TO RAISE THE PROFILE OF LEASING AND INITIATE LEGISLATIVE REFORM TO IMPROVE THE LEGAL AND TAX ENVIRONMENT FOR LEASING IN UKRAINE.
• **Conduct nation-wide informational and educational campaign on international best practice in leasing**	▪ ATCI WORKED WITH INDUSTRY ASSOCIATIONS AND OTHER TA PROJECTS TO HOLD THREE ROUND-TABLES AND DISTRIBUTE INFORMATION IN ORDER GATHER SUPPORT FOR TAX AND LEGAL REFORMS AMONG INDUSTRY STAKEHOLDERS AND RELEVANT GOVERNMENT OFFICIALS. THESE EVENTS RESULTED IN SIGNIFICANT PRESS (TV AND PRINT) COVERAGE AND RESULTED IN INITIATIVES ON BEHALF OF MEMBERS OF PARLIAMENT AND THE CABINET OF MINISTERS TO INTRODUCE REFORMS. ▪ ATCI, TOGETHER WITH IFC, DELIVERED A SEMINAR IN LVIV FOR JOURNALISTS FROM WESTERN UKRAINE ON THE BENEFITS OF LEASING AND THE NECESSARY STEPS FOR THE INDUSTRY'S DEVELOPMENT IN UKRAINE, RESULTING IN SEVERAL ARTICLES IN LOCAL PUBLICATIONS. ▪ ATCI WILL CONTINUE TO WORK WITH INDUSTRY ASSOCIATIONS TO ORGANIZE EVENTS AND DISTRIBUTE INFORMATION THAT RAISES THE PROFILE AND INCREASE UNDERSTANDING OF LEASING AND ITS BENEFITS WITHIN THE GOVERNMENT AND BUSINESS COMMUNITIES.

Task 3. Financial Leasing - Consulting Services

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Provide advisory services to market participants**	▪ PROVIDED CONSULTING SERVICES TO UKRAINE'S FIRST SMALL-TICKET LESSOR TO REFINE BUSINESS STRATEGY AND ATTRACT BOTH EQUITY AND DEBT FINANCING. ▪ PROVIDED CONSULTING SERVICES TO AMAKO TO ASSIST THEM IN ESTABLISHING UKRAINE'S FIRST CAPTIVE LESSOR OF AGRICULTURAL MACHINERY. ▪ PROVIDED ADVISORY SERVICES AND FACILITATED RELATIONSHIP BUILDING BETWEEN VARIOUS LESSORS, BANKS, EQUITY INVESTORS, AND VENDORS TO ENABLE INCREASED LEASING ACTIVITY BASED ON INTERNATIONAL BEST PRACTICE. ▪ IN THE NEXT QUARTER, WILL CONTINUE PROVIDING CONSULTING SERVICES TO LEASEIT AND AMAKO. ▪ ATCI WILL CONTINUE TO FACILITATE RELATIONSHIPS BETWEEN LESSORS, BANKS, EQUITY INVESTORS, AND VENDORS TO FACILITATE INCREASED LEASING ACTIVITY BASED ON INTERNATIONAL BEST PRACTICE.

LIST OF ATTACHMENTS

ATTACHMENT 5 Engagement Letter and Confidentiality Agreement Between ATCI & Lease-IT

ATTACHMENT 6 Engagement Letter and Confidentiality Agreement Between ATCI & Amako

ATTACHMENT 7 Table of Contents for CLP Program Content Study- Guide

ATTACHMENT 8 Project Strategy and Scopes of Work for the Series of Three Training/Consulting Assignments for Ukrainian Lessors to be jointly implemented by ATCI and FTF

ATTACHMENT 9 Agenda and List of Participants for Leasing Practice in Ukraine, Seminar held in Lviv for Managers of Potential Lessees, Vendors, Government Officials and Banks.

ATTACHMENT 10 Letter and Other Attachments provided to Ukraine's Ministry of Finance Regarding Tax Policies that would facilitate Growth of the Leasing Industry as well as Increase Investment in fixed assets.

D. CREDIT BUREAU/CREDIT RATING AGENCY

I. COMPONENT DESCRIPTION

Credit Bureau

This report provides details on events and activities relating to the Credit Bureau component of the USAID Access to Credit Initiative, as implemented by the Pragma Corporation, during the period from October 1, 2005 through December 31, 2005.

The objective of this activity is to establish and develop a Credit Bureau in Ukraine, which is a key piece of financial infrastructure. A Credit Bureau serves as a financial intermediary between the lender and the borrower in order to stimulate, in the first instance, the SME and retail markets within a free market competitive economic system.

The practical definition of a Credit Bureau, for design and implementation purposes in Ukraine, is one of an impartial entity that will store all past and present credit transactions entered into by a particular legal or physical person, and one that will indicate the manner in which the subject of the credit profile repaid the obligation to the respective creditors. The Credit Bureau would contain gender-neutral demographic information on a consumer to ensure proper identification, information that is pertinent to their creditworthiness, and an indication of the overall risk relating to an applicant. The Credit Bureau will provide an avenue for the verification or validation of any information that may be questioned or disputed by the subject of the credit profile. A Credit Bureau serves both parties in a credit transaction and is an excellent tool to reduce risk and facilitate and accelerate the approval process.

II. SIGNIFICANT EVENTS

- ATCI DRAFTS RFP FOR FIRST NATIONAL BUREAU OF CREDIT HISTORIES (FNBCH)
- CREDITINFO, D&B, KKB, CHUFA, AND TRANSUNION/CRIF. RESPOND TO TENDER
- ATCI PRESENTS AT BANKING CONFERENCE (ATTENDED BY THE LEADING UKRAINIAN BANKS).
- FNBCH REQUESTS FURTHER ATCI ASSISTANCE
- CREDIT INFO ALSO REQUESTS FURTHER ATCI ASSISTANCE
- CABINET OF MINISTERS AUTHORIZES MINISTRY OF JUSTICE TO LICENSE AND REGULATE CREDIT BUREAUS

- ARTICLE PUBLISHED ON THE IMPACT OF AN EFFECTIVE CREDIT REPORTING SYSTEM IN DEVELOPING CREDIT MARKETS.

- ATCI BEGINS DRAFTING THE IMPLEMENTING REGULATIONS GOVERNING CREDIT BUREAU OPERATIONS IN UKRAINE.

III. EXECUTIVE SUMMARY

ATCI continued to finalize the credit bureau business plan, to provide on-going consultancy to ensure compliance with international standards of best practice during the development phase of a credit reporting system, and to provide advise primarily focused on data sharing and the reduction of data fragmentation.

Moreover, ATCI further helped to consolidate the interests of commercial banks to fund a private credit bureau, and to deepen the market's awareness of a credit bureau's role in risk and portfolio management. ATCI, based on experience in other markets and interviews in country, understands the educational challenges in communicating to all stakeholders the importance of data sharing.

ATCI continues to interface on a regular basis with both the First Credit Bureau of Ukraine, the Association of Ukrainian Banks and other interested parties, including foreign credit bureau operators. Major highlights and accomplishments over the past quarter follow:

1. RFP and Tender Proposals Submitted by International Credit Bureau Operators.

At the request of FNBCH, ATCI drafted the RFP, which is the key tender document to engage a professional international credit bureau operator. This tender document was developed in compliance with international standards and best international practice.

Respondents to the tender document are expected to provide a separate business proposal on the information system delivery, specifications and servicing. Pricing Information with respect to the business proposal shall include the respondent's best estimate of costs and expenses and fees required of the FNBCB.

Tender bidders are also expected to specify a business model for the proposed credit bureau structure that would deal with information on natural persons and legal entities, as well as details of its implementation procedure (minimum required functionality and its extension options). The proposal will include the following blocs, corresponding to the projected stages of the system development:

- sharing information on natural persons (minimum functionality);
- sharing information on natural persons (extension of minimum functionality to the optimum one);
- sharing information on legal entities (minimum functionality);

- sharing information on legal entities (extension of minimum functionality to the optimum one);
- sharing insurance information (minimum functionality);
- sharing insurance information (extension of minimum functionality to the optimum one);
- sharing additional information and other functionality extensions.

The RFP document was successfully distributed among the major credit bureau operators and subsequently tender proposals were submitted by the following companies: CREDITINFO, D&B, KKB, SCHUFA, AND TRANSUNION/CRIF. It is expected that as a result of this tender FNBCH will select a professional international partner whose input will be essential for securing successful credit bureau operation.

2. Banking Conference

In the beginning of October, ATCI participated in a banking conference attended by the leading Ukrainian banks, as well as representatives of donor and credit bureau community. ATCI made a presentation on the importance of credit reporting system and effective use of credit bureau products. The goal of this presentation was to further help consolidate the interest of commercial banks to fund a private credit bureau, and to deepen the market's awareness of a credit bureau's role in risk and portfolio management, as well as the importance of data sharing and the reduction of data fragmentation.

3. FNBCH Request for Further Assistance

Development of credit bureau business plan and preparation of RFP for the engagement of profession international partner were the key highlights of cooperation between ATCI and AUB (which is one of FNBCH founders) as outlined in the Protocol on Cooperation. After the completion of these two major tasks, FNBCH again confirmed in writing its interest in cooperation with ATCI and on October 14, 2005 submitted to ATCI a letter requesting further assistance in the development of its credit bureau. This letter outlined areas of cooperation where ATCI input can secure maximum positive impact. These areas of cooperation include the following:

- Work with banks and other financial institutions.
- Work with non-financial institutions to secure their participation in data sharing.
- Work on the documents that govern credit bureau operations.
- Work with governmental institutions.
- Public awareness activities.
- Work in the regions.

Full English version of this letter is attached to this Quarterly Report.

4. CreditInfo Request for Assistance

Although FNBCH is ATCI's primary counterpart, the Project is open to cooperation with all interested parties as long as activities promote market development and reduction of data

fragmentation. In this context, ATCI maintains cooperation with Experian and other operators. More specifically, ATCI maintains relatively close contacts with CreditInfo, which is one of the leading international credit bureau operators. It has established its own credit bureau in Ukraine (CreditInfo partners in Ukraine include Financial and Investment Group "TAC" and National Association of Credit Unions). On November 21, 2005 CreditInfo-Ukraine submitted a letter requesting ATCI assistance in the development of credit reporting system in Ukraine. Pursuant to this letter ATCI assistance is required in the following areas:

Educating market participants:

- Preparation and holding of training and seminars for banks, insurance companies, credit unions and other financial institutions with participation of international consultants and ATCI/USAID experts.
- Preparation and holding of training for journalists and other mass media representatives.
- Preparation of educational materials for both creditors and borrowers.

Support to the relevant state authorities in regulation of lending-related issues and development of credit reporting, in particular:

- Provide consultation to experts of the National Bank of Ukraine on regulation of lending-related issues and compliance with the Basel requirements.
- Consultations on preparation of documents for the authorized body called to regulate credit bureau operations.
- Training seminars for the specialists of relevant state authorities, etc.

Support for the development of credit unions and credit bureaus in Ukraine:

- Credit unions at the regional and local levels require a high quality information about the importance of the exchange of credit information, in particular, about rights of access and use of such information;
- Clients of credit unions must understand how the exchange of positive information meets the interests of good faith borrowers.

Full version of the above mentioned letter is attached to this report (ATTACHMENT___). ATCI is committed to cooperation with all interested parties and will continue its cooperation with CreditInfo for the establishment and development of credit reporting system in Ukraine.

5. Authorized Body Responsible for Regulation of Credit Bureau Operations in Ukraine and Development of Credit Bureau Related Regulations

On December 7, 2005 the Cabinet of Ministers of Ukraine issued a Resolution in which it assigned the Ministry of Justice of Ukraine to serve as the authorized body responsible for licensing and regulation of credit bureau operations. Pursuant to the Ukrainian Credit Bureau Law the authorized body is mandated to draft (within three months) the regulations governing licensing requirements and other rules for credit bureau operations in Ukraine. Pursuant to the request of FNBCH, ATCI has started work on drafting the above mentioned regulations.

However, considering the very complex nature of this task, its successful fulfillment will significantly depend on the degree of cooperation and input from all interested parties.

6. Legal Changes

The Law of Ukraine "On Amending Certain Laws of Ukraine to Improve Legal Regulation of International Cooperation for Prevention of Terrorism Financing" will come into force as of January 1, 2006. This Law amends the Law of Ukraine "On Banks and Banking Activity" and authorizes the National Bank of Ukraine to adopt regulations on safe-keeping, protection, use, and disclosure of information that represents banking secret. The consequences of this amendment are so far unclear. However, potentially this amendment can lead to contradictory regulations or confrontation between the National Bank of Ukraine and the Ministry of Justice which (pursuant to the Ukrainian Credit Bureau Law and Resolution of the Cabinet of Ministers of Ukraine) was assigned to serve as the authorized body regulating credit bureau operations in Ukraine.

The State Commission of Ukraine for Regulation of Financial Services Market placed on its web site the draft decree related to new requirements for credit unions. Under this draft decree, the total amount of capital that a credit union may contribute may not exceed 50% of total credit union capital. On the one hand, this ruling can prevent small credit unions from participation in credit bureaus. On the other hand, the ruling may lead to the consolidation of credit unions and drive them to merge in order to be eligible to participate as a shareholder in a credit bureau. Currently this draft decree is being considered and discussed by interested market participants.

7. FNBCH Tender

By year end 2005 FNBCH has not made a decision on the successful tender bidder. Considering the fact that pursuant to the RFP tender proposals are valid for 90 days, FNBCH will have to make its decision regarding the tender winner by the end of January – beginning of February 2006.

IV. ADMINISTRATIVE MATTERS

NONE

V. DESCRIPTION AND STATUS OF TASKS

Defined Activity	PROGRESS MADE DURING QUARTER/PROPOSED FUTURE ACTIONS
• **Develop and establish linkages with primary international credit bureau operators**	• CREDITFO MOVES BEYOND ESTABLISHING COMPANY AND BEGINS TO MARKET ITS STRENGTHS TO BANKING SECTOR. OTHER INTERNATIONAL CREDIT BUREAU OPERATORS RECONFIRM INTEREST IN UKRAINE. DISCUSSIONS CONTINUE WITH EXPERIAN (UK), CRIF (ITALY/CZECH REPUBLIC) AND D&B (SIGNAPORE).
• **Secure buy-in of local data providers and users**	• MARKET REMAINS SPLIT – DATA FRAGMENTATION BECOMING A REALITY AS IT APPEARS THAT AT LEAST 4 CREDIT BUREAUS WILL BE ESTABLISHED. • ARTICLE PUBLISHED ON THE IMPACT OF AN EFFECTIVE CREDIT REPORTING SYSTEM IN DEVELOPING CREDIT MARKETS. • ATCI PRESENTS AT BANKING CONFERENCE (ATTENDED BY THE LEADING UKRAINIAN BANKS)
• **Sponsor visits to potential foreign CB partners**	• NO ACTION BUT ANTICIPATED WITHIN THE NEXT 4 MONTHS
• **Determine and review CIC development strategy with government and counterparts**	• FNBCH REQUESTS FURTHER ATCI ASSISTANCE • CONTINUED TO DISCUSS WITH AUB AND OTHER REPRESENTATIVES OF THE CIC (OR FCB) DEVELOP IMPLEMENTATION STRATEGY FOR THE DEVELOPMENT OF CB.
• **Market best approach for structuring, establishing and operating CIC**	• PUBLIC RELATIONS STRATEGY CONTINUED, AND INCLUDED VISITS TO INDIVIDUAL MARKET PARTICIPANTS. • WILL BE HARD SELL TO GET TELECOMMUNICATIONS SECTOR TO WORK WITH BANKS – WORK CONTINUES TO CONVINCE THEM.
• **Analyse and Coordinate passage of law**	• IN JULY 2005, THE PRESIDENT OF UKRAINE, FOLLOWING PASSAGE BY PARLIAMENT IN JUNE, SIGNED THE UKRAINE'S CREDIT BUREAU LAW: "*ON ORGANIZATION, FORMATION AND CIRCULATION OF CREDIT HISTORIES*". • CABINET OF MINISTERS AUTHORIZES MINISTRY OF JUSTICE AS REGULATORY BODY TO LICENSE AND REGULATE CREDIT BUREAUS • ATCI BEGINS ANALYZING OPTIMAL APPROACH TO DRAFT REGULATIONS GOVERNING CREDIT BUREAU OPERATIONS IN UKRAINE.
• **Define Business and Operations Plan**	• BUSINESS PLAN FINALIZED AND DELIVERED TO THE AUB IN BOTH RUSSIAN AND ENGLISH. DISTRIBUTED TO MAJOR CREDIT BUREAU OPERATORS • BUSINESS PLAN IN PROCESS OF IMPLEMENTATION AFTER FORMAL PRESENTATION TO BANKING SECTOR
• **Outline Package of Technical Requirements**	• ATCI DRAFTS RFP FOR FIRST NATIONAL BUREAU OF CREDIT HISTORIES (FNBCH) • CREDITINFO, D&B, KKB, CHUFA, AND TRANSUNION/CRIF. RESPOND TO TENDER
• **Discussions with Government Data Providers**	• IN PROGRESS ALBEIT VERY SLOW BECAUSE OF THE DIFFICULTY OF FINDING THE "PERSON" IN CHARGE

• **Secure Buy-in of Foreign Investors and Banks**	• INTERNATIONAL CREDIT BUREAU OPERATORS MOVE TO ESTABLISH OFFICES IN KIEV AND CONTINUE TO UNDERTAKE "DUE DILIGENCE" • CREDIT INFO FORMALLY REQUESTS FURTHER ATCI ASSISTANCE • EXPERIAN AGAIN DECLARES ITS WILLINGNESS TO INVEST IN UKRAINE
• **Develop and Deliver Package of Training Programs (banks, leasing, credit unions)**	• AUB REQUESTS ATCI TO CARRY OUT A SERIES OF REGIONAL PRESENTATIONS AND DISCUSSIONS UNDERWAY WITH IFC FOR JOINT COOPERATION .

LIST OF ATTACHMENTS

ATTACHMENT 11 Letter from FNBCH requesting further ATCI assistance.

ATTACHMENT 12 Letter from CreditInfo -Ukraine requesting ATCI assistance.

E. GENDER

I. COMPONENT DESCRIPTION

Programs related to gender have political and cultural implications that should be considered in any approach. ATCI is seeking opportunities for increased income and empowerment for both women and men.

The project plans to undertake several activities in the area of gender analysis. ATCI staff sees the importance of carrying out gender sensitivity training for the staff, in order to have a solid basis for the monitoring work.

With respect to monitoring participation in training programs and events by gender, the following activities will be undertaken to the extent feasible and possible.

- Examine the program to ascertain whether if there are any provisions that could differentially discourage persons of one sex or another from participating;
- Inquire about how program outreach is conducted to understand whether if these procedures may be differentially affecting participation by gender;
- Examine the actual patterns of participation by gender in selected programs, to the extent permitted by the data;
- Where differential participation by gender is identified, try to understand its causes and make appropriate changes.
- With respect to the representation of women in higher positions in government agencies, the Pragma project will work to balance the composition by gender of groups being trained by the project.

Pragma continues to partner with local organizations managed by women or consisting mostly of women. Three good examples are the Association of Ukrainian Banks and the Commercial Law Center as well as the PFTS securities trading system

II. SIGNIFICANT EVENTS AND ACHIEVEMENTS

- 22 WOMEN (40%) PARTICIPATE IN TRAINING ON THE PRATICE OF LEASING IN UKRAINE

III. EXECUTIVE SUMMARY

All ATCI tasks present opportunities to identify and address gender bias, and to actively promote gender equality in Ukraine's financial sector. For example, ATCI is working closely with the Association of Ukrainian Banks, the Commercial Law Center and other organizations which understand the importance of gender sensitivity with respect to product and services development. These issues have not only been discussed but plans are underway to draft material and articles which point out important opportunities in this area.

During the quarter, ATCI developed and delivered a one-day training seminar on Risk Management in Lviv for 55 practitioners (twenty-two women). The training focused on credit analysis, financial management and deal structuring practices that were in accordance with International standards of practice.

The Project staff of ATCI project includes 11 women out of 24 with professional and technical skills in finance and law.

IV. ADMINISTRATIVE ISSUES

NONE

II. DESCRIPTION AND STATUS OF TASKS

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Partner with Woman – run organizations (CLC & UAB)**	• ATCI IS WORKING CLOSELY WITH THE ASSOCIATION OF UKRAINIAN BANKS, THE COMMERCIAL LAW CENTER AND OTHER ORGANIZATIONS WHICH UNDERSTAND THE IMPORTANCE OF GENDER SENSITIVITY RELATED TO PRODUCT AND THE DEVELOPMENT OF SERVICES.
• **Increasing the role of women in the financial sector through training and /or other initiatives**	• STAFF OF THE ATCI PROJECT INCLUDES WOMEN WITH PROFESSIONAL AND TECHNICAL SKILLS IN FINANCE AND LAW. RECENT TRAINING IN INTERNATIONAL STANDARDS OF PRACTICE INCLUDED 40% WOMEN.
• **Gender and cultural sensitization training**	• UNDER DISCUSSION / RESPECT FOR GENDER SENSITIVITY IS PREACTICED DAILY BY ALL ATCI STAFF.

LIST OF ATTACHMENTS

NONE

ATTACHMENT 1

CONFERENCE ON THE STATE OF MORTGAGE MARKET DEVELOPMENT IN UKRAINE: A STRATEGY FOR THE FUTURE

Co - sponsored by the Ministry of Finance, the State Mortgage Institution, and the United States Agency for International Development (USAID) in cooperation with the EU Commission, the EBRD, UNIA, and the Association of Ukrainian Banks

Date:	**December 5 & 6, 2005**
Place:	Ukraine House, 2 Khreschatyk Street
Attendees:	Senior leadership of the Government of Ukraine involved in policy decisions affecting market development to include the Prime Minister, Cabinet Ministers and their senior staff, members of the Rada, the Governor of the National Bank of Ukraine, the Heads of Oblast Administrations, Chairmen of the SSMSC and Financial Services Regulator, senior representatives of financial institutions, and mortgage market professionals.
Purpose:	To explore what role Government can or should play to make housing more affordable; to examine the role the financial markets play, and to analyze what has worked in other countries facing similar circumstances and what has not. The conference will explore the practical aspects of mortgage market development and the ingredients for successful development of the primary and secondary market and its associated market infrastructure on a comparative basis; examine the economic basis for mortgages and mortgage - backed securities, the necessary legal framework, and means of minimizing risk of default; and consider the reforms now on the agenda for Ukraine. The conference will provide an opportunity for government officials, market professionals and potential securities issuers to share information and perspectives for use by senior leadership when framing policy choices.

CONFERENCE CHAIRPERSON: Anatoly Maksiuta, First Deputy Minister,

Ministry of Finance of Ukraine

Monday, December 5

9:00 – 9:30	Registration
9:30 – 10:20	Welcome by the President of Ukraine
	Introductory Remarks Prime Minister of Ukraine Yuriy Yekhanurov; First Deputy Minister of Finance Anatoly Maksiuta; U.S. Ambassador to Ukraine John Herbst; First Vice Governor of National Bank of Ukraine Anatoly Shapovalov
Monday, Dec. 5 *Continued*	*OVERVIEW OF THE MORTGAGE MARKET*
	Session 1:
10:20 – 10:50	State Policy in Developing Ukraine's Mortgage Market: Challenges and Opportunities *Anatoly Maksiuta, First Deputy Minister of Finance & Chairman, Supervisory Board, State Mortgage Institution*
	Session 2:
10:50 – 11:20	Housing in Ukraine 2006-2010 *Pavlo Kachur, Minister of Construction and Architecture, Housing and Communal Services*
	Session 3:
11:20 - 11:50	The Mortgage and Housing Market from the Perspective of Primary Creditors *Igor Yushko, President, UNIA*
11:50 – 12:10	*Coffee and Convenience Break*
	MORTGAGES AS A TOOL FOR IMPLEMENTING SOCIAL POLICY
	Session 4:
12:10 – 12:40	Part I
	Legal Infrastructure and Mortgage Lending – Next steps for Ukraine (registration, foreclosure, eviction) *Dmytro Sviatosh, Deputy Chair, Parliament Committee for Finance and Banking*

12:40 – 13:10	Part II To Subsidize or Not to Subsidize - The Role of the State in Developing Affordable Housing : Comparative Analysis of Systems Worldwide *Douglas Diamond, Senior Advisor, Access to Credit Initiative, USAID/Ukraine*
13:10 – 13:40	Part III Alternatives in Housing Policy - The Potential of Mortgage Insurance in Affordability and Credit Risk *Dr. Sally Merrill, Senior Advisor, Access to Credit Initiative, USAID/Ukraine*
13:40 – 14:40	**LUNCH**

Monday, Dec. 5 *Continued*	**ISSUES AND DECISIONS FACING UKRAINE**
14:40 - 15.10	**Session 5:** Accounting and taxation of mortgage lending transactions in Ukraine *Olexander Boyko, Advisor to the Prime Minister, President, Association of Consulting Firms*
15:10 – 15:40	**Session 6:** Mortgage Market Development in the CIS: Considerations for Ukraine – Perspectives of a Central Banker *Grigori Marchenko – Former Governor, National Bank of Kazakhstan*
15:40 – 16:10	**Session 7:** Comparative Approaches to Mortgage Lending Internationally – Considerations for Ukraine *Achim Duebel, EU Commission*
16:10 – 16:40	**Session 8:** International Experience with Liquidity Facilities – Lessons for Ukraine *Douglas Diamond, Senior Advisor, Access to Credit Initiative, USAID Ukraine*
16:40 – 17:00	Coffee and Convenience Break

Session 9:

17:00 – 17:30 The Danish Experience with Liquidity Facilities – Lessons for Ukraine
Palle Ulstrup, CEO Retired , Danish Mortgage Liquidity facility

Session 10:

What Can International Donors Do to Vitalize the Ukrainian Mortgage Market?

17:30 – 18:00 *Part I*

Elena Klepikova, Senior Operations Manager, International Finance Corporation

18:00 – 18:30 *Part II*

Peter Stredder, Deputy to Director, European Bank for Reconstruction and Development

18:45 – 19:30 Cultural Event, Ukraine House, 2 Khreschatyk

Tuesday, Dec. 6

CONFERENCE CHAIRPERSON: Vitaliy Lisovenko, Deputy Minister, Ministry of Finance of Ukraine

9:00 – 9:30 Registration

9:30 - 9:45 Opening Remarks,

Vitaliy Lisovenko, Deputy Minister, Ministry of Finance of Ukraine

DEVELOPMENT OF MORTGAGE SECURITIES IN UKRAINE AND THE SECONDARY MARKET

Session 11:

Part I

9:45 – 10:15 Covered Bond Systems in Europe - Considerations for Ukraine
Wolfgang Kaelberer, Association of German Pfandbrief Banks

	Part II
10:15 – 10:45	Secondary Market Trends – The Spanish Example *Simon Walley, Deputy Secretary General, European Mortgage Federation*
	Session 12:
10:45 – 11:15	What's needed in a mortgage securities law – Consideration for Ukraine *Glib Bondar, Senior Banking & Finance Lawyer, Baker&McKenzie*
	Session 13:
11:15 – 11:45	What are Mortgage – Backed (Covered) Bonds; Who Buys Them and Why? *Ilya Goncharov, Director, EM Structured Debt, Deutsche Bank London*
11:45 - 12:00	Coffee and Convenience Break
	Session 14:
12:00 – 12:30	Impact of Secondary Market Financing on Mortgage Interest Rates - Considerations for Ukraine *Wolfgang Kaelberer, Association of German Pfandbrief Banks*
	Session 15:
2:30 – 13:00	Mortgage – Backed Securities: Considerations for Institutional Investors *Zhanat Kurmanov, Head, State Accumulation Pension Fund, Republic of Kazakhstan*
13:00 – 14:00	**LUNCH**
Tuesday, Dec. 6, *Continued*	**ANALYSIS AND DISCUSSION OF ISSUES RAISED**
14:00 – 16:30	**Working Group I** Housing Affordability - *Moderator, Sally Merrill*
14:00 – 16:30	**Working Group II** Liquidity Facilities and Banks – *Moderator, Palle Ulstrup / Douglas Diamond*
14:00 – 16:30	**Working Group III** Development of Mortgage Securities - *Moderator, Steve Moody / Ilya Goncharov / Zhanat Kurmanov*

16:30 – 17:30	Presentation of Findings & Conclusions
	Evening Reception, Ukraine House, 2 Khreschatyk
17:30 – 20:00	

Please note that all presentations will be available at www.ipoteka.gov.ua

ATTACHMENT 2

THE STATE OF MORTGAGE LIFE INSURANCE IN UKRAINE

Executive Summary

The Ukrainian mortgage market in fall 2005 is experiencing robust growth with no signs of slowing as real estate prices surge upward. Life insurance policies designed specifically for a mortgagor do not exist in Ukraine, but life insurance can be purchased for any underlying credit agreement, including mortgages. Currently, the majority of lenders do not require mortgage applicants to purchase any insurance in addition to the legally-mandated property insurance, however the trend is towards more lenders requiring either mortgage life insurance ("MLI") which covers natural death or Accidental Death and Disability ("ADD"). Despite the mortgage boom, the competition amongst lenders is great enough that they are reluctant to burden borrowers with the extra cost associated with insurance.

Background on the Mortgage Industry

According to UNIA, as of July 1, 2005, some characteristics of the Ukrainian mortgage market are:

- UAH 5.625b of mortgages are outstanding, which represents 5.2% of banks' credit portfolios. For 1H05, 90.6% more mortgages were written than in 1H04.
- In that same period, real estate prices have increased some 40-60% in Kiev, slightly less in large regional centers, and to a much lesser extent in the regions.
- The average mortgage term is a mere 2.5 years, but is increasing significantly. Terms of up to10-20 years are offered by most banks.
- 82.2% of all mortgages are denominated in a currency other than UAH, because of the lower interest rates: 11.5–14% $, € vs. 15-20% UAH. Interest rates do vary with selected term. Adjustable rate mortgages are available, but rarely used.
- Approximately 30-35 banks write mortgages, with 12 banks having about 85% of the market, and the top 5 controlling nearly 63% as follows:

1) PrivatBank	15.2%	4) UkrSibBank	12.3%
2) Praveks-Bank	13.3%	5) UkrSotsBank	10.4%
3) APPB "Aval"	12.3%		

The mortgage sector in Ukraine is dynamic, with bank requirements adjusting to overall economic conditions. For example, a few months ago, several banks allowed zero down payment, but as of mid-Oct., only one bank still allows it with the majority requiring 10-20%.

Mortgage-related Insurance Products

According to Ukrainian law, currently the only mandatory mortgage-related insurance is **property insurance** which covers loss and damage due to fire, flooding, natural disasters (earthquakes, lightning, etc.) and third-party malicious acts to the mortgaged property. Interestingly, it does not cover structural building defects, however discovered, such as by neighbors' legal renovations. The homeowner may choose a deductible to reduce the premium.

Generally, when a bank has an insurance subsidiary or closely affiliated insurance partner, it dictates to mortgage applicants where to buy property insurance. Otherwise, it gives the customer a choice of several insurance companies, with which it has agreements in place. We surveyed the 12 largest mortgage-writing banks in Ukraine and the insurance companies with which they work. The results are summarized in Appendix #1, and are explained below.

Several banks require **title insurance**, which usually costs between .3 and .5% of the property value (some insurance companies base it on loan value?!), though it is not universally mandated, unlike in the U.S. This is explained, again, by banks' desire to limit supplemental costs in order to reach out to the broadest market possible, by the lack of a unified state register of property rights, and by the minimal risk of defective title owing to only 14 years history of private property and the few transfer of titles (i.e. purchase/sale transactions) occurring during this period for any given piece of real estate. Nevertheless, in coming years, 2nd generation re-sale of newly constructed apts., faulty legal or administrative recording of privatizations, divorces, inheritance and other property transfer transactions provide a basis to expect growth in this segment. Thusfar, the banks bear the costs of the title search investigation. [1]

[1] Journal "Delovoy" October 2005, page 52

Five of the twelve largest banks require either **MLI** or **ADD**. The cost to consumer for MLI ranges from .2 to .8% of the insured sum, which is the declining outstanding loan value, depends on risk factors and is calculated using underwriting criteria (e.g. age, gender, occupation, medical history, current state of health) and actuarial data. It is noteworthy that life insurance associated with MLI is frequently bundled together with ADD, but not always. For example, TAS separates them into separate policies, whereas ASKA Life and others we surveyed cover both natural and accidental death and natural and accidental disability in one policy. When ADD alone is required, the application procedure is easier for borrowers and doesn't require any medical exams.

Further, such insurance is always term life and not endowment nor whole life, though the latter savings/retirement-oriented non-mortgage policies are offered in Ukraine, with very few customers purchasing.

Because of the prevalence of mortgage early redemption, in actual practice, MLI and ADD are more often sold for a 1 yr. term with annual renewal as necessary, rather than for the life of the credit, though a length-of-credit term is also practiced. In the latter case, the mortgagor may choose to either pay premiums all up front (with no discount) or in installments, and they almost always choose to pay it once up front. (The basic "time value of $" principle is missing here.)

In all these insurance policies, the insured party is the mortgagor and the beneficiary is always the bank.

SMI

Although the SMI is pushing for making MLI and ADD mandatory, and even proposing to **impose caps** (no consideration for free-market forces?) on the premiums which can be charged [2] for (i) property .2% and (ii) MLI+ADD .8% of property value, it is questionable how much influence the SMI will have on the insurance market in the near-to-medium term, since ambitious plans for the size of its pilot bond issue have been scaled back to 20M UAH (more below), which pales when compared to the 5.6B UAH overall mortgage market. Until the SMI's fund-raising reaches critical mass, it remains to be seen whether the largest banks will want to sell, either directly or pooled in an MBS, their mortgages to the SMI, since they will weigh the SMI's small purchasing capacity against any additional administrative costs to be imposed by making a mortgage SMI-conformant.

Former Prime Minister Timoshenko had hoped to attract $2b from abroad under GoU guarantees to infuse into the mortgage lending structure. When that failed, the Cabinet of Ministers passed Resolution 643 requiring insurance companies to invest a minimum of 15% of their reserves into SMI securities and ordered the State Committee for the Regulation of the Financial Services Market ("SCRSFM") to develop accompanying regulations on insurance reserves to guarantee purchase of at least 750 million of SMI debt. Since the SCRSFM regulations aren't yet developed, and the law on Mortgage Backed Securities has yet to be ratified, it will likely be the second half of 2006 (and certainly after Parliamentary elections in March) before any SMI securities of any significance could be placed in the market. [3]

Life Insurance Not Related to Mortgages

As in Russia, where "life insurance products are almost non-existent" [4], life insurance accounts for less than 1% of all gross insurance premiums collected in Ukraine in 2003 and 2004, yet like all insurance segments, experienced dramatic growth (256%) between mentioned years[5] . This compares to 60% of total insurance premiums in the West [6]. Since most banks don't require it, the average homebuyer doesn't buy MLI and the general public doesn't buy life insurance, preferring to be uninsured over "putting money into financial institutions that have a checkered past of money laundering and bankruptcy"[7]. No more than 10% of MLI policies are purchased by borrowers who voluntarily elect to protect their loved ones.

Select financial data for 13 of the largest life insurers are presented in Appendices #2A and 2B.

Mortgage Default Insurance

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[2] SMI draft document "Standards for Extension, Refinancing and Servicing of Mortgage Housing Loans" 1.4 Terms of Insurance
[3] "Kontrakti" issue # 39 Sept. 26, 2005
[4] Financial Times, Oct. 11, 2005 – Special Report "Investing in Russia", pg.4
[5] "Insurance Business of Ukraine" 2005 directory published by the League of Insurance Companies of Ukraine ("LICU"), pg. 19
[6] Kyiv Post, referencing LICO, May 26, 2005 pg. 8
[7] ibid., referring to comments of TAS Insurance Deputy Chairman Pavlo Tsaruk.

The situation with Mortgage Default Insurance is quite fluid. Five of the larger, well-known insurance companies claim to offer it, but data is sparse. Our findings are summarized below:

	Ins. Co.	# Client Banks	Cost
1.	Oranta	Several	n.a.
2.	TAS	n.a.	.5 - 5% of loan amount
3.	Ingo	Raiffeissen	.3% of loan amount
4.	Velta	2	1 – 2% of loan amount
5.	Kontingent	1	n.a.

Conclusions, Recommendations

Mortgage life insurance, though still applied on a small scale as of 4Q05, is poised for sustained growth. SMI's requiring mortgage life insurance is a sound and correct policy, consistent with the trend in Russia (where the mortgage market is more developed and MLI is required by their SMI-analogue and increasingly required by banks), and its standard-setting importance portends its adoption by large mortgage lenders, wishing to minimize their risk, in the medium-term even before they join in SMI's securitization structures.

Future possible direction of analysis Given the short time frame, this paper focused on where the majority of mortgages are written – the large regional centers – without adequate attention to smaller population centers and rural areas. A more balanced picture could look at any potential geographic and demographic distinction of lenders' and insurance companies' practices.

ATTACHMENT 3

RECENT CHANGES IN THE FISCAL ENVIRONMENT OF LOCAL BUDGETS IN UKRAINE AND THEIR IMPACT ON APPRAISING CITY CREDITWORTHINESS

Prepared by

Wayne Thirsk

for

The Access to Credit Initiative
USAID/Ukraine

November 2005

The author wishes to acknowledge the helpful discussions he has had with Yuriy Hanushchak, Ihor Shpak, Saule Ilynykh, Iryna Scherbyna and Richard Genz in preparing this report, although none carry any responsibility for the content and conclusions contained in this report.

EXECUTIVE SUMMARY

One of the major aims of Ukraine's new Budget Code was to establish a stable fiscal climate for the country's local budgets. An important feature of this Code was the transition towards a formula-based transfer system that in principle promised several benefits in the form of better preparation and execution of local budgets; greater budgetary transparency; equalization of expenditure potential; and much better incentives for expenditure economy and revenue mobilization.

This formula-based transfer system, in conjunction with clear-cut and sensible expenditure and revenue assignments, was designed to make local budgeting a highly predictable event. Local governments, and cities in particular, were thought to have been provided all of the fiscal tools that would allow them to reliably forecast their future revenues and expenditures. In this new and presumably stable fiscal environment, it was expected that many cities would be in a position to issue new debt to refurbish their inadequate, and in some cases crumbling, public infrastructure with a minimal risk of debt default. In short, there would be no more Odessas.

This report challenges the rosy scenario one gets from a reading of the Budget Code. Starting in 2004, a series of events have conspired to erode a number of the expected budgetary benefits in the Budget Code. The assault on the Code has come from two quarters: first, through the negative influence of other Ukrainian legislation; and secondly, from the failure to properly apply and enforce the provisions in the Code itself.

This report describes how city budgets have been subjected to a number of unexpected expenditure and revenue shocks in recent years that have raised the risk attached to municipal borrowing. The Verkhovna Rada has given with one hand and taken back with the other. In the 2005 State budget the Rada gave all of the proceeds obtained from the single or unified tax to local budgets. A few months later, in response to a pension funding crisis, the Rada amended the budget to reclaim about half of the single tax proceeds for the State budget. Since 2004 there has also been a dizzying rate of increase in the minimum wage that has reduced the expenditure flexibility of local budgets and has not been coordinated with the local budget cycle. To partially offset the impact of higher minimum wages the Rada has, in 2004 and 2005, provided additional grants to local budgets. However, these grants restore the old budget hierarchy. They are allocated to oblasts, who then have significant discretion in how to further reallocate them to cities and rayons. This practice contravenes the Code. In the 2004 State budget, inter-budgetary lending was reintroduced in the form of medium term Treasury loans, again contrary to the Code.

The flat rate personal income tax reform that was ushered into existence in 2004 has also rocked the local budget boat in several ways. It first of all exposed how vulnerable city finances are to changes in national tax legislation. The formula- based transfer should have been able to accommodate this reform but by and large, the equalization transfer failed the test. It failed largely because income tax reform wiped out the revenue forecasting capability of the Ministry of Finance. Transfers in 2004 did not adequately compensate for the revenue losses experienced by local budgets. To regain its revenue forecasting capability the Ministry has adopted a new forecasting technique that runs counter to the provisions in the Code. For 2006, the Ministry jettisoned the use of indexes of relative fiscal capacity, as required by the Code, and instead based its forecasts on an extrapolation of observed revenues in 2005. This report carefully documents how the new forecasting method is inimical to revenue-raising incentives, another outcome that the Code tried very hard to avoid. The report concludes with the message that municipal borrowing is an inherently risky affair and discusses ways in which this risk might be safely contained.

Introduction

With the adoption of a new Budget Code in 2001 it was felt in many quarters that Ukraine was firmly set on a new path of intergovernmental finance that would successfully resolve almost all of the problems of inter-budgetary relationships that had been experienced since independence. The Budget Code established clear, and sensible, expenditure assignments for all levels of governments and distinct, and rational sources of revenue for both State and local budgets. Greater fiscal decentralization was achieved by abolishing the previous budget hierarchy and replacing it with independently formulated and executed budgets at the oblast, city and rayon levels of local budgeting. All of these different types of local government became linked instead to the State budget through a system of formula based equalization transfers intended to provide sufficient revenues for local budgets to fulfill their transfer related expenditure obligations and compensate for differences in the size of local tax bases. Local budget autonomy was protected by making these equalization transfers unconditional in nature and allowing local governments considerable discretion in deciding how to use the resources at their disposal.[8] Another important linkage to the State budget was in the form of conditional transfers to local governments to pay for national programs of social protection. As a result of these new fiscal arrangements, the funding of local budgets was expected to be much more transparent and predictable than in the past.

This report examines recent changes in Ukrainian legislation and the administration of the Budget Code in light of how they have affected the ability to accurately assess the creditworthiness of Ukrainian cities. The report is organized in the following manner. Part one considers how the Budget Code should have been a positive factor in appraising creditworthiness. In the second part a series of recent events, beginning in 2004, is discussed that, in combination with each other, have all worked to undermine the potentially positive impact of the Budget Code and have seriously compromised any effort to confidently appraise city creditworthiness. Despite this pessimistic conclusion, the third, and final, part of this report argues that, while it may not be possible to determine absolute credit worthiness, it is feasible to compile a profile of city creditworthiness and rank different cities according to their relative creditworthiness.

I. The contribution of the Budget Code to the Evaluation of Creditworthiness

In principle, a number of the provisions in the Budget Code should have made the task of appraising city creditworthiness easier. For one thing, the Code encourages prudent borrowing practices by establishing a relatively low ceiling on debt servicing of ten per cent of general fund revenues and allowing borrowing only for purposes of development or capital fund financing. It also heavily penalized any act of debt default. In addition, if all the provisions of the Code were strictly enforced cities would face a firm or hard budget constraint fostering fiscal discipline and discouraging reckless budgeting.[9] Moreover, the Code provided cities with relatively stable, annual revenue flows, primarily in the form of proceeds from the buoyant personal income tax, that enhanced the predictability of future revenues and the ability to repay debt obligations. Finally, the Budget Code built into the calculation of formula based transfers fairly strong incentives for cities to grow their revenues without the fear that the State, as it did before the adoption of the Code, would try to extract any “surplus” revenues.[10] This incentive to grow revenues was anchored in the Code’s requirement of the use of relatively stable indexes of relative fiscal capacity to estimate a city’s

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[8] Although neither the formula nor the State budget dictate how local budgets should allocate their resources, local budgets are nonetheless hemmed in by a proliferation of service provision norms laid down by State line ministries. These norms, prescribing how local services should be delivered, limit the expenditure flexibility of local budgets.

[9] Before the Budget Code, local budgets’ revenues were established through a highly non-transparent and unpredictable bargaining process. Oblast officials annually negotiated their transfer levels and revenue shares with State officials and when that round of negotiations ended city and rayon officials could begin to make their revenue demands to the oblast financial office. Without any clear-cut revenue allocation rules, no participant in this murky process could ever be certain of what their revenue level would be in any year or how that amount might change from one year to the next.

[10] Cities can enlarge their revenue base by improving the quality of their public services in a way that attracts new economic activity, especially high wage activities, by leasing land to new businesses, by encouraging new business to register on their territory, and possibly by bolstering tax collection efforts.

forecasted revenues in determining the size of any transfer, either to or from the State budget, for the fiscal year ahead. According to the Code, the value of these indexes could be adjusted no more than once every three years.

Local budgets can be planned with a deficit if reasonable sources of deficit financing are available but can only be planned with a surplus if that surplus is intended for repayment of debt principal (articles 14(1) and (2) of the Code). However, in the course of budget execution, local budgets may develop an operating surplus either by generating higher than expected revenue or by trimming some planned expenditure. These operating surpluses can be carried forward from one year to the next and are having no effect on transfer calculations. Most local governments use these surpluses as a source of finance for their development or capital funds.

Article 55 of the Code allows State and local budgets to specify certain protected expenditure items whose budgeted amounts cannot be altered if any budget sequestration occurs after budgets have been approved. The list of protected items is spelled out in the annual State budget law and in recent years has been confined to wages, the social security taxes tied to wages, food expenses, medicines, debt servicing and debt repayment obligations and transfer payments. Local governments are not required to copy this list but in practice almost invariably do so.

How well, then, have these promising features of the Budget Code been realized in practice?

II. Recent Fraying of the Budget Code

Starting in 2004, a concatenation of events has conspired to erode a number of the expected budgetary benefits in the Budget Code. This erosion of the Code has occurred in two ways, first through the influence of other Ukrainian legislation and, secondly, through the failure to properly apply the provisions of the Code itself. In no particular order, each of these events is described below.

(a) The Single Tax Zigzag

The single tax is a presumptive tax levied on small businesses and entrepreneurs at a flat rate on business turnover. In the Budget Code it is a component of so-called first basket revenues that are used in the calculation of equalization transfers.[11] Until 2004 it was a shared tax with local governments receiving 43 per cent of the total proceeds and the State pension fund the remainder. In 2004, however, the Verkhovna Rada passed a 2005 State budget law that allocated all of the proceeds of this tax to local budgets and local budgets were prepared for the 2005 fiscal year on the assumption that they would continue to receive all of these revenues.

However, in a complete policy reversal, the Verkhovna Rada passed a supplementary budget law early in 2005 restoring the original revenue sharing arrangements and local budgets suddenly faced an unanticipated drop in their first basket revenues of about 5 per cent. Populist politics appear to lie behind this flip-flop in tax policy. The central government in its desire to raise living standards of ordinary Ukrainians, both before and after the Orange Revolution, has been rapidly escalating the levels of both public pensions and minimum wages. Pension benefits currently constitute 16 per cent of GDP, a relatively high figure by international standards, and the pension fund has been unable to finance the more generous level of benefits setting off a scramble to find more sources of revenue for

[11] First basket revenues consist of a portion of the personal income tax. For cities this is a 75 per cent share of the amount collected on their territories, a portion of the stamp duty, license fees, business registration fees, fees from trade patents, proceeds from administrative fines and a portion of the single tax. A heterogeneous second revenue basket, comprised mainly of proceeds from the land tax, is not relevant for transfer payment calculations.

the State budget. As a result, the reclaimed share of the single tax has been earmarked to help finance the pension fund.

The tale of the single tax zigzag is a classic example of the well-observed tendency of higher level governments to shift down their deficit problems to lower levels governments. The Budget Code was not oblivious to the likelihood of these pressures and sought to prevent them from damaging local budgets. Article 103 of the Code states than any time the State provides benefits that result in revenue losses for local budgets, the State Budget Law will be amended to provide compensation for those losses. Such compensation simply did not happen in the case of the unified, or single, tax.

(b) Rapid Acceleration in the Growth of Minimum Wages

Since 2004 there have been several hefty increases in the legal minimum wage. From November 30, 2004 to July 1, 2005 minimum wages have grown by 68 per cent and in real terms by over fifty per cent during this period. These wage increases affect not just low paid government workers but the entire local government labor force, because many salaries paid by local governments are geared to a multiple of the minimum wage.

Higher minimum wages have created two kinds of problems for local budgets. First, local government total spending and revenues have not kept pace with the growth in minimum wages. In part this trend reflects another trend in the share of local government spending in the consolidated budget. This share peaked at 42.4 per cent in 2003 and has fallen steadily since then to 38.1 per cent in 2005.[12] As a result, wage payments of local budgets (including rayon and oblast budgets) as a fraction of general fund revenues have risen steadily, from 64 per cent in 2004 to almost eighty per cent in 2005. As a result, when other protected expenditure items such as food and medicines are taken into account, local budgets currently have much less expenditure flexibility than they had a few years ago. Also worth mentioning is the fact that cities also have limited revenue flexibility to respond to higher wages as the tax rates on their most important revenue sources are set by national legislation. As a result, higher wages normally force cuts in other types of spending such as capital spending.

In the second place, the cycle of increases in the minimum wage has not been coordinated and synchronized with the local budgeting process. Hikes in the minimum wage have typically been announced after local budgets have been prepared and approved, leaving local budgets scrambling to stretch for the revenue room with which to pay the higher wages and generally upsetting the budget priorities set out in the approved budget.

While rapid growth in minimum wages in no way violates the Budget Code it does run counter to the philosophy of the Code that stressed the need of the State budget to adequately finance the delegated expenditure responsibilities of local budgets. To be fair, however, the Verkhovna Rada has made belated efforts to ameliorate the impact of higher wages in the form of additional grants to local budgets, although these new grants have also inflamed old budgetary sores as explained next.

(b) Additional Grants to Local Budgets

In 2004 the Verkhovna Rada introduced a new type of grant to assist local governments in paying for higher wages in the amount of 633 million UAH, an amount which represents about two per cent of local government general fund expenditures in that year. A grant of a similar size was recently made in 2005.While the amounts involved are too small to have a major impact on city borrowing capacity, it is the way the grants have been administered that signals a serious departure from Budget Code principles.

While these grants no doubt helped to relieve some of the pressure exerted on local budgets by higher wages, they are entirely ad hoc and have several disquieting features. Somewhat disturbingly, the method of distributing these grants revives old budgetary practices that the Budget Code tried to firmly lay to rest. Once again, grants from the State budget are being channeled to cities and rayons in a hierarchical chain. Additional grants are made first to oblast level governments who are supposed to use discretionary means to further redistribute these funds to cities and rayons within the oblast.[13] The Budget Code attempted to squeeze discretionary elements from Ukraine's transfer system because discretionary allocation of grants had become highly politicized prior to the adoption of the

[12] The point to be grasped here is that the consolidated budget contains an overall expenditure envelope for local budgets and the size of this envelope is one determinant of the amount of planned transfers to local budgets. If the amount in this envelope falls in relative terms so does the amount of planned transfers.

[13] Apparently, the Ministry of Finance did issue recommendations to the oblasts on how to distribute these funds but oblast governors are not bound by them and can exercise a great deal of discretion in allocating these grants.

Code and supported the prevailing system of bargained and negotiated local budgets. With the restoration of lobbying pressures under the new additional grants Ukraine runs the risk of reverting to the pre Budget Code era when local budget resource allocations were highly non-transparent and in many cases bordered on the arbitrary. It is dangerous in any country to operate without clear-cut rules and procedures of the budgetary game.

(c) The 2004 Reform of the Personal Income Tax and its Aftermath

At the beginning of 2004 a flat rate personal income tax of 13 per cent was introduced and replaced the previous income tax that had five rate brackets ranging from 10 to 40 per cent. The flat rate of 13 per cent is scheduled to rise to 15 per cent in 2007. Low income tax relief was also featured in the reform as taxpayers with an annual income of less than 40 minimum monthly wages were allowed to claim a deduction from taxable income equal to the minimum monthly wage multiplied by the number of months the taxpayer worked during the year. This so-called social tax privilege was to be gradually phased in at 50 per cent in 2005, 80 per cent in 2006 and 100 per cent in 2007.

This episode of tax reform highlights the lack of city control over the major component of its revenue base and the vulnerability of city finances to changes in national tax legislation. The reform also heightened uncertainty over how particular local budgets would be affected by the reform.

It was widely recognized that the benefits of this income tax reform would be reaped primarily by high income earners, who would see their effective income tax rate fall, and by low wage earners, many of whom would be removed from the income tax roll due to the application of the social tax privilege. It was also recognized that the reform would seriously challenge the ability of the Ministry of Finance to accurately forecast local government revenues in 2004 and calculate the formula based transfers of each local government. Historically calculated indexes of relative fiscal capacity would no longer be valid because of the expected uneven geographic incidence of the reform. High wage cities and low wage rayons were the most likely candidates to experience significant revenue declines. If it were adroitly administered, the formula in principle should have been capable of compensating every local government for any revenue loss associated with the reform.

Disputes even broke out within the Ministry of Finance over the estimated global impact of the reform on personal income tax revenues. The Ministry stood accused of deliberately underestimating the loss of personal income tax revenue that would accompany the reform. In particular, it was accused of willful overestimation of the economy's wage fund and excessive optimism in forecasting the positive revenue effects anticipated from the movement of workers out of the shadow economy. As a result of these controversies, the Ministry's chief revenue forecaster resigned in protest. That resignation was followed soon after by the departure of the head of the Ministry's department of territorial budgets.

In the end local budgets did not fare especially well in 2004. The formula could have ridden to the rescue of local budgets only if updated and accurate indexes of relative fiscal capacity could have been constructed in advance of the

personal income tax reform. But the Ministry of Finance was not up to the task and as a result many local budgets suffered. Table 1 below traces the evolution of positive and negative transfers over the period 2002-05 when the formula based transfers have been in effect.

Table 1

The Course of Equalization Transfers, 2002-05

(millions of UAH)

	2002	2003	2004	2005
Negative Transfers (Contributions to the State)	3,091	2,369	1,593	1,322
Positive Transfers (Equalization transfers from the State)	4,253	5,905	7,365	11,053
Positive Transfers Over GDP (%)	1.9	2.2	2.1	2.7

Local budget revenues, in the absence of transfers, increased a mere 4.4 per cent in 2004 compared to nominal GDP growth of nearly 27 per cent. With transfers included, local revenues grew by 15.3 per cent in 2004, less than the previous year's growth rate of 21 per cent.

If transfers had been equal to the task of compensating for a lower volume of personal income tax revenues, one would have expected the amount of transfers to increase as a percentage of GDP. Instead, as shown in the last row of Table 1, that percentage dipped slightly in 2004. A more direct comparison leads to the same conclusion. Forecasted revenues taken into account in 2004 for the purpose of calculating transfers were only 2.1 per cent lower, or by 326 million UAH, than in 2003. By contrast personal income tax revenues fell by 942 million UAH in 2004.

The finding that the transfer formula did not operate to offset local budget revenue losses in 2004 requires one important qualification. In the State budget planned for 2004 the share of local government spending in consolidated government spending declined by two percentage points and this decline by itself, as explained in an earlier footnote, would have naturally resulted in a smaller volume of transfers compared to earlier years. Note also that transfers as a

percentage of GDP increased by more than a third in 2005 so there may have been a lagged response to the revenue losses associated with the personal income tax reform

(d) Changes to the Formula in the Formation of the 2005 State Budget

Shortly after the end of the first quarter of 2004 the Ministry of Finance had acquired sufficient data on personal income tax collections in different local government areas to begin a much needed recalculation of the indexes of relative fiscal capacity for each oblast, city and rayon. The methodology underlying these recalculations appeared in the Cabinet of Ministers Resolution number 1203 of September 14, 2004.

Assuming no computational errors crept into the recalculation process, the methodology utilized by the Ministry seems entirely appropriate.[14] That said, once the indexes were calibrated their new values should have been fixed for the next three year period according to the fourth closing provision of the Budget Code. But this did not happen as will be seen in a later section of this report.

At the same time, however, the Ministry seems to have committed a serious methodological mistake in also introducing a revenue stimulation factor into the revenue side of the formula. This new factor is peculiar in its design and does not seem to have been well thought out. Without delving into the rather messy mathematical details, this revenue stimulation factor works in the following fashion. If the estimated revenue capacity of a local government in 2005, based on the recalculated indexes, exceeds its estimated revenue capacity in 2004 by an amount greater than the national average ratio of these two capacities, a fiscal reward is given.[15] The estimated revenue capacity of the local government is written down in 2005 by a factor equal to the inverse of the ratio between the local government's capacity ratio and the national average capacity ratio. This is an odd procedure because, if anything, it rewards past rather than future success in growing revenue. A more sensible approach would have been to award, outside of the formula calculation, an additional grant if the growth of executed revenues exceeded the national average growth rate.

The policy rationale for fixing the value of the index of relative fiscal capacity for a certain period was that it rewarded good revenue raising efforts. If a city, for example, were able to increase its revenues faster than the forecasted growth rate of revenues for all local budgets, it could retain all of the amounts it collected without any repercussions on the amount of equalization transfer it would either receive or make.

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[14] Based on observed income tax collections in 2004, the Ministry of Finance calculated new indices of relative fiscal capacity for that year. The Ministry further adjusted each of the three base years income tax calculations using the ratio of income tax collected in 2004 to the amount collected earlier. The previous capacity indexes were then calibrated by multiplying them by a factor equal to one plus the observed change in the value of the index.

[15] It is perhaps worth noting that this procedure gives the Ministry of Finance an opportunity to play favorites among cities simply by overestimating a city's 2005 revenue capacity.

To make matters even worse, to avoid having the State budget bear the cost of the revenue stimulation adjustment, a further adjustment to estimated revenue capacities is made. It implies that all local governments not benefiting from the stimulation provision will have their estimated revenue capacity artificially inflated in order to cover the revenue cost of any stimulation. The scheme is in effect a cross-subsidization mechanism for transferring budgetary resources from low to high revenue growth local governments and its disequalizing effects have no proper place in an equalization formula. It also adds to the increasingly opaque quality of the formula. Whether this practice was continued in the preparation of the 2006 State budget is unknown at the moment.

In the same September 2004 Cabinet of Ministers' Resolution, new procedures are spelled out for the determination of the value of "alpha" in the formula. The value of this formula parameter dictates the degree of equalization produced by the formula. A value of one, for example, means that transfers will be provided to finance all of a local government's estimated expenditure needs. Deviations from one have different implications for donor and recipient governments. In the case of a donor, a value for alpha of .9 would mean that it could retain ten per cent of the estimated revenues that exceeded estimated expenditure needs. Recipients in this case, however, would receive a transfer sufficient to cover only ninety per cent of their estimated expenditure needs.

For local governments that receive equalization transfers, the resolution sets the value of alpha at one. For donor governments, on the other hand, the value of alpha is fixed at a value of less than one according to a sliding scale that depends on the donor's year-over-year growth in contributions to the State budget. For growth rates than vary between zero and one hundred per cent, the value of alpha is .9. In the unlikely case that the growth rate surpassed ten thousand per cent, the value of alpha would dip to .6.

This asymmetric treatment of the alpha parameter has no basis in the Budget Code. The smaller value of alpha for donors appears to reflect the lobbying power of richer cities in Ukraine.

(e) The Reemergence of Inter-Budgetary Loans in the 2004 State Budget

The Budget Code explicitly banned inter-budgetary lending. Several factors lay behind this prohibition. Most important among these were that prior to the Code this type of lending was observed to take place on highly non-transparent terms, was often politically motivated and more often than not these loans were never repaid, becoming in effect disguised grants. To promote a new budget environment with hard budget constraints and to help create a harder credit culture, the Code banished these types of loans from the credit scene. The Code did permit, however, short term (up to three months) Treasury loans to finance liquidity gaps related to seasonal fluctuations in revenue collections.

It did not take politicians long to overturn this ban. In the 2004 State budget inter-budgetary loans were once again permitted and a new lending facility was opened up to local governments in the form of medium term Treasury loans. Unlike the short term liquidity loans provided for in the Budget Code, these new interest free Treasury loans could be repaid anytime within the budget year. Loans were tied to the financing of protected items of local government spending. Eligibility for receiving these loans required demonstrating that prospects for fully financing protected expenditure items were poor.

Table 2 below presents some recent data on the size and increase in the volume of medium term Treasury lending.

Table 2

Medium Term Treasury Lending

(millions of UAH)

	First six months of 2005	First six months of 2004
Medium Term Loans	3,956	1,325
Protected Expenditures	12,432	8,946
Over-due Loans	n/a	336.4

A few features of Table 2 stand out. First, medium term Treasury loans have grown rapidly since their inception in 2004 and in 2005 represent almost one third of the value of protected expenditure items. Medium term lending now rivals in size the amount of short term lending by the Treasury, which for the first half of 2005 were about four billion UAH. Secondly, a significant fraction of the loans incurred in the first half of 2004, about 25 per cent, are overdue. Moreover, there is a widely held expectation that most of these overdue loans will be written off by the Ministry of Finance in which case the loans are commingled with subsidy elements. This write off could occur because the Ministry feels some responsibility for the generally poor quality of its revenue forecasts in 2004 that adversely affected many local budgets, in particular some large city donors.

In the case of the relatively rich city of Zaporizhya for example, the Ministry overestimated its revenue capacity in

2004 and the city took out 22.4 million UAH in medium term Treasury loans to execute its budget. However, according to the Cabinet of Ministers Resolution, number t367 of March 24, 2004, this loan is to repaid through a central government subvention that will be received in subsequent budgetary periods. To some extent the advent of Treasury medium term loans has acted as a safeguard to protect local budgets from the adverse effects of the Ministry of Finance's revenue forecasting errors.

Article 60 of the 2005 State budget was even more explicit about writing off a portion of the outstanding medium term loans of the Treasury. This article stated that if any of these loans were unpaid, the Cabinet of Ministers would write off up to 250,000 UAH on each unpaid 2004 loan. Further, if the outstanding loan balance was not paid by the end of 2005, the deadline for repayment would be extended to the end of the first quarter of 2006. Besides being the government paymaster and the executing agency of State and local budgets, the role of the Treasury has been expanded to include that of a small credit institution.

(f) Abandonment of the Indexes of Relative Fiscal Capacity in the Formation of the 2006 State Budget

To the surprise of many, and the alarm of some others, the Ministry of Finance radically altered the manner in which it forecast local government revenue in preparing the first draft of the 2006 budget. Directly contravening article 98 of the Budget Code, requiring the use of indexes of relative fiscal capacity to estimate local government revenue capacity, the Ministry instead extrapolated revenue trends observed for the first half of 2005 and added a real growth and inflation adjustment to the result.

This revised technique for forecasting local government revenue could improve the accuracy with which forecasts are made, but regardless of whether it does or not, the consequences for revenue enhancing incentives are dire. The Budget Code went to considerable lengths to ensure that the estimated revenue capacity of local governments was not heavily influenced by the most recent revenue performance of local budgets. As a result, local governments that cultivated their revenue base and grew revenues at a faster than average rate were entitled to keep any revenues that exceeded their estimated revenue capacity. Now, however, the opposite is true. Local governments that have better than average revenue growth will find either that their equalization grant from the State budget is diminished or that their contribution to the State budget will be greater.

This disincentive to growing revenues, rooted in the change in the Ministry of Finance's forecasting technique, can be illustrated by the experience of the city of Ivano-Frankivsk, which has been a small transfer recipient since 2004 when

the personal income tax reform occurred. For the year 2005 the city received an equalization grant of about ten million UAH. But for the year 2006 the city's equalization grant was scheduled to decline to seven million UAH according to the first draft of the 2006 State budget, in all a 30 per cent drop. At the same time, equalization grants in the aggregate were planned to increase by 24 per cent. So why was Ivano-Frankivsk's equalization grant slated to decline?

The answer to the preceding question can be found in the Ministry of Finance's new way of calculating equalization transfers for 2006. Transfer levels (TR) are still defined as the difference between expenditures taken into account for calculating transfers (E) and the amount of revenues taken into account in calculating transfers (R). The percentage change in the level of transfers can be expressed by the following equation:

$$\Delta TR/TR = E/TR(\Delta E/E) - R/TR(\Delta R/R)$$

In the case of Ivano-Frankivsk, the Ministry of Finance estimated that the city's first basket revenues, those taken into account in the formula, would increase by 26 per cent in 2006. By comparison, the nationwide increase in first basket revenues was forecast to rise by 21.9 per cent. The Ministry also estimated that expenditures taken into account by the formula would increase by 20 per cent. In 2005 the transfer of ten million UAH represented the difference between 97.4 million in estimated expenditure needs and 87.4 million UAH in estimated revenue means. Applying these numbers to the equation above yields the following result:

$$\Delta TR/TR = 9.7(20\%) - 8.7(26\%) = .3 \text{ or } 30 \text{ per cent.}$$

If the Budget Code approach to estimating revenue capacity had been used instead in calculating the percentage change in transfers, the 26 per cent estimated gain in the city's revenues would have been replaced by the national average estimated growth in revenues of 21.9 per cent. As a result, Ivano-Frankivsk's transfer would have increased by 4 per cent, instead of falling by 30 per cent. In other words, in the case of Ivano-Frankivsk the new method of estimating revenue capacity generates an effective revenue claw-back for the State of about one-third.

What this example illustrates is that if a city has faster than average revenue growth it is destined under the new formula approach to estimating revenue capacity to experience either a drop in transfers or a rise in contributions. In other words, rapid revenue growth will, to some extent, crowd out transfers or inflate contributions and efforts to grow

revenues rapidly will be discouraged. It's safe to predict that if a city such as Invano-Frankivsk continues to enjoy above average revenue growth it will soon be converted from a transfer recipient into a donor city. Elements of State revenue claw-back of local government revenue "surpluses", that the Budget Code tried extremely hard to avoid, have been reintroduced to the system of local budgeting in Ukraine. The only silver lining is that the size of the claw-back is likely to be less than one hundred per cent in most cases.

(g) An Overview: Cities Now Face Greater Uncertainty

In looking at the entire canvas of budgetary changes that have occurred since 2004 it may be concluded that there is more uncertainty now than a few years ago about the future strength of local budgets in general and city budgets in particular. Recent shifts in the budgetary landscape that have been discussed are indicative of a diminished capacity to predict what the future holds. As noted, these shifts have happened since the beginning of 2004. If so much can change in the relatively short span of a year and a half, and if not much of that change can be labeled as positive, how is it possible to confidently peer even 3-5 years into the future and make a firm judgement about a particular city's credit worthiness?

This climate of accentuated uncertainty casts some doubt on the ability to make accurate and reliable forecasts of a city's future revenue stream. One such attempt to cope with this hostile forecasting environment is described in detail in an annex to this report.

Sustained rates of positive economic growth of four per cent or better in real terms will no doubt contribute to the strength of local budgets and help to mitigate recent instability in tax laws, in government transfer policies and in the administration of the equalization formula. Still, there are some worrying warning signs that local budgets in general are struggling so far in 2005. First quarter monitoring of local budgets indicates that short term Treasury loans to cover temporary cash gaps have risen by 96 per cent compared to the same period a year earlier. Total local budgetary arrears have also surged by 17 per cent to a level of 97 million UAH. In addition capital spending from local budgets has shrunk by 34 per cent, a sure sign of tight local budgets, and energy spending has been only executed at an eleven per cent rate raising the looming specter of growing energy arrears.[16]

[16] Budget monitoring report for the first quarter of 2005, issued by the USAID Municipal Budget Reform Project, 2005

(h) Prudent Regulatory Control over Local Borrowing

In response to the Odessa bond default, the Ministry of Finance developed a regulatory framework for local government borrowing in the form of the Cabinet of Ministers' Resolution 207, February 24, 2003. According to this resolution municipal borrowers require approval of any borrowing from the Ministry and have to satisfy a fairly stringent set of budgetary tests before approval is given. Potential borrowers, for example, are asked to submit their budget plans for repaying debt for review by the Ministry along with information on the value of assets they own. In addition, prospective borrowers must undergo a credit rating assessment by a designated credit rating agency.

Recent events indicate that the Ministry of Finance is preparing to loosen its grip on local borrowing eligibility. The Ministry appears poised to life the credit rating requirement, probably in 2005. Moreover, an October 2005 draft Law on Local Borrowing would eliminate the Ministry's review and approval of local borrowing in most cases. In view of the erosion of local budget stability that has been described in this report, the question that quickly comes to mind is whether this is the right time for the Ministry to take its hands off the wheel.

III. A Creditworthiness Checklist

The recent history of budget-related events in Ukraine suggests that one will never know what lies around the next policy corner, but whatever lies in wait, it could have nasty implications for local budgets. The high level of uncertainty created by this situation operates to increase credit risk and complicates the task of identifying which cities in Ukraine are good credit risks. Nonetheless, despite the many concerns raised so far in this report, it should still be possible to rank the relative creditworthiness of different cities and say, with some confidence, that one city is more creditworthy than another. Discovering which cities are better credit risks, rather than fruitlessly searching for cities which present no risk, may be the most promising way to move ahead in Ukraine.

To pinpoint better credit risks, I would suggest approaching the matter from the angle of a conventional credit analysis and examine a prospective borrower's income, income prospects, collateral, and previous debt history along with other bits of revealing data discussed below. Starting from the sample of medium sized cities of oblast significance, one could look at a list of traditional debt capacity indicators that would include the following items:

- General fund revenues per capita compared to the average for all cities; one hypothesis, which can be only verified from an inspection of the data, is that donor cities will have consistently higher values for this variable

as a result of their favorable “alpha” treatment. Because of alpha, higher contributions per capita should translate into higher general fund revenues per capita.

- Recent growth rates in per capita general fund revenues compared to the all city average; given the Ministry of Finance’s new methodology in estimating a city’s revenue capacity this variable should not be given too much weight. Nonetheless, the claw-back features of the current formula are unlikely to remove all of the revenue advantages of rapid revenue growth.
- The value of a city’s disposable assets in the form of land and buildings and the rate at which these assets have been depleted in the past.
- Previous debt history related to the servicing and frequency of bank and Treasury loans; the level of current debts including budgetary arrears. A distinction should be drawn between short term and long term arrears. Short term arrears that are quickly paid down represent a much less serious budgetary problem.
- The relative size of the wage bill compared to the average and the proportion of protected expenditure items in the general fund revenues. One minus the ratio of protected expenditure items to general fund revenue provides a useful measure of the amount of discretionary revenue available to a city and indicates its capacity to carry debt. If this proportion were less than fifteen per cent for any city it would suggest almost no budgetary room to issue debt.
- Consistency in generating executed revenues in excess of planned revenues.
- Diversity of the local tax base and the absence of any declining companies or industries.
- Regularity in making general fund transfers to the development or capital expenditure fund; similarly, a consistent ability to produce sizable operating surpluses in the range of five to fifteen per cent of recurring revenues.
- Although something of a judgement call, signs of good management practices and an experienced and knowledgeable financial department and department head. Reasonable indicators of sound management would include the adoption of program budgeting techniques, computerized accounting systems, consistent and transparent data collection and reporting and the publication of well articulated budget reports.
- The proportion of the desired or intended investment projects which will generate either verifiable new revenue for the city or cost savings in operations.
- Existence of a recent audit report issued by KRY, the external auditing arm of the Ministry of Finance, that suggests satisfactory budget performance.
- The extent to which a city may be legally obligated to provide subsidies to local utility companies because the city allows less than full cost utility tariffs to be charged.

Cities that received high marks on all of these benchmarks would constitute the group of preferred credit risks. A more refined ranking within this group could be achieved by assigning weights to each benchmark. More thought would have to be given as to what would be a sensible weighting scheme.

Cities that passed these evaluation hurdles might be deemed to have survived the first line of debt scrutiny. From that point, a more detailed financial and fiscal second line of scrutiny could be carried out as has already been done in preparing credit assessment dossiers for the cities of Cherkasy, Berdyansk, Korosten and Ivano-Frankivsk.

Some additional steps might be considered that would work towards the early identification of threats to city budgets and the minimization of city credit risk. Much of the recent pressure on city and other local budgets, both on the expenditure side and the revenue side, emanates from the annual State budget law. This law should be subjected to careful scrutiny after second reading to ascertain what changes in the law will have an impact on local budgets and how those changes might affect the ability of cities in particular to service both their current and prospective debts. But other laws besides the annual State budget law also influence the viability of local budgets, for example, the law on minimum wages, and these laws should also be systematically monitored.

Other events that impinge on the performance of local budgets, such as the recent change in the Ministry of Finance's revenue forecasting procedures, are more subtle in nature and more difficult to detect. To keep abreast of such changes requires regular consultations with local budget experts who have access to information concerning altered institutional practices.

It should also be possible to take advantage of some provisions in the Budget Code to mitigate credit risk and enhance credit worthiness. For example, cities could be required, if they are to receive project assistance in issuing bonds, to make debt servicing and debt repayments a protected item of expenditure. Moreover, article 74(1) of the Code requires obligatory repayment of debt obligations and this article could be the foundation for creating revenue intercept mechanisms to protect against the risk of default.

ANNEX: A SIMPLE FORECASTING MODEL OF CITY REVENUES

The use of sophisticated revenue forecasting models for Ukrainian cities is precluded by recent structural changes in local budgets associated with the introduction of the Budget Code and the reform of the personal income tax, the main revenue engine of city budgets. Consequently, any forecasting exercise has to rely on limited data and a set of plausible assumptions about the future path of the Ukrainian economy.

The revenue forecasting model that has been developed for Ukrainian cities is constructed on a four layered set of assumptions that are discussed in turn below.

(1) It is assumed that cities will maintain a stable revenue structure in the future. More precisely, this assumption implies that the proportion of different types of revenue in a city's revenue base will not change over the time period for which the forecast is made.
This assumption is borne out by the revenue data that has been inspected for the cities of Ivano-Frankivsk and Cherkasy. The non-PIT (personal income tax) share of total revenue has remained constant both before and after PIT reform in these two cities.

An important implication of this assumption is that the forecasted growth of PIT will mirror the growth of total revenue (TR) or, in mathematical language,

$$\Delta PIT/PIT = \Delta TR/TR$$

(2) It is further assumed that the predicted growth of PIT over the forecasting period will reflect the predictions made about the growth of the personal income tax base. If that base is expressed as the product of real wages (W) and employment (N), the predicted growth of real PIT is captured by the following equation:

$$\Delta PIT/PIT = \Delta W/W + \Delta N/N + \Delta W/W\Delta N/N$$

This second assumption will need some small modification for the year 2007 when the flat rate personal income tax rate will be bumped up to 15 per cent from its current level of 13 per cent.

(3) The third assumption is that the current explosive growth in real wages is not sustainable over the medium term of the next five years. If the current growth rate in real wages were to continue over this period the share of wages in national income would reach unreasonably high levels. A more reasonable assumption is that the growth in real wages will track the growth of real output in the medium term and that the share of wages national income will stabilize

Thus the assumption made in the forecasting model is that real wages will grow in the future at the expected rate of growth of real GDP. Equivalently, the assumption is that nominal wage growth in the future will be equal to the nominal growth rate of GDP.

(4) A final assumption is that future employment growth of any city can be measured by the expected real rate of growth of GDP. Of the cluster of assumptions made in the forecasting model this last one is undoubtedly the weakest. A more refined approach would disaggregate the economic base of a city and forecast the future growth of each economic sector in the city. That was not done here because of data limitations and time constraints.

The model has been applied to the city of Ivano-Frankivsk using the data contained in the IMF's medium term macro-economic framework for Ukraine. The first two rows of Table 1 below show the IMF's macro forecasts for real GDP growth and inflation for the period 2006-10. Using that information and utilizing the methodology outlined in this annex generates the forecast of total revenue growth for the city of Ivano-Frankivsk shown in the final row of this table.

Table 1

Forecasting Results for Ivano-Frankivsk

	2006	2007	2008	2009	2010
1.real GDP growth(%)	5.5	5	5	5	5
2. Inflation rate(%)	14.2	14.4	10.7	4	4
3. Total Revenue Growth Forecast For Ivano-Frankivsk(%)	27.3	22	18	14.7	14.7

ATTACHMENT 4

Ivano-Frankivsk Tender for Bond Underwriting and Payment Agent Services: ATCI Recommendations for Technical Components

October 10 2005

Recommended Tender Type

Price Quotation Request Procedure

Background Information

Purpose of bond issue: Finance budget for development for capital expenditures and infrastructure projects.
ATCI collaboration: The Access to Credit Initiative, USAID/Ukraine, will assist the city in completing the following tasks:

Bond issue structuring and legal advising
Facilitating Credit rating by Standard & Poor's
Developing investment memorandum and other materials
Developing documents for MinFin borrowing approval (COM Res. 207)
Developing documents for SSMSC registration (SSMSC Res. 414)

Bond Issue Terms

Bond Issuer:	Ivano-Frankivsk City Council
Total Issue Volume:	UAH 5.5 million
Type of bond:	Coupon
Interest Rate:*	Not to exceed 14% per annum.
Interest payment frequency:	quarterly
Maturity:	5 years
Par value:	UAH 1000
Issue Form:	non-documentary
Legal status:	To be approved by Ministry of Finance, Registered with SSMSC, and comply with all applicable GOU requirements.

*Note: The entire Bond Issue will be placed at par.

Scope of Services

Guaranteed Placement of the Bond Issue

The bond underwriter:

1. shall guarantee to place (purchase) 100% of the total volume of the Bond Issue at par provided that the coupon rate of the bond equals to the underwriter's offer in the tender bid.
2. shall place the Bond Issue at any time after the Bond Issue is legally capable of being issued, from the date of contracting with the city through December 23, 2005.
3. shall provide payment agent services for the duration of the period that bonds remain in circulation, or contract with a licensed and qualified third party for payment agent services.
4. shall provide custodial services or contract with a licensed and qualified third party for custodial services
5. shall, at the underwriter's option, advise the city on the structure and characteristics of the Bond Issue.

Payment of Fees Necessary for the Bond Issue

The bond underwriter shall pay the following fees:

1. Expenses for required publication of information on the Bond Issue
2. Fee for ICIM securities code from National Depository of Ukraine
3. Fees for MFS Inter-regional Securities Depository
4. First-year and annual fees for listing the Bond Issue on PFTS
5. First-year and annual fees for payment agent services.

All of the fees and commissions of the underwriter shall be reflected in the coupon rate that it offeres in the tender bid unless contractually agreed otherwise with the city.

Secondary Market

The bond underwriter will list the bonds on PFTS and will maintain the listing throughout bond circulation. The City and the Access to Credit Initiative will prepare an Investment Memorandum to support secondary market trading. The bond underwriter must quote the bonds for sale through PFTS throughout the period of Bond Issue circulation, for as long as the underwriter owns part of the Bond Issue, but is not required to be market-maker for the Bond Issue.

Contract and Security Deposit

The selected bond underwriter and the City shall, no less than three and no more than fourteen days after selection, execute a contract to provide all services requested by this Tender.

At the time of bidding for the tender with the City, the bidder shall make a security deposit in the form of a bank guarantee of UAH 15000. The guarantee will be effective till the winning bidder has signed the contract and provided the security deposit for fulfillment of the contract.

Proposed Effective Interest Rate

Bidders must propose the coupon interest rate at which they guarantee to place the 100% of the total volume of the Bond Issue (UAH 5.5 mln) at par (UAH 1000).

The coupon interest rate for the Bond Issue will be the City's sole compensation to the underwriter for all services to be provided and all fees to be paid by the bond underwriter under the tender unless otherwise contractually agreed.

Selection Criteria

The contract will be awarded to the qualified bidder proposing the lowest coupon interest rate on the Bond Issue.

Bidders should propose coupon interest rates in one-hundredths of one percent, for example 5.55%.

Minimum Requirements for Participants

Necessary licenses from GOU

ATTACHMENT 5

December 7, 2005

Dear Dmitri:

We are pleased to offer expertise and advisory services to LeaseIT in the area of assessing the company's business plan and certain business processes that are incorporated therein.

ATCI, which has the goal of facilitating the development of Ukraine's leasing industry, considers the successful development of LeaseIT to be of great importance to the industry as a whole. LeaseIT is the first company to target the small-ticket leasing market and leasing of IT equipment and will provide critical financing to SMEs to improve the efficiency and competitiveness of their business. The goals are consistent with the goals of USAID in Ukraine and therefore, through ATCI, we are pleased to offer LeaseIT technical assistance in the form of advisory services free of charge.

Specifically, ATCI proposes to provide LeaseIT with the following services:

1. Assessment of LeaseIT's business plan and recommendations for its improvement in order to make it most suitable for western debt and equity investors.
2. Assessment of LeaseIT's fundraising strategies and recommendations to make them appropriate for different audiences.
3. Assessment and recommendations to LeaseIT regarding its pricing strategies based on international best practice for small-ticket equipment financing;
4. Assessment and recommendations to LeaseIT with regard to the company's credit policy and procedures to incorporate international best practice and valuable lessons learned by small-ticket lessors.
5. Support to LeaseIT in identifying, contacting, and developing cooperation agreements with US and other foreign IT equipment suppliers and accessing financing from these suppliers and/or related sources.

The activities explained above fall under the goal of ATCI to provide technical assistance on behalf of the United States Agency of International Development (USAID) to facilitate the development of Ukraine's financial sector, in particular, Ukraine's leasing industry.

In connection with cooperation between LeaseIT and ATCI, the parties shall agree to terms and guidelines outlined in the attached confidentiality agreement to be signed by both parties prior to beginning cooperation.

Sincerely,

David C.M. Lucterhand
Chief of Party
The Pragma Corporation
Access to Credit Initiative
USAID/Ukraine

CONFIDENTIALITY AGREEMENT

Kyiv 15 of December, 2005

Closed joint-stock company “Leasing of information technologies” (hereinafter referred to as “LeaseIT”), a legal entity under the laws of Ukraine, represented by General Director Mr. Dmitri Bogodukhov, on the one hand, and The Access to Credit Initiative The Pragma Corporation (hereinafter referred to as - "ATCI") a legal entity duly incorporated under the laws of Ukraine, represented by Chief of Party Access to Credit Initiative USAID/Ukraine Mr. David C. M. Lucterhand, acting based on the Letter of attorney _____, on the other hand, hereinafter jointly referred to as Parties, have concluded the present Agreement (hereinafter referred to as "the Agreement") further to the ATCI’s Letter dated “15” December 2005, #____(hereinafter referred to “the Letter”) as follows:

1. SUBJECT

1.1. The subject of this Agreement shall be procedures and terms for using and protecting information transferred by the Parties to each other in the process of provision of expert and advisory services by the ATCI to LeaseIT, which are defined in the Letter.

1.2. The confidential information for the purposes of this agreement shall be any information transferred by each of the Parties to the other Party in the course of negotiations and subject to protection under this Agreement but for the exceptions listed below.

Such information can be stated in letters, reports, analytical materials, results of surveys, schemes, charts, specifications and other documents, both in material and electronic forms (hereinafter "the Information").

1.3. The information to be kept confidential and not to be disclosed under the Agreement shall include (but not limited to) in particular:

a) financial statements;

b) accounting registers;

c) business plans;

d) information on financial, legal, structural and

УГОДА ПРО КОНФІДЕНЦІЙНІСТЬ

Київ 15 грудня 2005 р.

Закрите акціонерне товариство «Лізинг інформаційних технологій» (надалі - LeaseIT), що є юридичною особою відповідно до законодавства України в особі Генерального директора пана Дмитра Богодухова, з одного боку, і "Ініціатива сприяння кредитуванню" Корпорації "Прагма" (надалі - "ІСК"), що є юридичною особою за законодавством України, в особі Керівника Проекту "ІСК" АМР США/Україна пана Девіда Ч.М. Лактерхенда, який діє на підставі Довіреності _____ з другого боку, разом - "Сторони", уклали цю Угоду (надалі - "Угода") на додаток до Листа ІСК від “15” листопада 2005р., вих. № _____ (надалі - Лист) про таке:

1. ПРЕДМЕТ

1.1. Предметом цієї Угоди є порядок та умови використання і захисту інформації, яку Сторони передають одна одній у процесі надання ІСК Украгазбанку експертних та консультаційних послуг, визначених у Листі.

1.2. Конфіденційна інформація для цілей цієї Угоди означає будь-яку інформацію, яка передається будь-якою зі Сторін іншій Стороні в процесі проведення переговорів і яка підлягає захисту згідно з цією Угодою за винятком випадків, які описано нижче.

Ця інформація може міститись у листах, звітах, аналітичних матеріалах, результатах досліджень, схемах, графіках, специфікаціях та інших документах, які оформлені як на паперових, так і на електронних носіях (надалі - "Інформація").

1.3. Інформація, яка підлягає збереженню в таємниці і нерозголошенню згідно з цією Угодою, включає (але не обмежується) у тому числі:

a) фінансову звітність;

b) облікові регістри;

c) бізнес-плани;

d) відомості про фінансові, правові,

other relations between the Parties and their affiliated entities.

1.4. The information subject to protection and non-disclosure under this Agreement shall not include the following:

a) information in statements and reports officially published;

b) information in official reports, statements, press-releases, as well as advertising statements.

2. DUTIES OF THE PARTIES

2.1. Unless otherwise stipulated in the Ukrainian legislation, the Parties will not share, discuss the content, provide copies, publish or disclose the Information in any other form to third partied without the prior written consent of the other Party.

2.2. The Party which receives the Information may disclose it without a preliminary written consent of the other Party, provided such Information:

- was at its disposal upon legal grounds before obtaining from the other Party;
- is generally available;
- has become known to the Party from a source other than the other Party, provided the source is not subject to the commitment on non disclosure of the Information;
- has been demanded from the Party by administrative or law-enforcement body in cases and per the procedures as envisaged by the Ukrainian legislation.

3. PERIOD OF THE AGREEMENT

3.1. This Agreement takes effect upon signature thereof and will be valid for 3 (three) years.

4. OTHER CONDITIONS

4.1. Expert and advisory services defined in the Letter shall be provided by the ATCI to LeaseIT

організаційні та інші взаємовідносини між Сторонами і їхніми структурними підрозділами.

1.4. До інформації, яка підлягає захисту та нерозголошенню згідно з цією Угодою, не відносяться:

a) відомості, які містяться у повідомленнях і звітах, які офіційно опубліковані;

b) відомості, які містяться в офіційних звітах, повідомленнях, прес-релізах, а також рекламних повідомленнях.

2. ОБОВ'ЯЗКИ СТОРІН

2.1. Якщо інше не передбачено законодавством України, Сторони зобов'язані не розголошувати, не обговорювати зміст, не надавати копій, не публікувати і не розкривати Інформацію у будь-якій іншій формі третім особам без отримання попередньої письмової згоди іншої Сторони.

2.2. Сторона, яка отримує Інформацію, може розкривати Інформацію без попередньої письмової згоди іншої Сторони у випадку, якщо ця Інформація:

- знаходилась на законних підставах в її розпорядженні до отримання від іншої Сторони;
- є загальновідомою;
- отримана Стороною від іншого джерела, яке не має зобов'язання щодо нерозголошення Інформації;
- вимагається від Сторони адміністративним або правоохоронним органом у випадках та у порядку, передбачених українським законодавством.

3. СТРОК ДІЇ УГОДИ

3.1. Ця Угода набирає чинності з моменту її підписання і діє протягом 3 (трьох) років.

4. ІНШІ УМОВИ

4.1. Надання ІСК LeaseIT експертних та консультаційних послуг, визначених у Листі, здійснюватиметься у межах діяльності ІСК з

within the ATCI's scope of technical assistance rendered on behalf of the USAID (the United States Agency for International Development) for the purpose of developing the financial sector in Ukraine on a free-of-charge basis. Any of the stated ATCI's expert and advisory services will be exclusively advisory in nature and in no case shall be qualified as direct recommendation for taking or not taking relevant actions by LeaseIT with respect to the corresponding individuals or legal entities, or as a guarantee with respect to such individuals or legal entities and, correspondingly, shall not be regarded as the basis for claims of ownership or any other types of claims on the part of LeaseIT and third parties, or for any other legal liability of the ATCI to LeaseIT and third parties.

4.2. Nothing herein shall be deemed to require the Access to Credit Initiative and/or their consultants to perform any duties which would require any of them to be licensed under the laws in force.

4.3. Any controversies that may arise in the course of implementation of this Agreement shall be settled by the Parties' mutual consent.

4.4. This Agreement neither creates nor restricts any rights of third parties.

4.5 Any appendices, alterations or additions to this Agreement can only be deemed valid if made in writing and signed by both parties hereto. Properly executed appendices, alterations and additions are an integral part of this Agreement.

4.6. This Agreement is made in two copies, one copy for each Party, both copies being equally authentic. In case of different interpretations of the Ukrainian and English texts, the English version of the Agreement has an interpretation priority.

надання технічної допомоги від імені USAID (Агенції з міжнародного розвитку США) з метою розвитку фінансового сектору в Україні, на безоплатній основі. Жодна із зазначених експертних та консультаційних послуг ІСК буде носити виключно дорадчий характер і у будь-якому разі не розцінюватиметься як пряма рекомендація до вчинення чи невчинення відповідних дій LeaseIT з відповідними фізичними чи юридичними особами, або ж як гарантія щодо таких фізичних чи юридичних осіб, а відповідно – не буде розглядатись як підстава для майнових та будь-яких інших різновидів позовів з боку LeaseIT та третіх осіб, чи будь-якої іншої юридичної відповідальності ІСК перед LeaseIT та третіми особами.

4.2. Жодне з положень цієї Угоди не може розглядатись як вимога до ІСК та/або її консультантів виконувати будь-які дії, які б потребували спосіб підлягали б ліцензуванню згідно чинного законодавства.

4.3. Будь-які розбіжності, які виникатимуть у процесі виконання цієї Угоди, підлягатимуть врегулюванню Сторонами у процесі переговорів на обопільно прийнятних умовах.

4.4. Ця Угода не породжує та не обмежує жодних прав третіх осіб.

4.5. Всі додатки, зміни і доповнення до цієї Угоди є дійсними за умови, що вони підготовлені у письмовій формі і підписані обома Сторонами. Оформлені належним чином додатки, зміни і доповнення є невід'ємною частиною цієї Угоди.

4.6. Цю Угоду складено у двох примірниках, по одному примірнику для кожної Сторони. Обидва примірники є рівно автентичними. У разі розбіжностей у тлумаченні положень примірнику на українській мові надається перевага.

PARTIES' ADDRESSES:

Closed joint-stock company "Leasing of information technologies" (LeaseIT)
Legal address: 28, Obolonsky prospect
Kyiv 04205, Ukraine
Mailing address: 28, Obolonsky prospect
Kyiv 04205, Ukraine
EDRPOU 33149830

Dmitri Bogodukhov
General Director of
CJSC "Leasing of information technologies"

АДРЕСИ СТОРІН:

Закрите акціонерне товариство «Лізинг інформаційних технологій»
Юридична адреса: 28, Оболонський проспект
Київ 04205, Україна
Фактична адреса: 28, Оболонський проспект
Київ 04205, Україна
Код за ЄДРПОУ 33149830

Дмитро Богодухов
Генеральний директор
ЗАТ «Лізинг інформаційних технологій»

The Access to Credit Initiative
The Pragma Corporation
72, V.Vasilkivska Street
Kyiv 03150
Ukraine

David C. M. Lucterhand
The Pragma Corporation
Chief of Party
Access to Credit Initiative
USAID/Ukraine

Ініціатива сприяння кредитуванню
Корпорації "Прагма"
вул. В. Васильківська, 72
03150, м. Київ-150
Україна

Девід Ч.М. Лактерхенд
Корпорація "Прагма"
Керівник Проекту
Ініціатива сприяння кредитуванню
АМР США/Україна

ATTACHMENT 6

December 7, 2005

Dear Mr. Skotskyk:

The Access to Credit Initiative is pleased to offer expertise and advisory services to Amako. Our efforts will focus on the company's business plan and certain business processes that are incorporated therein.

ATCI, which has the goal of facilitating the development of Ukraine's leasing industry, considers the successful development of Amako's finance company to be of great importance to the industry as a whole. Amako is the first company to establish a captive finance company targeting the agricultural sector in Ukraine. ATCI's assistance comports with the goals of USAID in Ukraine. Consequently, ATCI is pleased to offer Amako technical assistance in the form of advisory services without cost.

Specifically, ATCI proposes to provide Amako with advisory services to achieve the following agreed upon results:

6. An internal business plan for Amako's finance company based on international best practice. ATCI will focus primarily on the following areas in assisting Amako in developing the business plan:
    - Marketing and sales strategy;
    - Development of specific leasing products and establishment of the company's pricing strategies;
    - The company's credit policy and procedures.
7. Appropriate strategies, analyses and documents for potential outside funding sources.

The activities explained above fall under the goal of ATCI to provide technical assistance on behalf of the United States Agency of International Development (USAID) to facilitate the development of Ukraine's financial and agriculture sectors, in particular, Ukraine's agricultural leasing industry.

Therefore, the parties should agree to the terms and guidelines outlined in the attached confidentiality agreement that is to be signed by both parties - prior to our beginning cooperation.

Sincerely,

USAID Contractor
David C.M. Lucterhand
Project Director
Access to Credit Initiative
USAID/Ukraine

CONFIDENTIALITY AGREEMENT

Kyiv _____2005

“AMAKO Ukraine” LTD, (hereinafter referred to as - "Amako") a legal entity under the laws of Ukraine, represented by Mr. Vitaliy Skotsyk, on the one hand, and **The Access to Credit Initiative**, The Pragma Corporation (hereinafter referred to as - "ATCI") a legal entity duly incorporated under the laws of Ukraine, represented by Chief of Party Access to Credit Initiative USAID/Ukraine Mr. David C. M. Lucterhand, acting based on the Letter of attorney _____, on the other hand, hereinafter jointly referred to as Parties, have concluded the present Agreement (hereinafter referred to as "the Agreement") further to the ATCI’s Letter dated **“7” December 2005,** #____(hereinafter referred to “the Letter”) as follows:

2. SUBJECT

1.3. The subject of this Agreement shall be procedures and terms for using and protecting information transferred by the Parties to each other in the process of provision of expert and advisory services by the ATCI to the Amako, which are defined in the Letter.

1.4. The confidential information for the purposes of this Agreement shall be any information transferred by each of the Parties to the other Party in the course of negotiations and subject to protection under this Agreement but for the exceptions listed below.

Such information can be stated in letters, reports, analytical materials, results of surveys, schemes, charts, specifications and other documents, both in material and electronic forms (hereinafter "the Information").

1.3. The information to be kept confidential and not to be disclosed under the Agreement shall include (but not limited to) in particular:

e) financial statements;

f) accounting registers;

g) business plans;

h) information on financial, legal, structural and other relations between the Parties and their

УГОДА ПРО КОНФІДЕНЦІЙНІСТЬ

Київ _____ 2005р.

ООО «АМАКО Україна», (тут і далі по тексту Амако), що є юридичною особою відповідно до законодавства України в особі Віталія Скоцика, з одного боку, і "Ініціатива сприяння кредитуванню" Корпорації "Прагма" (надалі - "ІСК"), що є юридичною особою за законодавством України, в особі Керівника Проекту "ІСК" АМР США/Україна пана Девіда Ч.М. Лактерхенда, який діє на підставі Довіреності _____ з другого боку, разом - "Сторони", уклали цю Угоду (надалі - "Угода") на додаток до Листа ІСК від “_7_” грудня 2005 року, вих. № _____ (надалі - Лист) про таке:

1. ПРЕДМЕТ

1.1. Предметом цієї Угоди є порядок та умови використання і захисту інформації, яку Сторони передають одна одній у процесі надання ІСК Амако експертних та консультаційних послуг, визначених у Листі.

1.2. Конфіденційна інформація для цілей цієї Угоди означає будь-яку інформацію, яка передається будь-якою зі Сторін іншій Стороні в процесі проведення переговорів і яка підлягає захисту згідно з цією Угодою за винятком випадків, які описано нижче.

Ця інформація може міститись у листах, звітах, аналітичних матеріалах, результатах досліджень, схемах, графіках, специфікаціях та інших документах, які оформлені як на паперових, так і на електронних носіях (надалі - "Інформація").

1.3. Інформація, яка підлягає збереженню в таємниці і нерозголошенню згідно з цією Угодою, включає (але не обмежується) у тому числі:

e) фінансову звітність;

f) облікові регістри;

g) бізнес-плани;

h) відомості про фінансові, правові, організаційні та інші взаємовідносини між Сторонами і їхніми структурними

affiliated entities.

1.4. The information subject to protection and non-disclosure under this Agreement shall not include the following:

c) information in statements and reports officially published;

d) information in official reports, statements, press-releases, as well as advertising statements.

2. DUTIES OF THE PARTIES

2.1. Unless otherwise stipulated in the Ukrainian legislation, the Parties will not share, discuss the content, provide copies, publish or disclose the Information in any other form to third partied without the prior written consent of the other Party.

2.2. The Party which receives the Information may disclose it without a preliminary written consent of the other Party, provided such Information:

- was at its disposal upon legal grounds before obtaining from the other Party;
- is generally available;
- has become known to the Party from a source other than the other Party, provided the source is not subject to the commitment on non disclosure of the Information;
- has been demanded from the Party by administrative or law-enforcement body in cases and per the procedures as envisaged by the Ukrainian legislation.

3. PERIOD OF THE AGREEMENT

3.1. This Agreement takes effect upon signature thereof and will be valid for 3 (three) years.

4. OTHER CONDITIONS

4.1. Expert and advisory services defined in the Letter shall be provided by the ATCI to Amako within the ATCI's scope of technical assistance rendered on behalf of the USAID (the United

підрозділами.

2.4. До інформації, яка підлягає захисту та нерозголошенню згідно з цією Угодою, не відносяться:

c) відомості, які містяться у повідомленнях і звітах, які офіційно опубліковані;

d) відомості, які містяться в офіційних звітах, повідомленнях, прес-релізах, а також рекламних повідомленнях.

2. ОБОВ'ЯЗКИ СТОРІН

2.3. Якщо інше не передбачено законодавством України, Сторони зобов'язані не розголошувати, не обговорювати зміст, не надавати копій, не публікувати і не розкривати Інформацію у будь-якій іншій формі третім особам без отримання попередньої письмової згоди іншої Сторони.

2.4. Сторона, яка отримує Інформацію, може розкривати Інформацію без попередньої письмової згоди іншої Сторони у випадку, якщо ця Інформація:

- знаходилась на законних підставах в її розпорядженні до отримання від іншої Сторони;
- є загальновідомою;
- отримана Стороною від іншого джерела, яке не має зобов'язання щодо нерозголошення Інформації;
- вимагається від Сторони адміністративним або правоохоронним органом у випадках та у порядку, передбачених українським законодавством.

3. СТРОК ДІЇ УГОДИ

3.1. Ця Угода набирає чинності з моменту її підписання і діє протягом 3 (трьох) років.

4. ІНШІ УМОВИ

4.1. Надання ІСК Амако експертних та консультаційних послуг, визначених у Листі, здійснюватиметься у межах діяльності ІСК з надання технічної допомоги від імені USAID (Агенції з міжнародного розвитку США) з метою

States Agency for International Development) for the purpose of developing the financial sector in Ukraine on a free-of-charge basis. Any of the stated ATCI's expert and advisory services will be exclusively advisory in nature and in no case shall be qualified as direct recommendation for taking or not taking relevant actions by Amako with respect to the corresponding individuals or legal entities, or as a guarantee with respect to such individuals or legal entities and, correspondingly, shall not be regarded as the basis for claims of ownership or any other types of claims on the part of Amako and third parties, or for any other legal liability of the ATCI to Amako and third parties.

4.3. Any controversies that may arise in the course of implementation of this Agreement shall be settled by the Parties' mutual consent.

4.4. This Agreement neither creates nor restricts any rights of third parties.

4.5 Any appendices, alterations or additions to this Agreement can only be deemed valid if made in writing and signed by both parties hereto. Properly executed appendices, alterations and additions are an integral part of this Agreement.

4.6. This Agreement is made in two copies, one copy for each Party, both copies being equally authentic. In case of different interpretations of the Ukrainian and English texts, the Ukrainian version of the Agreement has an interpretation priority.

PARTIES' ADDRESSES:

"AMAKO UKRAINE" LTD.
Legal address: 2 Brovarska st., Prolisky vil.
Borispol region, Kyiv oblast, Ukraine, 08322

розвитку фінансового сектору в Україні, на безоплатній основі. Жодна із зазначених експертних та консультаційних послуг ІСК буде носити виключно дорадчий характер і у будь-якому разі не розцінюватиметься як пряма рекомендація до вчинення чи невчинення відповідних дій Амако з відповідними фізичними чи юридичними особами, або ж як гарантія щодо таких фізичних чи юридичних осіб, а відповідно – не буде розглядатись як підстава для майнових та будь-яких інших різновидів позовів з боку Амако та третіх осіб, чи будь-якої іншої юридичної відповідальності ІСК перед Амако та третіми особами.

4.3. Будь-які розбіжності, які виникатимуть у процесі виконання цієї Угоди, підлягатимуть врегулюванню Сторонами у процесі переговорів на обопільно прийнятних умовах.

4.4. Ця Угода не породжує та не обмежує жодних прав третіх осіб.

4.5. Всі додатки, зміни і доповнення до цієї Угоди є дійсними за умови, що вони підготовлені у письмовій формі і підписані обома Сторонами. Оформлені належним чином додатки, зміни і доповнення є невід'ємною частиною цієї Угоди.

4.6. Цю Угоду складено у двох примірниках, по одному примірнику для кожної Сторони. Обидва примірники є рівно автентичними. У разі розбіжностей у тлумаченні положень примірнику на український мові надається перевага.

АДРЕСИ СТОРІН:

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ATTACHMENT 7

Qualified Leasing Specialist

Outline of Course Content

Course I – The Leasing Environment

- History of Leasing
  - International evolution of leasing industry
  - Evolution of Leasing in Ukraine
  - Industry Standards and 'Code of Ethics'

- Classification and Terminology
  - Types of Leases in Ukraine
  - Other Common Types of Leases Internationally
  - Views of Leasing
  - Types of Lessors

- Legal Framework in Ukraine
  - Leasing legislation
  - Relevant Commercial Law
  - Relevant Bankruptcy Law
  - Legal Definitions and Terminology
  - Major Aspects of EU and American legal framework
  - Cross-border and International Lease Agreements

- Tax Treatment of lease Transactions
  - Ukrainian Tax Law
  - Major Aspects of EU and US tax framework

- Accounting Treatment of Lease Transactions
  - Ukrainian Accounting Standards
  - IAS 17 and GAAP 13

- Lease vs. Buy Analysis
  - Options for acquisition/use of lessee
  - Analysis of Lessee Cost and Profitability Indicators
  - Financial Decision Making Criteria
  - Non-Financial Decision Making Criteria
  - Presenting / Selling the Lease vs. Buy Decision

Course II – Lease Transactions

- Credit Process and Financial Statements
  - Types of Lease Transactions – Determines the type of Analysis
  - Financial Statement Analysis
  - Analysis of Non-Financial Information
  - Credit Enhancement
  - Using Financial Indicators in the Sales and Credit Processes

- Lease Documentation
    - Types and Flow of Lease Documents
    - Forms of Contract
    - Elements of a Lease Contract
    - Guarantee Documentation
    - Documenting Other Risks – Insurance, Related Parties, Monitoring Structures
    - Additional Collateral Agreements

- Collections
    - Monitoring Lessee Finances and Operations
    - Equipment Monitoring
    - Signs of Delinquency
    - Typical Reasons for Deliquency
    - Progression of a Delinquency and Lessor Actions
    - Possible Collection Remedies
    - Types of Repossession

- Lease Pricing
    - Present Value and Time Use of Money
    - Elements of Pricing and Profitability for a Lease Transaction
    - Payment Structures
    - Leasing Math – Solving for Different Payment Structures

Course III – Lessor Strategy and Operations

- Working with Funding Sources
    - Types of Funding Agreements
        - Equity
        - Recourse Lending (current situation)
        - Discounting and Brokering
        - Warehouse lines
        - Revolving Credit lines
    - Working with Ukrainian Banks
    - Post Import Financing (US ExIm Bank and Similar Entities)
    - Working with IFIs
    - Working with Venture Capital and Private Equity Investors
    - Portfolio Sales
    - Asset Securitization
    - Cross-Border Leasing / Subleasing

- Marketing and Sales
    - Defining Your Market
    - Targeted Marketing Programs
    - Working with Vendors
    - Elements of a Marketing Plan
    - Purpose of the Sales Function
    - Elements of a Successful Sales Process
    - Sales Techniques

- Lease Company Management
    - Structure / Organization of Leasing Company
    - Key Managers and their Roles
    - Key Management Issues

ATTACHMENT 8

Agribusiness Volunteer Program – Ukraine

Leasing Project/Amako, ULC, LH Project

Project Strategy

Beneficiary Organization:	Amako, Ukrainian Leasing Company, Leasing House
Location:	Kyiv, Lviv
Program Focus Area:	FA2 - Improving Farmer Access to Credit
Year Covered by Strategy:	1/1/06 – 12/31/06
Date Project Began:	August 2005
Partner Sponsor of Project:	Access To Credit Initiative, The Pragma Corporation
Prepared By:	Yana Kovdrysh, SED Project Coordinator
Date Submitted:	

I. Project Overview and Background:

(Begin with a one-paragraph summary of the thrust of the project; follow with a brief discussion of information additional to that contained in the (attached) Host Profile that is essential to understanding the project, including (a) background on the organization and why it is attractive as a recipient of training; (b) how CNFA became acquainted with it and conceived the project; (c) information about the partner sponsor if any, its relationship to the host, the objectives and assistance methodology in that relationship, and the anticipated division of labor between CNFA and the sponsor; and (d) background on key host and sponsor individuals and their relationships.)

At the beginning of 2004, the official rate of obsolescence for all agricultural fixed assets in Ukraine was approximately 52% and required over $8.5 billion for their renewal or replacement. More specifically, the obsolescence rate of agricultural machinery, equipment and motor vehicles was at least 80% for the same year. At the same time, total investments made in Ukraine by agricultural enterprises to upgrade old and purchase new fixed assets amounted to only a little over $300 million.

In order to replace the vast amount of old and inefficient machinery in Ukraine, enterprises need access to improved equipment finance products. Leasing, the world's most popular financial instrument for the acquisition of machinery and equipment, is still underdeveloped in Ukraine. Leasing is best suited for small and medium-sized business and the agricultural sector, which have neither lengthy credit histories, nor additional collateral to help secure funding. Relative to other financing sources, leasing companies typically focus more on a borrowers' ability to generate cash flow from business operations to service the lease payment and less on the balance sheet or on past credit history.

To support the growth of agricultural equipment leasing in Ukraine and expand access to this important financial instrument for Ukrainian farmers, CNFA and Pragma, implementing the USAID-funded Access to Credit Initiative (ATCI), have agreed to work together to strengthen the institutional capacity of three leasing companies. ATCI's in-depth knowledge and experience with Ukraine's finance markets and leasing industry, combined with the knowledge and experience of CNFA and its visiting U.S. agricultural finance consultants, will provide these strategically important financial service providers with access to advisory services that are unavailable in the Ukrainian market. The project will assist the three companies with: development of strategic plans, improvement of risk management and enterprise analysis skills, development of new leasing products and establishment of appropriate policies and procedures to better serve agricultural clients. **As a result of this joint project, CNFA anticipates that 107 agricultural lessees will benefit from increased access to credit.**

As stated above, leasing in Ukraine is still in its infancy. Financial leasing accounts for up to 30% of the total investment in fixed assets of enterprises in highly developed economies, but in Ukraine the share is around one percent. The overall need for renewed fixed assets in Ukraine that could be provided through leasing is 70 times more than current leasing market volume.

Development of leasing in Ukraine was spurred by the adoption of law "On Financial Leasing" in 2003. According to research conducted by IFC, there were just over 30 active leasing companies in Ukraine at the end of 2004. The total value of leased assets grew 89% from 318,818,000 UAH in 2003 to 602,886,000 UAH in 2004. Ownership of leasing companies in the market include state-owned (3%), bank-affiliated (16%) and leasing companies owned by other legal entities and individuals, including machinery vendors (81%). Bank credit is still the main source to finance leasing operations and, in 2004, financed about 80% of all lease contracts.

According to IFC's research, at the end of 2004, eight leasing companies in Ukraine offered leasing of agricultural equipment. Developing rural and agricultural finance programs within leasing companies is a challenging task in Ukraine. Leasing companies have not been eager to target SMEs and the agricultural sector because other sectors such as transport, real estate, construction, manufacturing, etc. still remain underserved by Ukraine's developing credit markets. Agribusiness lending and leasing require special programs and procedures and, in Ukraine, this segment does not offer easy returns and has historically seen high default rates.

One of CNFA's main goals in Ukraine is to increase farmer incomes through better access to credit and to date CNFA has achieved impressive results by bringing agriculture finance specialists to Ukraine to build capacity within the Ukrainian bank, Nadra. Experts helped Nadra, one of the ten largest banks in Ukraine, to develop strategies and internal procedures for marketing, credit analysis, and risk management in providing financing to agricultural and agriculture-related businesses. A natural next step is to build such capacity within leasing companies, which happens to be a key objective of the USAID Access to Credit Initiative (ATCI). The goal of ATCI's Leasing Component is to facilitate the development of Ukraine's leasing industry, providing SMEs and agricultural enterprises access to equipment finance to advance their growth and competitiveness.

ATCI has identified and introduced CNFA to lessors from the three main segments of the leasing industry: an independent lessor - Leasing House, a bank-owned lessor - Ukrainian Leasing Company, and a captive leasing company - AMAKO, owned by an agricultural machinery and equipment manufacturer.

Ukrainian Leasing Company (ULC):
Was created in 1999 as a limited liability company with UkrSibBank as the main founder and shareholder (99,996% of the shares). ULC offers both financial and operating leases, constituting 90% and 10% of the leasing portfolio respectively. ULC is one of the leading Ukrainian leasing companies, which, until recently was focused on leasing automobiles and train cars, trucks, buses, real estate, medical equipment, etc. Agricultural leasing is a new and insufficiently studied business direction for the company with numerous specific risks and little knowledge of the business capacity of potential clients who as a rule do not have liquid assets. To insure itself against potential risks, ULC has until now dealt with large Ukrainian agricultural companies or food processors like Myronivskyi Bakery, Nasha Ryaba (38% of Ukraine's poultry market), Rise Agro, Grain Trade Company. At the same time, ULC realizes the potential of leasing to the large SEM sector of the agriculture and food industries of the country and wants assistance with formulating a strategy or a work plan for working with this group of clients and training staff in its implementation.

Leasing House (LH):
The company was created in 2001 by five individuals as a limited liability company. LH offers both operational and financial leasing, employs a staff of ten specialists and has a current portfolio of over 80 lease contracts. LH began offering agricultural leasing services in 2005. Agricultural machinery and food processing equipment account for 18% of the value of all leased assets. LH established high credibility with six Ukrainian banks using them as a source of finance for leasing operations. The company is willing to increase the share of agricultural contracts in the portfolio provided it can find and properly select ag clients and assess risks related to ag leasing.

Amako:
The company was created in 1996 as a Ukrainian branch of the big machinery and equipment seller American Machinery Company. Recently, Amako Ukraine Ltd., a Ukrainian company with 100% foreign capital and $1.5 million net income, has decided to create an independent leasing company to increase sales to its current clients and significantly expand its client base and range of services. The business plan to create a leasing company is currently under development and operation of the leasing company is expected to begin in late January 2006.

Amako Ukraine now has about 7,000 clients with farms ranging from 120 to 75000 acres of land. It offers machinery, equipment and spare parts from 20 world leading manufacturers such as Massey Fergusson, Kuhn, Great Plains, Terra Marc, Wil-Rich LLC, etc. The company offers trade-in options when selling new machinery and provides trade credit (including leases) to some extent. Amako Ukraine seeks assistance in launching and managing an agricultural leasing company.

As Amako has yet to officially register its finance company, its participation in the project is tentative upon completion of this task. Development of these three leasing models will help to build capacity within each of the segments by showcasing lessor strategies and internal procedures for marketing, credit analysis and risk management in leasing to agricultural clients. The three leasing companies are interested in increasing their agribusiness leasing portfolio but lack expertise in the sector and require outside assistance. The objective of this joint project is to assist Ukrainian leasing companies to develop sound strategies as well as special procedures and products to provide lease financing for agricultural field and processing equipment to a greater number and more diverse range of agribusiness clients.

As its input, ATCI will provide CNFA consultants with a detailed and thorough analysis of the tax, legal, and business environment in which Ukrainian lessors operate. In addition, ATCI will incorporate the documents and procedures developed from this joint activity into its training, educational, and public awareness materials in order to build the agricultural leasing capacity in the maximum number of leasing companies operating in the Ukrainian market.

For its part, CNFA plans a total of three assignments over the course of fiscal year 2006: 1) sales and risk assessment, to provide the lessors with practical skills for serving and managing agricultural clients; 2) marketing and product development, to improve company efforts to attract a greater number and more diverse range of agricultural clients and 3) strategic planning, to help the three companies put their newly-gained knowledge and experience to use in developing a comprehensive strategy for further expansion into the agricultural sector in 2007 and beyond.

II. Anticipated Assignments and Objectives:

Assignment	Dates	Objectives
Sales and Risk Assessment	1st Quarter 2006	1. Leasing companies willing to expand their ag leasing activity, acquire practical skills to attract and select new ag clients, as well as assess and prevent ag leasing risks.
Marketing & Product Development	2nd Quarter 2006	1. Leasing companies willing to expand their ag leasing activity acquire skills to develop effective marketing strategies for their businesses and new leasing products attractive to ag clients. 2. Assist Amako, ULC and LH leasing companies develop new/update their current marketing strategies with a clearly defined agricultural component and create new ag leasing products attractive to their local ag clients.
Strategic Planning	2nd / 3rd Quarter 2006	1. Leasing companies willing to expand their ag leasing acquire strategic planning skills. 2. Amako, ULC and LH leasing companies develop new/update their current strategic plans stipulating steps to expand their agricultural leasing.

III. Desired Impacts

Impacts	Baseline Year - [1.01.04-12.31.04] Result	Last Year - [1.01.04.-09.30.05] Result	Current Year - [1.01.06-12.31.06] Target
1. Leasing companies develop new agricultural leasing products.	ULC: 0 LH: 0 A: 0	ULC: 0 LH: 0 A: 0	ULC: 1 LH: 1 A: 1
2. Leasing companies increase the total value of their leased agricultural assets.	ULC: 13,066,600 UAH LH: 0 UAH A: 0 UAH	ULC: 7,503,800 UAH LH: 2,570,668 UAH A: 0 UAH	ULC: 15,007,600TBD LH: 4,284,445 UAH A: 50,500,000 UAH
3. The number of ag sector clients increases.	ULC: 12 LH: 0 A: 0	ULC: 5 LH: 3 A: 0	ULC: 10 LH: 5 A: 100
Total Increased Access to Credit			**107 lessees** **59,717,577 UAH**

IV. Discussion of Anticipated Impact:

Explaining as necessary the impacts shown in the chart above. Include calculation of: ***a) income increase per beneficiary, b) income increase per volunteer assignment and c) number of beneficiaries per volunteer assignment*** *as key indicators of anticipated project impact. Highlight any numbers in boldface. Close with a summation of the role of CNFA volunteer assistance in producing the impacts anticipated for this project. If relevant, address also: possible influence of external factors and explanation of availability of net income data (Is net income available? If not, what information will be available that gives an indication of increased income?).*

As a result of the implementation of the ACTI/FtF Leasing Project during 2006, CNFA anticipates achieving the following impacts, which will translate into increased access to credit for Ukrainian farmers: a) a 59,717,577 UAH ($11,825,262) cumulative increase in the total value of the three companies'agricultural leased assets (almost sevenfold) and b) an increase of 107, or 93%, in the total number of the three companies' agricultural leasing clients.

CNFA believe that 115 clients (agribusinesses of all types, including farming enterprises, food processors and other related businesses) will obtain agricultural leases from ULC, LH and Amako. Also, because all three companies have clearly stated that expanding their agricultural leasing programs and developing an institutional capacity in agricultural leasing knowledge and procedures are their priorities, CNFA believes that ULC, LH and Amako will use the staff trained during these assignments to continue dissemination of the training and that these impact numbers will multiply many times over in succeeding years.

Attachment: Host Profile

Date of Submission:	November 2, 2005
Host Organization:	Amako, Ukrainian Leasing Company, Leasing House
Assignment Location:	Kyiv and Lviv
Scope Developed By:	Yana Kovdrysh, SED Project Coordinator and Roman Shynkarenko, ATCI

Assignment	Dates	Objectives
Marketing & Product Development	2nd Quarter 2006	1. Leasing companies seeking to expand their ag leasing activities will acquire skills to develop effective marketing strategies and new leasing products attractive to ag clients. 2. Leasing companies analyze opportunities and constraints for expanding business with small and medium farmers. 3. Amako, ULC and LH leasing companies will develop new/update their current marketing plans with a clearly defined agricultural component and create new ag leasing products attractive to their local ag clients.

Desired Qualifications of Volunteer:

- Extensive experience in practical aspects of financing for agricultural field machinery and processing equipment.
- Significant experience as a marketing, client or credit manager at a leasing company or bank focused on rural and/or agribusiness is preferred.
- Ability to compile appropriate instructional materials and effectively present a two-day seminar on marketing and product development for Ukrainian leasing professionals.

Issue Description:

The objective of this project is to facilitate access to credit for Ukrainian farmers and agribusinesses by assisting Ukrainian leasing companies **to develop sound strategies**, **improve risk management and enterprise analysis skills**, **develop specific products,** as well as **establish efficient procedures** for leasing equipment to agricultural and agriculture-related firms. These deliverables will facilitate the lessors' ability to increase lease volumes and adequately manage risks for such transactions. The project is implemented in conjunction with Access to Credit Initiative (ATCI), funded by USAID.

During this second assignment of the project, the CNFA consultant will **help** Ukrainian leasing companies Ukrainian Leasing Company, Leasing House and Amako **develop new/update their current marketing plans with a clearly defined agricultural component and create new agricultural leasing products attractive to their rural and agribusiness clients.** Special attention will be paid by the volunteer to opportunities for expansion of marketing efforts targeting smaller, less-capitalized clients, particularly small and medium farming operations.

As with all CNFA Agribusiness Volunteer Program assignments, this assignment will require some amount of pre-departure preparation in the United States. The amount of time required will depend on the experience, qualifications and resources of the volunteer. Specifically, the volunteer is expected to develop an outline and materials for the seminar portion of the training prior to arrival in country, in order to make maximum use of the time available once in Ukraine.

Desired Impacts:

Desired Impacts	Host Profile Verification Items
1. Leasing companies develop new ag lease products.	**Section D**, *Question 16* "What new agricultural lease products have you introduced this year?"
2. Leasing companies increase the number of their ag contracts.	**Section D**, *Question 2* "What is the total number of agricultural leases?"

3. Leasing companies increase the value of their ag leased assets.	**Section D,** *Question 5* "What is the total value of agricultural leased assets?"
4. The number of ag sector clients increases.	**Section D,** *Question 3* "How many agricultural clients have obtained leases?"

Background Update:
No background update since the Project Strategy of November 1, 2005.

The VASOW is to be updated and fine-tuned upon a needs assessment, which Access To Credit Initiative plans to conduct with the leasing companies involved in the project in December 2005 to survey their specific technical assistance needs and required areas of training.

Assignment Itinerary:

Day	Activity
Day 1	Arrive Kyiv, met by CNFA representative.
Day 2	Briefing at CNFA. Review assignment objectives and schedule. Lunch Briefing at ATCI to acquire firsthand knowledge of the situation with agricultural leasing in Ukraine and ATCI's leasing development activities, discuss expectations from the assignment.
Day 3-4	Prepare for the workshop. With CNFA and ATCI, review workshop agenda and training materials. If required, meet with ULC and Amako.
Day 5-6	Workshop for reps of several (up to 15) leasing companies with ag contracts. Make sure to cover the following: 1. Development of targeted marketing strategy of leasing company. 2. Sources of market information for marketing strategy development. 3. Client management as a source of market information. 4. Designing the pattern of marketing campaigns, effective use of resources available. 5. Strategic and marketing planning as an instrument of risk management. 6. Types of equipment, structuring the basket of products. 7. Types of ag leasing products.
Day 7	Day off.
Day 8-10	Hands-on training: **Ukrainian Leasing Company**. With Director Lyudmila Zolotareva and appointed staff, revise the company's marketing plan to include anexpanded ag leasing component. Brainstorm about and develop new ag leasing products attractive to their local ag clients, including, if appropriate, small and medium farmers.
Day 11-13	Hands-on training: **Amako**. With company director and appointed staff, revise the company's marketing plan and brainstorm about and develop new ag leasing products attractive to their local ag clients including, if appropriate, small and medium farmers.
Day 14	Review of conducted training with CNFA and ATCI. Take overnight train to Lviv
Day 15-17	Arrive Lviv. Hands-on training: **Leasing House.** With Director Oleg Sytyuk and appointed staff, revise the company's marketing plan to include an expanded ag leasing component. Brainstorm about and develop new ag leasing products attractive to their local ag clients. Brainstorm about and develop new ag leasing products attractive to their local ag clients including, if appropriate, small and medium farmers. Take train back to Kyiv.
Day 18	Arrive Kyiv. Day off
Day 19	Trip report writing. Debriefing at CNFA.
Day 20	Leave for US.

Lodging:

While in Kyiv, accommodations will be at the SED Volunteer apartment. This modest Ukrainian apartment is a short distance from the CNFA Ukraine office. The volunteer will have full access to bathing and cooking facilities and laundry and cleaning services. All services are included in the price of rent.

On assignment, the volunteer and translator will stay with a host family. Separate rooms will be provided for the volunteer and translator and all meals and laundry services will be provided by the host family. As a token of appreciation, small gifts for the host family are acceptable, e.g. American chocolate, handcrafts, and photographs (p*lease note that CNFA cannot pay for these items out of expense accounts*).

Recommended Preparation:

- For specific medical and packing recommendations, please see the CNFA Ukraine briefing book. For economic, health, agricultural and general information on Ukraine, visit CNFA's AVP Resource Center on the "Volunteer Now" section of our web site at www.cnfa.org.
- The use of slides, videos, overheads, *PowerPoint* presentations and hands-on activities to emphasize main points are strongly recommended during your assignment. **All workshop resource materials that the volunteer intends to use in Ukraine and that need to be translated must be sent to Eric Wallace as soon as possible and no later than 2 weeks before departure from the U.S**.
- The volunteer has full access to CNFA Ukraine's slide projector, overhead projector, television, VCR, laptop computer, flip-chart stand and library. A comprehensive list of our library's contents may be obtained from Eric Wallace before arriving in Ukraine.
- CNFA strongly recommends full review of the project Host Profile, Project Strategy, and Project Impact Assessment (if any) before arriving in-country on assignment.

Project Contacts:

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Date of Submission: November 2, 2005
Host Organization: Amako, Ukrainian Leasing Company, Leasing House
Assignment Location: Kyiv and Lviv
Scope Developed By: Yana Kovdrysh, SED Project Coordinator and Roman Shynkarenko, ATCI

Assignment	Dates	Objectives
Sales & Risk Assessment	1Q 2006	1. Leasing companies willing to expand their ag leasing activities will acquire practical skills in identifying and attracting clients, as well as assessing and managing ag leasing risks. 2. Leasing companies analyze opportunities and constraints for expanding business with small and medium farmers. 3. Leasing companies identify their specific technical assistance needs and required areas of training, filling out a needs assessment questionnaire to be prepared and submitted by the CNFA volunteer by December 10th, 2005.

Desired Qualifications of Volunteer:

- Extensive experience in theoretical and practical aspects of financing for agricultural field machinery and processing equipment.
- Experience working in a leasing company or financial institution in sales, client or risk management for the rural and/or agribusiness market is preferred.
- Ability to compile appropriate instructional materials and effectively present a two-day seminar on sales techniques and risk assessment for Ukrainian leasing professionals.

Issue Description:

The objective of this project is to facilitate access to credit for Ukrainian farmers and agribusinesses by assisting Ukrainian leasing companies **to develop sound strategies**, **improve risk management and enterprise analysis skills**, **develop specific products,** as well as **establish efficient procedures** for leasing equipment to agricultural and agriculture-related firms. These deliverables will facilitate the lessors' ability to increase lease volumes and adequately manage risks for such transactions. The project is implemented in conjunction with Access to Credit Initiative (ATCI), funded by USAID.

During this first assignment of the project, the CNFA consultant will help Ukrainian leasing companies Ukrainian Leasing Company, Leasing House and Amako acquire **practical skills to select and meet the needs of new agricultural clients,** as well as **assess and manage agribusiness leasing risks.** Special attention will be paid by the volunteer to the opportunities and constraints associated with serving smaller, less-capitalized clients, particularly small and medium farming operations.

As with all CNFA Agribusiness Volunteer Program assignments, this assignment will require some amount of pre-departure preparation in the United States. The amount of time required will depend on the experience, qualifications and resources of the volunteer. Specifically, the volunteer is expected to develop an outline and materials for the seminar portion of the training prior to arrival in country, in order to make maximum use of the time available once in Ukraine. **Importantly, the volunteer will also develop and submit a needs assessment questionnaire by December 10th**, in order to survey in advance the specific technical assistance needs and required areas of training of the participating leasing companies.

Desired Impacts:

Desired Impacts	Host Profile Verification Items
1. Leasing companies develop new ag lease products.	**Section D**, *Question 16* "What new agricultural lease products have you introduced this year?"
2. Leasing companies increase the number of their ag contracts.	**Section D**, *Question 2* "What is the total number of agricultural leases?"
3. Leasing companies increase the value of their ag leased assets.	**Section D,** *Question 5* "What is the total value of agricultural leased assets?"
4. The number of ag sector clients increases.	**Section D,** *Question 3* "How many agricultural clients have obtained leases?"

Background Update:
No background update since Project Strategy of November 1, 2005.

The SOW is to be updated and fine-tuned based upon results of the needs assessment, which ATCI plans to conduct with the leasing companies to be involved in the project. The needs assessment will take place in December 2005 and survey the specific technical assistance needs and required areas of training for participating lessors. The CNFA volunteer will develop and submit to CNFA a relevant needs assessment questionnaire by December 10th, 2005.

Assignment Itinerary:

Day	Activity
Day 1	Arrive Kyiv, met by CNFA representative.
Day 2	Briefing at CNFA. Review assignment objectives and schedule. Lunch Briefing at ATCI to acquire firsthand knowledge of the situation with agricultural leasing in Ukraine and ATCI's leasing development activities, discuss expectations from the assignment.
Day 3-4	Prepare for the workshop. With CNFA and ATCI, review workshop agenda and training materials. If required, meet with ULC and Amako.
Day 5-6	Workshop for reps of several (up to 15) leasing companies with ag contracts. Make sure to cover the following: 1. Knowing client needs and advisory support. 2. Effective sales techniques. 3. Using additional services as a marketing tool. 4. Staff training, useful skills and principles of client management. 5. Client and equipment monitoring as an effective tool to secure leasing portfolio. 6. Main sources of risks while dealing with agribusiness clients. 7. Principles of risk assessment and risk rating. 8. Risk mitigation strategies. 9. Managing risks of long-term portfolio. 10. Risk instruments for agribusiness. 11. Product development at a leasing company. 12. Accumulation of product portfolio and securitization.
Day 7	Day off.
Day 8-10	Hands-on training: **Ukrainian Leasing Company**. Upon becoming familiar with ULC's ag lease products and clients, train appointed staff in effective sales techniques of the company's

	products, assessment/mitigation of related ag leasing risks, as well as management and monitoring of the company's clients.
Day 11-13	Hands-on training: **Amako**. Upon becoming familiar with Amako Ukraine's range of products, services and clients, train appointed staff of the new leasing company in effective sales techniques of the company's products, assessment/ mitigation of related ag leasing risks, as well as management and monitoring of the company's clients.
Day 14	Review of conducted training with CNFA and ATCI. Take overnight train to Lviv.
Day 15-17	Arrive Lviv. Hands-on training: **Leasing House**. Upon becoming familiar with LH's ag lease products and clients, train appointed staff in effective sales techniques of the company's products, assessment/mitigation of related ag leasing risks, as well as management and monitoring of the company's clients. Take train back to Kyiv.
Day 18	Arrive Kyiv. Day off
Day 19	Trip report writing. Debriefing at CNFA.
Day 20	Leave for US.

Lodging:

While in Kyiv, accommodations will be at the SED Volunteer apartment. This modest Ukrainian apartment is a short distance from the CNFA Ukraine office. The volunteer will have full access to bathing and cooking facilities and laundry and cleaning services. All services are included in the price of rent.

On assignment, the volunteer and translator will stay with a host family. Separate rooms will be provided for the volunteer and translator and all meals and laundry services will be provided by the host family. As a token of appreciation, small gifts for the host family are acceptable, e.g. American chocolate, handcrafts, and photographs (*please note that CNFA cannot pay for these items out of expense accounts*).

Recommended Preparation:

- For specific medical and packing recommendations, please see the CNFA Ukraine briefing book. For economic, health, agricultural and general information on Ukraine, visit CNFA's AVP Resource Center on the "Volunteer Now" section of our web site at www.cnfa.org.
- The use of slides, videos, overheads, *PowerPoint* presentations and hands-on activities to emphasize main points are strongly recommended during your assignment. **All workshop resource materials that the volunteer intends to use in Ukraine and that need to be translated must be sent to Eric Wallace as soon as possible and no later than 2 weeks before departure from the U.S**.
- The volunteer has full access to CNFA Ukraine's slide projector, overhead projector, television, VCR, laptop computer, flip-chart stand and library. A comprehensive list of our library's contents may be obtained from Eric Wallace before arriving in Ukraine.
- CNFA strongly recommends full review of the project Host Profile, Project Strategy, and Project Impact Assessment (if any) before arriving in-country on assignment.

Project Contacts:

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011 (380 32) 298-2939 [office fax]
opti@infocom.lviv.ua

Date of Submission: November 2, 2005
Host Organization: Amako, Ukrainian Leasing Company, Leasing House
Assignment Location: Kyiv and Lviv
Scope Developed By: Yana Kovdrysh, SED Project Coordinator and Roman Shynkarenko, ATCI

Assignment	Dates	Objectives
Strategic Planning	2nd/3rd Quarter 2006	1. Leasing companies that are willing to expand their ag leasing, acquire strategic planning skills. 2. Leasing companies determine role of small and medium farmers in their strategic plans. 3. Amako, ULC and LH leasing companies develop new/update their short- and long-term strategic plans to expand their agricultural leasing.

Desired Qualifications of Volunteer:

- Extensive experience in practical aspects of financing for agricultural field machinery and processing equipment.
- At least 5 years professional experience working for a leasing or finance institution with a stable portfolio of agribusiness-related transactions is preferred.
- Ability to compile appropriate instructional materials and effectively present a two-day seminar on strategic planning for Ukrainian leasing professionals.

Issue Description:

The objective of this project is to facilitate access to credit for Ukrainian farmers and agribusinesses by assisting Ukrainian leasing companies **to develop sound strategies**, **improve risk management and enterprise analysis skills**, **develop specific products,** as well as **establish efficient procedures** for leasing equipment to agricultural and agriculture-related firms. These deliverables will facilitate the lessors' ability to increase lease volumes and adequately manage risks for such transactions. The project is implemented in conjunction with Access to Credit Initiative (ATCI), funded by USAID.

During this third assignment of the project, a CNFA volunteer will help three Ukrainian leasing companies - Ukrainian Leasing Company, Leasing House and Amako – to **develop new or update existing short-term and long-term strategic plans, stipulating steps to expand their agricultural leasing**. Special attention will be paid by the volunteer to opportunities and constraints associated with serving smaller, less-capitalized clients, particularly small and medium farming operations.

As with all CNFA Agribusiness Volunteer Program assignments, this assignment will require some amount of pre-departure preparation in the United States. The amount of time required will depend on the experience, qualifications and resources of the volunteer. Specifically, the volunteer is expected to develop an outline and materials for the seminar portion of the training prior to arrival in country, in order to make maximum use of the time available once in Ukraine.

Desired Impacts:

Desired Impacts	Host Profile Verification Items
1. Leasing companies develop new ag lease products.	**Section D**, *Question 16* "What new agricultural lease products have you introduced this year?"
2. Leasing companies increase the number of their ag contracts.	**Section D**, *Question 2* "What is the total number of agricultural leases?"
3. Leasing companies increase the value of their ag leased assets.	**Section D,** *Question 5* "What is the total value of agricultural leased assets?"

4. The number of ag sector clients increases.	**Section D,** *Question 3* "How many agricultural clients have obtained leases?"

Background Update:
No background update since the Project Strategy was completed on November 1, 2005.

The VASOW is to be updated and fine-tuned upon a needs assessment, which Access To Credit Initiative plans to conduct with the leasing companies involved in the project in December 2005 to survey their specific technical assistance needs and required areas of training.

Assignment Itinerary:

Day	Activity
Day 1	Arrive Kyiv, met by CNFA representative.
Day 2	Briefing at CNFA. Review assignment objectives and schedule. Lunch Briefing at ATCI to acquire firsthand knowledge of the situation with agricultural leasing in Ukraine and ATCI's leasing development activities, discuss expectations for the assignment.
Day 3-4	Prepare for the workshop. With CNFA and ATCI, review the workshop agenda and training materials. If required, meet with ULC and Amako.
Day 5-6	Workshop for reps of several (up to 15) leasing companies with ag contracts. Make sure to cover the following: 1. Identification of company strategic targets. 2. Goals and objectives of a leasing company (segments, client groups, prospective product lines). 3. Setting timeframe for goals achievement. 4. Structuring company business and products diversification. 5. Staff training and motivation to meet strategic goals. 6. Optimization of company procedures. 7. Strategic and marketing planning as an instrument of risk management.
Day 7	Day off
Day 8-10	Hands-on training: **Ukrainian Leasing Company**. With Director Lyudmila Zolotareva and appointed staff, review the company's strategic plan. Assist with revision of their immediate and long-term strategic plans, aiming to increase the ag share of the lease portfolio and, if appropriate, the volume of business with small and medium farmers.
Day 11-13	Hands-on training: **Amako**. With Director Vitaliy Skotsyk and appointed staff, review the company's strategic plan. Assist with revision of their immediate and long-term strategic plans, aiming to increase the ag share of the lease portfolio and, if appropriate, the volume of business with small and medium farmers.
Day 14	Review of conducted training with CNFA and ATCI. Take overnight train to Lviv.
Day 15-17	Arrive Lviv. Hands-on training: **Leasing House.** With Director Oleg Sytyuk and appointed staff, review the company's strategic plan. Assist with revision of their immediate and long-term strategic plans, aiming to increase the ag share of the lease portfolio and, if appropriate, the volume of business with small and medium farmers. Take train back to Kyiv.
Day 18	Arrive Kyiv. Day off
Day 19	Trip report writing. Debriefing at CNFA.
Day 20	Leave for US.

Lodging:

While in Kyiv, accommodations will be at the SED Volunteer apartment. This modest Ukrainian apartment is a short

distance from the CNFA Ukraine office. The volunteer will have full access to bathing and cooking facilities and laundry and cleaning services. All services are included in the price of rent.

On assignment, the volunteer and translator will stay with a host family. Separate rooms will be provided for the volunteer and translator and all meals and laundry services will be provided by the host family. As a token of appreciation, small gifts for the host family are acceptable, e.g. American chocolate, handcrafts, and photographs (*please note that CNFA cannot pay for these items out of expense accounts*).

Recommended Preparation:

- For specific medical and packing recommendations, please see the CNFA Ukraine briefing book. For economic, health, agricultural and general information on Ukraine, visit CNFA's AVP Resource Center on the "Volunteer Now" section of our web site at www.cnfa.org.
- The use of slides, videos, overheads, *PowerPoint* presentations and hands-on activities to emphasize main points are strongly recommended during your assignment. **All workshop resource materials that the volunteer intends to use in Ukraine and that need to be translated must be sent to Eric Wallace as soon as possible and no later than 2 weeks before departure from the U.S**.
- The volunteer has full access to CNFA Ukraine's slide projector, overhead projector, television, VCR, laptop computer, flip-chart stand and library. A comprehensive list of our library's contents may be obtained from Eric Wallace before arriving in Ukraine.
- CNFA strongly recommends full review of the project Host Profile, Project Strategy, and Project Impact Assessment (if any) before arriving in-country on assignment.

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ATTACHMENT 9

The Access to Credit Initiative (ATCI), funded by USAID is hosting the seminar:

"Leasing Practice in Ukraine"

The seminar targets enterprise managers who are seeking ways to finance the purchase of capital assets to modernize and grow their business. Participants will also include manufacturers and sellers of equipment who are interested in working with leasing companies to facilitate financing for their customers as part of their marketing and sales strategy. Also present will be Ukraine's leading lessors with whom managers can speak about the specific asset financing needs of their business.

The seminar will explain in practical terms how leasing works in Ukraine, the legal and tax treatment of lease transactions, how lessors decide whom to provide lease financing, and conditions typically offered by Ukrainian lessors. The goal of the seminar is to provide enterprise managers with the necessary information to assess whether lease financing is right for their business

ATCI is a five-year project funded by USAID to facilitate greater access to credit by Ukraine's SMEs and individuals by promoting the development of Ukraine's financial markets in four key areas: primary and secondary mortgage markets, leasing industry, municipal finance using capital markets, and establishment of a credit bureau for Ukraine.

The seminar will take place on October 28, 2005 at The Dnister Hotel in Lviv from 10.00-14.00. Please find the seminar agenda attached.

The seminar is open to the public and free of charge. However, space is limited and it is recommended that you contact ATCI as soon as possible to confirm your participation by email to kozyaruk@pragmacorp.com.ua or by telephone at 537-0966. **To be added to the list of participants it is necessary to register before 17.00 on Wednesday, October 26.**

Seminar - Leasing Practice in Ukraine

October 28, 2005
The Dnister Hotel, 6 Matyeka Str., Lviv

09.30 – 10.00	**Registration**
10.00 – 10.10	**Introduction*** *Richard Caproni, Senior Advisor - ATCI*
10.10 – 10.30	**Leasing – International Experience and the Situation in Ukraine** *Roman, Shynkarenko, Leasing and Credit Advisor - ATCI*
10.30 – 10.45	**Results from the Survey of Ukraine's Leasing Market** *Julia Shevchuk, Legal Advisor - IFC Ukraine Leasing Development Project*
10.45 – 11.00	**Strategies and Development of Ukrainian Lessors** *Ludmila Zolotereva, Director - Ukraine Leasing Company*
11.00 – 11.30	**Is Leasing the Right Strategy for Your Business?** *Liliya Snigir, Leasing and Credit Advisor - ATCI*
11.30 – 11.50	**Coffee Break**
11.50 – 12.30	**Legal Aspects of Lease Transactions in Ukraine** *Serghiy Kysil, Senior Legal Advisor - ATCI*
12.30 – 12.50	**Working with Lessors** *Liliya Snigir, Leasing and Credit Advisor - ATCI*
12.50 – 13.10	**How to Choose the Right Lessor for Your Business** *Roman, Shynkarenko, Leasing and Credit Advisor - ATCI*
13.10 – 13.25	**Practical Lessons for Working with Lessors in Ukraine** *Oleg Sytyuk, General Director – Leasing House Ltd.*
13.25 – 13.45	**Ответы на вопросы и закрытие семинара** *Richard Caproni, Senior Advisor - ATCI*
13.45 – 14.30	**Reception and Networking**

Seminar report

Dear Colleagues:

ATCI held its third seminar, "Leasing Practice in Ukraine," for leasing industry participant in Lviv on October 28th.

The overall goal of the seminar was to increase the knowledge and understanding of leasing and its benefits among key target groups.

In achieving this goal, the event contributed to each the four objectives of ATCI's Leasing Component:

- Improving the capacity of industry participants such as lessors, banks, insurance companies and equipment vendors to engage in sound leasing activity based on international best practice, and help the industry reach its growth potential;
- Establishing a supportive legal, tax, regulatory and credit environment for lease transactions that encourages development of the industry and increases access to medium- and long-term equipment financing for SMEs, Agribusiness, and other industries;
- Helping attract both debt and equity capital from domestic and foreign sources for existing leasing companies and attract new market participants;
- Creating a better understanding and image of leasing and its benefits in Ukraine's business, banking, investment and government communities to increase demand and facilitate achieving the other three objectives.

More specifically, the seminar contributed to meeting these objectives by accomplishing the following:

- Building capacity among existing and potential leasing industry participants in attendance, which included vendors, banks, potential lessees, and government officials by providing a clear understanding of exactly how leasing works in Ukraine today;
- Explain why and for whom leasing is a good alternative for financing equipment and how it compares to other financing options available in the market;
- Facilitate an increase in leasing activity by providing a forum for potential industry participants to establish contact and begin working together;
- Provide a clear understanding of the legal and tax treatment of lease transactions
- Garner grass-roots level support for the development of leasing in Ukraine including improvement of the tax and legislative environment for leasing;

Overall, there were 58 participants that registered, excluding representatives from ATCI and IFC. The attendees are broken down as follows:

- A total of 10 leasing companies attended; three of them gave presentations; and six of the ten have at least 10% of their portfolio in leases for production equipment and/or agricultural machinery.
- Three banks attended; two of them are in the process of deciding whether to begin leasing activity in the near future, ATCI discussed with them at length how we may assist them and have scheduled follow-on meetings.
- Sixteen local companies attended who were interested in either accessing lease financing (lessees) or partnering with a leasing company (vendors) to provide financing to their customers and therefore increase sales. Of the sixteen, the Project is aware that three are in the agribusiness sector. One of them, Lviv Macaroni Factory who leases most of the equipment used in its business, is part of a holding company that is doing due diligence regarding the establishment of their own leasing company.
- Government officials from the Oblast Economic Department, the Securities Commission, the Financial Services Regulator and representatives from the Ukrainian Union of Industrialists and Entrepreneurs (UUIE) also attended. Subsequently, ATCI has met with UUIE and agreed to cooperate in terms of facilitating improvements to the legal and tax environment for leasing (see ATCI Weekly Digest – Nov. 11).

Therefore, specific results or project activity resulting from the seminar include:

- ATCI has preliminary agreed to working with Universal Bank to assess and develop their strategy for entering the leasing market. A meeting is tentatively scheduled for this week.
- ATCI has agreed to cooperate with UUIE in lobbying for improvements to the legal and tax environment for leasing. ATCI participated in a round table held by UUIE regarding the organization's recommendations to be presented to the Cabinet of Ministers for the second reading of the Law on the Budget of Ukraine for 2006. ATCI provided its recommendations and will confirm this week that the recommendations were included.

- ATCI agreed to provide legal and tax advice regarding a customer default for an ‘international finance lease contract.’
- ATCI followed up with Lviv Macaroni Factory to discuss ATCI providing assistance in establishing a leasing company. They are very interested in working with ATCI and informed us that they will be registering with the Commission on Regulation of Financial Services Markets within the next 2 weeks after which they will begin development of their business plan. It was agreed to hold a meeting at that time (the last week of November) to discuss specific services and assistance that ATCI may provide.

Richard F. Caproni
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The Pragma Corporation
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fax:+38 044 537-0967

-----Original Message-----
From: Richard Caproni
Sent: Friday, October 14, 2005 9:45 AM
To: David Lucterhand
Cc: Roman Shynkarenko; Alsou Khoussainova
Subject: Seminar in Lviv

Dear David:

Attached is the budget for the Lviv Seminar. It is rather comprehensive and even includes the cost of in-house materials used for handouts, etc.

As this is our second seminar in the ‘regions,’ it incorporates lessons learned and is very representative of what the cost will be for the many seminars we will deliver over the next 2 years. We plan to do such seminars about every 6 weeks, about 15 in total.

As a reminder, here is information about the seminar:

Seminar: ***Leasing Practice in Ukraine*** **– October 28, 2005, Lviv**
Goal: To increase awareness of leasing as an effective method to finance the acquisition of capital equipment among SMEs and Agribusinesses. This seminar is part of a series of seminars to be delivered throughout Ukraine to fulfill Task B of the Project Plan - Public Awareness and Education Campaign.
Target Audience: SMEs and agribusinesses in the Lviv Oblast who are a) potential lessees or b) equipment vendors. ATCI worked with Ukrleasing Association, local lessors, government officials in Lviv, industry associations and others to identify target companies from both categories. Attendees will also include local government officials who work in the area of economic development, USAID's Agriculture Marketing Project, the BIZPRO Project and their client organizations, local area banks, and representatives of leasing companies.
Subject / Content: The seminar will provide attendees with a detailed explanation of what leasing is, its advantages relative to other forms of financing, and exactly what to expect when working with leasing companies in Ukraine. The seminar uses practical examples and documents from lessors in Ukraine. Representatives from two leasing companies and the IFC Leasing project will be making presentations as part of the seminar.
Additional Benefits: The seminar also allots time and conditions for 'match-making' between lessors, potential lessees, equipment vendors, and representative of banks who fund leasing companies.
Other: In addition to this seminar, ATCI will be making a presentation at a seminar for journalists hosted by IFC on Thursday, October 27.

Kind regards,

Richard F. Caproni
Senior Advisor
Ukraine Access to Credit Initiative
The Pragma Corporation
tel: +38 044 537-0966
fax:+38 044 537-0967

Actual participants

	Organization	Name	Position	Nr.	55
1	Brodyagrobud	Skoryk Grigoriy, Bogdan Hitka	Director, Commercial Director	2	
1	Bank Universalnyy	Anatoliy Pokhodzyaev, Sergiy Stratonov	Consultant of the General Director	2	
1	Galych-Auto	Volodymyr Bodnaryuk	Deputy of the President on economic issues	1	
1	Rosan-Capital	Oleksandra Drabyk	Head of Investment Projecting	1	
1	Lviv territorial securities department	Diana Savytska, Maria Yakubovych, Zinovia Odnorig, Galyna Nashkerska	Head of the Territorial Administration, Head of the Territorial Administration Department, Head of the Ter. Administration Sector, Director of the audit company "LIM-audit-partner"	4	
1	Management Consulting Group	Mykhailo Gumenchyk	Director	1	
1	PL Leasing	Yuriy Svidzinskyy, Mykhailo Yaremko	Director; Head of Projects and Programs dep.	2	
1	Ukrainian Union of manufacturers and entrepreneurs	Tetyana Ponomarenko, Anastasiya Perbushena	Deputy Director, Department of Economic Policy	2	
1	GalAvto	Bogdan Kroshnyak	General Director	1	
1	Rodon	V. Guts	Head of the Financial department	1	
1	"IMBO"	Lyudmyla Svischova	Head of the Legal Department	1	
1	Factor, Consulting Corp.	Vadym Novakivskyy	Director	1	
1	Las-Instrument	Galyna Shnitsar	Head Economist	1	
1	Lvivagromashproject	Stepan Semyrak	Deputy Chief of the Board	1	

1	Raiffeisenbank Ukraine	Oleg Pelykh, Oksana Volchko	Head of the Department of Financing Small and Medium Business, Economist of the Servicing sector	2
1	Euro Leasing	Yulian Ryshnyak	Director, Business Development Manager	2
1	Optima Leasing	Ihor Karachevskyy	Representative in Western Region	1
1	Ukreximleasing	Oleksiy Panchenko	Economist of the Leasing Department	1
1	Ilta-Lviv	Oleg Dykyy	Deputy Commercial Director	1
1	Lviv pasta factory	Mykola Matveev	Deputy Head of the Board on economical issues	1
1	Techno	Oleksandra Tybitka	Head Accountant	1
1	Leasing company Avis	Igor Naumenko, Aleksey Taran	Account Manager	2
1	Lviv State Administration, Head Economic Department	Yuriy Tymoshenko, Oleksandra Baytsar, Liliya Moravska, Lyubov Maksymovych, Rostyslav Soroka, Olga Duma		6
1	Lviv Car Factory	Anatoliy Zagorodniy	Deputy Chief of the Board	1
1	International Finance Corporation	Julia Shevchuk	Legal Advisor	1
1	Company Leasing House	Oleg Sytyuk	General Director	1
1	Regional Department of the State committee of Financial Monitoring	Oleksandr Glushchenko	First Deputy	1
1	Repair and Instrument plant	Lesya Kovalenko	Accountant, Financial Specialist	1
1	Mike	Yuriy Melnik	Deputy Director	1
1	Lvivautozapchastyna	Volodymyr Dyakiv	Chief Engineer	1
1	Radar LV	Natalya Tkachenko	Head Accountant	1
1	Ukrsibbank	Ihor Sovyak	Head of the Small and Medium Business	1

			Development Dep.	
1	First Lease / Hertz	Sergiy Dmytruk, Frederic Hamain, Petro Petryshyn	National Sales Manager, Commercial Manager for Lviv Office	1
1	First Western-Ukrainian Leasing Company	Sergiy Fedorov	Manager	1
1	Expert Group	Tetyana Lisova	Manager	1
1	Jetstream Staffing	Mykhailo Detsyk	Staff Manager	1
1	"Astra" Renault Trucks	Roman Tarasymchuk		1
1	Western Informational Corporation	Ulyana Fminko	Journalist	1
1	HTH-Novotech Sp.	Borys Furdas	Technical Specialist	1
	Ukrainian Leasing Company	Oksana Kleban	Regional Representative	1

ATTACHMENT 10

December __, 2005

Deputy Minister Lisovenko:

USAID is working closely with other international donors and key industry participants to develop a taxation strategy that will stimulate the growth of Ukraine's leasing industry and thus increase the amount of capital investment in Ukraine. The purpose of this letter is to request a meeting with you and specialist in your tax department to discuss this important matter.

In December of 2003, Ukraine adopted a Law of Financial Leasing which regulates the contractual relationship between lessees and lessors. However, this law did not address the critical issues of tax and accounting. As a result, Ukraine's financial leasing industry has not developed. This is disappointing, as financial leasing could be an excellent means to increase greatly capital investment in this country, particularly in the important agricultural sector. Experts agree that the current tax policy in Ukraine is a major constraint to the growth of the leasing industry.

As a result of current tax legislation, the penetration rate (percent of all investment in fixed assets funded through leasing) for leasing has remained around one percent. This compares to penetration rates of 15-30% in countries where the leasing industry is well developed. When the government of Russia adopted a favorable tax regime, the penetration rate grew from 3% in 2002 to 6-7% in 2004, totaling almost $6 billion new contracts. Other comparisons among Ukraine's neighbors include penetration rates of 15% in Slovakia, 22% in Hungary, and 11% in Poland. Each of these countries used different policies that may serve as examples for Ukraine.

The USAID funded Commercial Law Center, the Access to Credit Initiative, and the International Finance Corporation (IFC) Leasing Project have developed a package of tax recommendations that are consistent with international best practices that would accelerate the growth of financial leasing in Ukraine. We are confident the implementation of these recommendations would increase long-term tax revenues for the Government of Ukraine.

Representatives from the three projects would like to meet with you and specialists from the tax department to vet the proposed recommendations. We look to the Ministry of Finance to determine how these recommendations should be adapted or amended to best suit the legal and regulatory (particularly tax) environment Ukraine.

Attached is a summary of potential approaches to taxation that would stimulate development of the leasing industry and increase capital investment in Ukraine. Also attached is a separate, but related, summary of the key legal and tax issues hindering the development of Ukraine's leasing industry.

My colleague, Darya Lisyuchenko, will follow-up to see if and when you would be available to meet with the USAID and IFC financial leasing projects representatives to discuss this important issue.

We look forward to our continued cooperation on matters related to the development of Ukraine's economy.

Sincerely,

Rick Gurley

Key Legal/Tax Issues Affecting the Development of Leasing in Ukraine

Some issues regarding the legal and tax treatment of lease transactions affect different sectors within the industry, however, there are over-arching themes that act as deterrents to the development of the industry overall and its ability to attract capital from investors and other potential market entrants. The major legal and tax issues fall into the following themes or categories:

- **Unequal tax treatment of leasing versus comparable forms of financing**
- **Inconsistent definitions and unclear legal and tax treatment**
- **Burdensome taxation for operating leasing of automobiles**

Please note that this document attempts to summarize the highest priority items that will create a more conducive environment for leasing in Ukraine. This is not meant to be a comprehensive list and should not be received as a complete set of recommendations. The goal of this document is to establish a starting point for in-depth discussion of these issues and as a basis for developing more detailed recommendations by industry stakeholders.

In addition to the issues noted below, one of the main concerns of investors is the overall instability of the taxation of lease transactions. An example of this includes the "Law On State Budget of Ukraine for 2005," (No. 2502 – IV), in which changes to taxation of lease transactions negatively affected leasing and were effective from the moment of their passing. This makes business planning almost impossible and the risk of similar changes being passed again has been one of the key factors that has prevented many investors from entering Ukraine's leasing market.

i. Unequal Tax Treatment of Leasing Versus Comparable Forms of Financing

- Before March 31, 2005, interest and commission charged by leasing companies as part of lease payments under a financial lease were not subject to VAT (same as bank interest). However, in accordance with the "Law On State Budget of Ukraine for 2005," (No. 2502 – IV), interest or commission accrued by leasing companies as part of lease payments under financial lease contracts exceeding double the NBU rate are subject to VAT. This provision of Ukrainian law has many drawbacks and may result in an unequal tax treatment of leasing versus bank financing.

This amendment to the VAT Law should be changed to result in equal tax treatment for financial leases and bank loans for VAT purposes.

- According to the Law of Ukraine "On Corporate Profit Tax," when a lessor repossesses a leased asset under a financial lease due to lessee default, the lessor is obligated to record income in the amount of the market value or book value of the asset (its historical cost less accrued depreciation), whichever is greater, upon the moment of repossession, and may record the amount of outstanding lease payments as an expense. Typically, this results in a tax obligation representing a considerable percentage of the asset's value due to relatively slow depreciation schedules, high down payments (20-30%) and short-term lease contracts (2-3 years). This does not correspond to the economic nature of such an event, which is not only not a profit-making event but typically results in losses.

This problem may be alleviated in the following ways:
1) Changing the value assigned to the leased asset so that it is equal to the outstanding debt amount to make the event a non-tax event. Whether the event is profitable or loss-causing is known only after the lessor sells or re-leases the asset, and therefore the profit or loss should be reflected at that time;
2) Allowing for accelerated depreciation of leased assets will result in a less significant taxable event from both the VAT and profit tax standpoint.

- Government policies to stimulate growth and competitiveness of Ukraine's agricultural sector provide for certain portions of interest on bank loans to be returned from the budget. However, for many agricultural enterprises who are seeking to acquire equipment, leasing is a more suitable option. Therefore leasing should be included in any government programs that are aimed to facilitate access to credit for agricultural businesses.

There are many policies available to encourage investment in equipment by agricultural enterprises. It is recommended that the GOU revisit its current policies and include leasing in whatever policies it adopts to ensure equal treatment relative to comparable forms of financing.

ii. Inconsistent Definitions and Unclear Legal Treatment of Lease Transactions Among Different Legislative Acts

- There are conflicting definitions and legal treatment of leasing in Ukraine's Commercial Code relative to the Civil Code and the Law on Financial Leasing and on Corporate Profit Tax. These ambiguities result in unclear rights of parties to a lease transaction, particularly regarding the three-party economic nature of a financial lease transaction and the validity of certain types of common leasing contracts.

All relevant laws should be amended to provide for a unified and clear definition and legal treatment of lease transactions, inconsistencies between the said laws should be eliminated.

iii. <u>Burdensome Taxation for Operating Leasing of Automobiles</u>

- According to the Law on Profit Tax of Ukraine, under an operating lease for an automobile, lessees may include only 50% of their lease payments as expenses when calculating profit tax.

Such treatment of operating leasing does not reflect the real economic nature of such transactions. Operating lease payments reflect real business expenses for enterprises and therefore it is not understandable why such payments would not be fully expensed.

- When purchasing an automobile, an enterprise may not record a VAT credit for VAT paid. The result is that the cost of the car immediately becomes 20% more expensive. This will result with each consecutive sale (including the purchase option in a lease) of an automobile from one legal entity to another. Furthermore, when this amendment was passed as part of "Law On State Budget of Ukraine for 2005," (No. 2502 – IV), it amended only the Law on VAT. Subsequently, the Tax Administration of Ukraine concluded that because this amendment did not address the Law on Profit Tax, which determines what may be recorded as expenses for calculating profit tax, enterprises are unable to include the VAT paid in gross expenses as was envisaged upon the passing of the "Law On State Budget of Ukraine for 2005," (No. 2502 – IV).

There are multiple issues relevant to this policy and many ways to address them. The following points represent an attempt to address each of the issues and suggest a possible solution:

1) *In the "Law On State Budget of Ukraine for 2005," (No. 2502 – IV), there is an exception for taxis as they are productive assets of such organizations. Given that automobiles represent the main productive assets for car rental companies and operating lessors of automobiles, they should also be included in the exception.*
2) *For the second-hand sale of automobiles, VAT should be charged only the amount paid for the automobile less the amount for which was sold. If this amount is zero or negative, there was no value added and therefore should not be subject to VAT.*
3) *The Law on Profit Tax should be amended to reflect the ability of enterprises who are unable to record a VAT credit upon purchasing an automobile should be able to include VAT paid in their gross expenses.*

As evidenced above, the legal and tax issues that hinder the development of the leasing industry are numerous and often complex. USAID through its technical assistance projects is ready and willing to assist the Government of Ukraine in addressing these issues through providing relevant information, analyses, and examples to key decision makers and working with relevant government bodies to develop detailed recommendations to improve the legal and tax framework for leasing in Ukraine.

Additional but less influential problems also need to be addressed with regard to elements of cross-border leasing, accounting treatment of lease transactions, details of VAT in the case of repossession, and more. We look forward to working with the Government of Ukraine and other industry stakeholders to find the optimal solutions to these problems in order to best facilitate Ukraine's economic development.

Using Tax Policy to Stimulate Development of the Leasing Industry and Increase Capital Investment in Ukraine

This document provides a brief overview of some tax policies that are likely to stimulate the development of Ukraine's leasing industry and increase capital investment in Ukraine. The document is meant to serve as a starting point for cooperation between USAID, the Government of Ukraine, and other industry stakeholders in developing an overall strategy for developing Ukraine's leasing industry. USAID, through its technical assistance projects may subsequently provide support in preparing in-depth analyses as to the specific economic impact of such policies on both a micro and macro level.

There are many policies that governments use to stimulate investment and development in a certain industry or sector of the economy. One of the more popular policies is to provide tax incentives through depreciation that allow enterprises or individuals to defer the payment of taxes until later periods. Depreciation-based incentives are provided directly to the purchaser or investor of certain equipment, therefore increasing investment demand.

Background

To assess depreciation-based policies, it is important to consider what depreciation is and its economic justification, for both tax and financial statement purposes. When considering depreciation, it is important to keep in mind the following basic concepts:

1. The economic justification of depreciation is two-fold:
    a. It reflects the expenditure and decrease in value of an asset as that value is used by a business; and
    b. It allows companies/taxpayers to accumulate a reserve in order to buy replacement equipment.

2. Accelerated depreciation does not reduce taxes, it DEFERS TAXES.

3. Companies take straight line depreciation for financial statement purposes and (usually) take accelerated depreciation for tax purposes. This is true in Ukraine and virtually all other countries.

4. The amount of taxes paid over the depreciable life of the asset ARE EQUAL regardless of the depreciation method used, accelerated, straight-line or other.

The existing declining balance method and current rate applied to category three assets in Ukraine provides companies with less incentive to replace equipment, because the depreciable life of an asset exceeds its economic life. This results in the following undesirable outcomes:

- Although companies still pay the SAME tax over the depreciable life of an asset, longer depreciable lives result in companies paying MORE TAX in the early years of the depreciable life of the asset, LESS TAX in the later years.

- It takes companies longer to build up a sufficient replacement reserve and therefore purchase replacement equipment LATER, rather than sooner, reducing the amount of investment in the economy.

- Ukrainian companies are provided the economic incentives to continue using and depreciating obsolete equipment beyond its ECONOMIC life but not before the end of its DEPRECIABLE life.

Therefore, given that the total tax paid by Ukrainian taxpayers is the same, no matter what the depreciable life is, one may conclude that shortening the depreciable lives of equipment in Ukraine would not decrease overall tax collections, but would likely increase them due to an increase in overall investment. The event that results in greater tax payment is the replacement of the equipment sooner rather than later, which also improves the productivity, profitability and competitiveness of Ukrainian businesses at the same time.

Therefore, adopting depreciation-based tax incentives would have the following positive effects:

- Faster development of Ukraine's leasing industry due to leasing becoming more attractive economically and eliminating the current price disadvantage of leasing compared with traditional bank financing; and

- Provide access to important equipment financing by SMEs and agribusinesses that cannot access traditional bank financing but have not yet considered leasing or for whom leasing is currently slightly too expensive.

- Increased investment in fixed assets due to more potential investment projects being profitable;

Below is a brief explanation of some possible depreciation-based tax programs that may be adopted by the Government of Ukraine to encourage the development of the leasing industry and therefore promote investment in capital equipment by companies that may otherwise be unable to purchase such equipment.

1. Accelerated Depreciation for Leased Assets of up to XX times of existing depreciation rates for Category 3 Assets

Accelerated depreciation has been very effective in other countries, including Russia, (which allows for a coefficient of 3x for certain asset groups), in stimulating growth of the leasing industry and capital investment in targeted sectors. Accelerated depreciation may be applied to specific types of equipment as well as to specific investment mechanisms used to buy equipment such as leasing.

There are different types of accelerated depreciation, however, it is important to remember that in order for accelerated depreciation to provide the desired stimulus for companies to replace equipment, a company must be able to write-off the entire value of the asset prior to the end of its economic useful life.

Such a policy for Ukraine would be relatively simple to implement from a legal perspective and would not require any major overhauls of current depreciation policy. Furthermore, such a policy may be adopted for a limited period of time in order to allow a healthy leasing industry to be established. Enacting such a policy for leasing would also allow for monitoring of the fiscal implications on a limited basis in considering such policies for larger sectors of the economy.

2. ***Straight-line depreciation using current depreciation rates (example: For Group 3 assets - 6% per quarter on the initial cost of the asset rather than on the remaining book value)***

This policy is the most conservative of those described into this document and would have the smallest effect on the amount of taxes deferred and therefore provide the least stimulus for increased capital investment. However, such a policy would make leasing more competitive with other traditional credit sources and therefore provide a slight boost to the leasing industry and thus capital investment in Ukraine.

3. ***Straight-line depreciation of leased asset over the term of the lease (with a minimum term of 2 years)***

Allowing for depreciation terms equal to the term of the lease contract would provide the strongest boost to the leasing industry and provide strong stimulus for increased investment in capital equipment.

The underlying economic fundamentals of such a policy are based on the assumption that leasing companies provide lease contracts for terms that match the period from which the lessee will receive the most economic benefits from the asset. As a result, the lessee is able to make lease payments from the increased productivity of the asset itself. Such practice results in optimal cash flow management for the lessee including replacement of the leased asset at the end of the lease term.

Although the fiscal impact of this policy would be most difficult to predict, it is likely to have to provide the most economic stimulus for increased capital investment, development of the leasing industry, and increased competitiveness of Ukrainian enterprises.

4. Other policies connected with depreciation include:

In addition to these specific policies, other positive policies that may be adopted include allowing the parties to a lease transaction to decide which of the parties will keep the leased asset on their balance sheet and depreciate it. Such a policy is particularly useful when a lessee does not have sufficient profits to use depreciation to establish a reserve to replace equipment at the end of its useful life. By allowing the lessor to record the depreciation and defer payment of income taxes, the lessor may pass on these savings by decreasing the cost of financing to the lessee.

In most European countries, various combinations of the above noted policies are used, for example providing the depreciating party the right to choose between accelerated depreciation and straight-line depreciation.

ATTACHMENT 11

FIRST NATIONAL BUREAU OF CREDIT HISTORIES

October 14, 2005

From: Antonina Palamarchuk
AUB Vice-President
General Director of FNBCH

To: David Lucterhand
Chief of Party
Access to Credit Initiative Project
USAID/Ukraine

Dear Mr. Lucterhand:

Thank you very much for fruitful cooperation that facilitated the establishment of the First National Bureau of Credit Histories (FNBCH), as well as for the development of business plan and provision of expert advise.

Despite the completion of the work phase related to the establishment of credit bureau, we would like to continue our further cooperation in line with the Protocol on Cooperation signed between the AUB and Pragma Corporation. In our opinion further cooperation areas might include the following:

1) Work with banks and other financial institutions
a) to convince banks to include the consent clause in application forms or loan agreements
b) to agree on the scope of data that will be provided in credit reports, as well as information that will not be provided (data masking)
c) to finalize reciprocity issues and data access rights
d) to hold seminars and conferences for financial and other interested institutions

2) Work with non-financial institutions to secure their participation in data sharing
a) cell communication operators
b) insurance companies
c) agribusinesses
d) other companies

3) Work on the documents that govern credit bureau operations
a) contracts with CB participants
b) contracts with CB users
c) tariffs and ways of payment

4) Work with governmental institutions
a) work with the institutions that maintain state registries (both existing and those being formed)
b) work on credit bureau licensing issues

5) Public awareness activities
a) publications in the press
b) creation of FNBCH webpage (with links for participants, users, other institutions and general public)

6) Work in the regions
a) seminars in 3-4 cities of Ukraine for financial and other institutions
b) publications in local press

We truly hope on our further fruitful cooperation

Sincerely,

Antonina Palamarchuk
AUB Vice-President
General Director of FNBCH

ATTACHMENT 12

КРЕДИТ**ІНФО УКРАЇНА**

ІНСТРУМЕНТИ ТА ТЕХНОЛОГІЇ КРЕДИТНОГО МЕНЕДЖМЕНТУ

Dear Mr. Lucterhand:

CreidtInfo Group highly appreciates ATCI/USAID activities in Ukraine related to the development of credit reporting system, specifically: participation in the development of Credit Bureau Law, organization of seminars, training sessions and conferences for Ukrainian banks and other financial institutions, conducting of market research and preparation of the business plan for the establishment and development of credit bureau in Ukraine. Support in training highly qualified local experts is critical for further successful development of credit reporting industry in a developing market.

CreditInfo Group is interested in supporting the development of Ukrainian lending market. We undertake diverse activities aimed at assisting local financial institutions in effective lending management. Our Ukrainian partners as well as other participants of Ukrainian lending market require further advisory assistance of ATCI/USAID experts. It is worth noting that credit reporting is extremely complex issue, which is still not well understood by Ukrainian public at large, government institutions and even certain banks. A number of issues that call for immediate attention are beyond our organizational capacity.

Considering the above, we kindly ask you to consider our request (previously expressed orally) for assistance to be provided by ATCI Credit Bureau component in the following areas:

Educating market participants:

- Preparation and holding of thematic trainings and seminars for banks, insurance companies, credit unions and other financial institutions with participation of international consultants and ATCI/USAID experts.
- Preparation and holding of training for journalists and other mass media representatives.
- Preparation of educational materials for both creditors and borrowers.

Support to the relevant state authorities in regulation of lending-related issues and development of credit reporting, in particular:

- Consultations to the experts of the National Bank of Ukraine on regulation of lending-related issues and compliance with the Basel requirements.
- Consultations on preparation of documents for the authorized body called to regulate credit bureau operations.
- Training seminars for the specialists of relevant state authorities, etc.

Support of the development of credit unions in Ukraine:

- Credit unions at the regional and local levels require high quality information about the importance of the exchange of credit information, in particular, about rights of access and use of such information;
- Clients of credit unions must understand how the exchange of positive information meets the interests of good faith borrowers.

The highlighted issues pertain not only to our partners and clients; rather, they are necessary for the development of the market as a whole.

We are prepared to cooperate with the ATCI Credit Bureau Component and USAID towards the stated ends and hope you will find our proposal of interest as a basis for further consideration and discussion.

Best regards,
E. Nevmerzhytsky
Director
CreditInfo Ukraine