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Ukraine Debt Market Assessment

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EXPEDITED BOND MARKET ASSESSMENT—UKRAINE

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A. Existing Issuers and Investors

Description of issuers

Name of the issuer	Industry	Revenues, UAH	Profitability	Authorized capital, UAH
Arkada-fund Ltd.	Mortgage agency for Arkada bank	68,600 (2001)	68,500 (2001), 5,300 (1 quarter of 2002)	1,300,500 (05.04.02)
Closed-joint stock company "Kyivstar GSM"	Mobile communication			347,805,450 (26.10.01)
Closed-joint stock company "AVK"	Confectionery			37,810,948 (16.07.02)
Open-joint stock company "VA Banк"	Banking	62,468 million (2001)	2,710 million (2001)	43,000,000 (18.06.02)
State international airport "Boryspil"	Airport service			555,806,000 (29.05.02)
State joint stock companies "Tytan"	Chemical industry: titan two-oxide	299,054,000 (2001)	31,790,300 (2001), profitability – 20.1% (2001)	363,419,404 (10.04.02)
Open-joint stock bank "Dnister"	Banking service			
Metalen Ltd.	Ferrous metallurgy: cast iron; steel, rolled metal, metal special ties			
Closed-joint stock company "Sarmat"	Brewery, malt, nonalcoholic/soft drink			215,082,035 (15.11.02)
Open-joint stock company "Galychfarm"	Pharmaceutical			
Closed-joint stock company "Ukrzernoprom"	Agricultural			
Budmaterialy-marketing Ltd.	Building materials trading	641,800 (2001)	252,200 (2001)	7,400 (11.12.02)
BMB Kompaund Ltd.	Food	6,303,500 (2001), 7,039,700 (9 month of 2002)	289,800 (2001), 288,500 (9 month of 2002)	1,500,000 (30.09.02)
Open-joint stock company "Monomah"	Tea and coffee production and import			
Open-joint stock company "Budmaterialy"	Building materials production			

Argo Ltd.	Package production	25,903,900 (2001), 32,057,500 (9 months of 2002)	656,800 (2001), 546,600 (9 months of 2002)	2,633,439 (30.09.02)
Galaktis Ltd (subsidaries of open-joint stock company "Galakton")	Dairy	379,900 (2001), 7,900 (9 months of 2002); Galakton – 137,087,200 (9 months of 2002)	300 (9 months of 2002); Galakton – 7,846,000 (9 months of 2002)	9,000 (30.09.02)
Raiffeisen bank	Banking			92,668,900 (23.05.01)
Darnytsky ZBK	Reinforced concrete construction			13,407,204 (03.07.01)

Convertible securities are not prohibited, but there is no Securities Commission regulation on how to do it. That is why nobody issues convertible securities.

Description of investors that bought the debt offerings (See appended Table 1.)

Unfortunately, Ukraine still has not approved a law on pension reform. As a result, there is just one state-owned pension fund, and it is restricted to investing in government bonds (T-bills).

The Ukrainian parliament approved the Law on Mutual Funds. However, mutual funds are actually just in the process of creation. So far, there has been no real active mutual fund in Ukraine. There are so- called "investment funds", but they were created during the privatization process to collect privatization vouchers and invest them into privatized enterprises. Now, according to the Law on Mutual Funds, they are to be closed or reorganized as mutual funds.

Insurance companies do not invest in bonds on a regular basis. However, they have good potential to do so, and there are some examples of insurance company investments made in bonds.

Individual investors are still potential investors in the corporate bond market. The main problem lies in taxation. There is no tax (from 1993) on bank deposit interest rates, but taxes on corporate debt income ranges from 10-40%. However, the draft of the Law on Physical Person Income (second hearing) proposes to equalize tax rates on income earned from deposits and bonds, with the rate to be 5%. Banks and issuers would pay at the time they make payments on interest to depositors and yields to investors.

Foreign investors are not in the market yet. The Ukrainian corporate bond market started from the end of 1999, when tax regulations were changed. Until the end of 1999, bond investors (legal entities) were supposed to pay up to 43% on bond interest, resulting in no investment from abroad. The year 2000-01 was just the beginning of the first debt issues, which led to a substantial increase in 2002. Notwithstanding the increase, the conventional view is that this is the very beginning of the bond market in Ukraine. For example, ING and some other banks forecast UAH 1 billion in real IPOs for 2003.

In this regard, ING, Alfa or Ukrsib should not be considered to be "foreign" investors, as they are registered in Ukraine according to Ukrainian law, and regulated by Ukrainian law and government agencies. They are also residents in terms of taxation, etc. Rather, they are wholly or partly non-resident investors.[1] In turn, residents can be owned by non-residents, such as is the case with Ukrainian banks that are, in large part, owned by non-residents such as offshore companies that are, in reality, Ukrainian companies. ITT-invest has been created by Ukrainians, but probably through offshore companies. The same is true for Kyiv Securities Group. All of this explains why there are no figures available to show the position of the foreign bank community from the domestic bank community. Now, NBU just considers this foreign banks working in Ukraine.

The main buyers of debt offerings are Ukrainian banks. Unfortunately, there are very few of these banks, mainly Ukrsibbank, Ukrsotsbank, Alfa Bank, Aval (pension bank), Arkada Bank, and ING. Meanwhile, in mentioning these banks, it needs to be clearly stated that these banks serve as underwriters for their own accounts and for their clients' issues on the one hand, and as buyers of other banks' and their clients' issues on the other hand. As of today, this has been a very narrow market in terms of the number of participants. The biggest buyers and underwriters from the broker/dealer community are ITT-Invest and Kiev Securities Group. Other brokers and banks' clients have some small investments at the corporate debt market. However, this is miniscule when compared to banks' engagement in these activities, and is really very insignificant (close to 0).

Minority shareholders have nothing to do with debt issues in Ukraine. Management of the issuer company makes the decision to issue. This is not really a problem in terms of the mechanics of the corporate bond market in Ukraine. However, it is a problem at the legal framework level in that there is not much regulation of shareholder rights, nor much protection afforded to minority shareholders or preferred (preference) shareholders.[2]

[1] ING is totally owned by non-resident. Alfa and Ukrsib are owned partly by residents and non-residents.

[2] 60% plus one share at the General meeting is needed for legitimate decision-making. Only 50% +1 is needed to make decisions on basic questions. However, 75% +1 is needed to change the company charter. Obviously, if management has 75% +1 support from shareholders, it can do almost anything it wants.

Characteristics of instruments issued

NAME OF THE ISSUER	DATE OF REGISTRATION BY UKRAINIAN SEC	SIZE OF THE ISSUE, UAH	YIELD, %	DURATION	STARTING DATE	MATURITY DATE	CURRENCY	FEATURES
Arkada-Fund Ltd.								
Series E	26.07.02	33,000,000	10	2 years	08.08.02	08.08.04	UAH	Book-entry form. Kind of mortgage bond. Payments are guaranteed by loans (apartments are collateralized). Loans are made by Arkada Bank to individuals to buy apartments. The Arkada Fund has been created by Arkada Bank and acts like a mortgage agency. A special Law has been approved by parliament for this. This Law does not regulate mortgage bonds. Rather, it regulates the operations of the Arkada Fund and Kyiv building company with respect to bond issuance and the pension fund. It is considered an experiment in which collected pension funds are used to finance housing construction and to make investments in housing/real estate portfolios. Arkada Bank is the market-maker for these bonds.
Series A	08.08.02	33,000,000	The coupon rate: 10 %; coupon period: 1 month	730 days	08.08.02	08.08.04	UAH	Book-entry form. Arkada Bank is the underwriter and market-maker.
Series B	08.08.02	20,000,000	The coupon rate: 10 %; coupon period: 1 month	3,650 days	08.08.02	01.08.12	UAH	Book-entry form. Arkada Bank is the underwriter and market-maker.
Closed-joint stock company "Kyivstar GSM"								
Series C	29.08.01	32,950,000	20% in UAH, but min 7% in US$	12 months	01.10.01	01.10.02	UAH	Paper form. Underwriters - Ukrsibbank and ING. Market-maker - Ukrsibbank.
Series B	29.08.01	10,800,000	11% in US$, payments once every 6 months	12 months	01.10.01	01.10.02	UAH	Paper form. Underwriters - Ukrsibbank and ING. Market-maker - Ukrsibbank.
Series D	29.08.01	27,000,000	12% in US$, payments once every 6 months	18 months	01.10.01	01.04.03	UAH	Paper form. Underwriters - Ukrsibbank and ING. Market-maker - Ukrsibbank.

Closed-joint stock company "AVK"									
Series A	05.07.02	9,000,000	Payment per quarter. First and second coupons - 20%, coupons 3-6 not less than KIBOR (90 days) minus 5%, but can be increased by issuers	540 days	25.07.02 to 13.09.02	16.01.04 to 20.01.04	UAH	Book-entry form. Underwriters - Alfa Capital, Alfa Bank. Market-maker - Alfa Bank. Offers to buy out before the maturity date (20.07.2003).	
Open-joint stock company "VABanк"									
Series B	25.04.02	2,500,000	19	12 months	02.07.02 - 02.10.02	02.07.03	UAH	Book-entry form. Underwriter - Ukrsibbank.	
Series C	25.04.02	2,500,000	20	18 months	02.07.02 - 02.10.02	02.01.04	UAH	Book-entry form. Underwriter - Ukrsibbank.	
State international airport "Boryspil"									
Series A	29.04.02	20,000,000	Payment with maturity, 20% in UAH, but not less then 12% in US$	12 months	12.06.02	12.06.03	UAH	Book-entry form. Underwriter - Ukrsibbank.	
State joint stock companies "Tytan"									
Series A	22.03.02	10,000,000	23%int UAH, but not less than 10% in US$	12 months	17.04.02	17.04.03	UAH	Book-entry form. Underwriter - Ukrsibbank.	
Series B	22.03.02	10,000,000	22% in UAH, but not < 10% in US$	12 months	15.05.02	15.05.03	UAH	Book-entry form. Underwriter - Ukrsibbank.	
Series C	22.03.02	10,000,000	24% in UAH, but not < 11% in US$	15 months	15.05.02	15.08.03	UAH	Book-entry form. Underwriter - Ukrsibbank.	
Series D	22.03.02	5,000,000	23% in UAH, not less 10% US$	12 months	05.06.02	05.06.03	UAH	Book-entry form. Underwriter - Ukrsibbank.	
Series E	22.03.02	5,000,000	22% in UAH, but not < 10% in US$	12 months	05.06.02	05.06.03	UAH	Book-entry form. Underwriter - Ukrsibbank.	
Series F	22.03.02	10,000,000	24% in UAH, but not < 11% in US$	15 months	05.06.02	05.09.03	UAH	Book-entry form. Underwriter - Ukrsibbank.	
Closed-joint stock company "Sarmat"									
Series A	16.10.02	30,000,000	17%, payments every 3 months	12 months	18.11.02	18.11.03	UAH	Book-entry form. Underwriter - Ukrsibbank.	
Budmaterialy-marketing Ltd.									
Series A	10.04.02	500,000	18	1.5 years	17.05.02 - 17.11.02	17.11.03 - 17.12.03	UAH	Paper form. Underwriter - Bank Aval.	
Series B	10.04.02	250,000	20	2 years	17.05.02 - 17.11.02	17.05.04 - 17.06.04	UAH	Paper form. Underwriter - Bank Aval.	
Series C	10.04.02	250,000	22	2.5 years	17.05.02 - 17.11.02	17.11.04 - 17.12.04	UAH	Paper form. Underwriter - Bank Aval.	

BMB Kompaund Ltd.								
Series A	11.12.02	10,000,000	17	18 months	25.12.02	25.06.04	UAH	Book-entry form. Underwriter –VA Bank.
Open-joint stock company "Galychfarm"								
Series A	10.10.02	3,190,000	Payments per quarter. First and second coupons - 19%; coupon 3 equals 4; 5 equals 6. Beginning with coupon 3, yield will be defined by issuer, but not less then KIBOR minus 5%.	546 days	04.11.02 - 31.12.02	03.05.04 - 07.05.04	UAH	Book-entry form. Underwriter - Alfa Bank.
Closed-joint stock company "Ukrzernoprom"								
Series A	16.10.02	6,400,000	Payments per quarter. First and second coupons - 18%; beginning with coupon 3, yield will be defined by issuer.	1 year	01.11.02 - 30.10.03	31.10.03	UAH	Book-entry form. Underwriter - Bank Aval.
Metalen Ltd.								
Series A	24.09.02	50,000,000	Payments per quarter. First and second coupons - 18.65%; coupon 3 equals 4; coupon 5 equals 6. Beginning with coupon 3, yield will be defined by issuer, but not less then KIBOR minus 5%.	546 days	28.10.02 - 27.12.02	26.04.04 - 30.04.04	UAH	Book-entry form. Underwriter - Alfa Bank.
Open-joint stock bank "Dnister"								
Series B	23.08.02	2,500,000	23	365 days	01.10.02	01.10.03	UAH	Book-entry form. Underwriter - Bank "Dnister".
Series C	23.08.02	1,000,000	25	548 days	01.10.02	01.04.04	UAH	Book-entry form. Underwriter - Bank "Dnister".
Open-joint stock company "Monomah"								
Series A		500,000	Payments per quater. 12% USD, but not more then 20% UAH.	1 year	02.09.02	02.09.03	UAH	Book-entry form. Underwriter - Bank Aval.
Open-joint stock company "Budmaterialy"								
Series A	10.04.02	500,000	Payments every 6 months, 18%.	1.5 years	17.05.02 - 17.11.02	17.11.03	UAH	Paper form. Underwriter - Bank Aval.

Series B	10.04.02	250,000	Payments every year, 20%	2 years	17.05.02 - 17.11.02	17.05.04	UAH	Paper form. Underwriter - Bank Aval.
Series C	10.04.02	250,000	Payments every year and at maturity, 22%	2.5 years	17.05.02 - 17.11.02	17.11.04	UAH	Paper form. Underwriter - Bank Aval.
Argo Ltd.								
Series A	13.12.02	3,000,000	Coupons 1-8: 16%, but not less than 11% in US$. Coupons 9-12 will be defined by issuers up to 30 days before coupon 9 payment.	36.1 months	27.12.02 - 14.03.03	15.12.05	UAH	Book-entry form. Underwriter - Bank Aval.
Series B	13.12.02	7,500,000	Coupons 1-10: 17%, but not less 12% USD. Coupons 11-14 will be defined by issuers up to 30 days to coupon 11 payment.	42.6 months	15.01.03 - 14.04.03	17.07.06	UAH	Book-entry form. Underwriter - Bank Aval.
Series C	13.12.02	7,500,000	1-12 coupons - 18%, but not less 12% in US$. Coupons 13-16 will be defined by issuers up to 30 days before coupon 13 payment.	48.6 months	03.02.03 - 04.05.03	01.02.07	UAH	Book-entry form. Underwriter - Bank Aval.
Galaktis Ltd (subsidaries of open-joint stock company "Galakton")								
Series A	27.11.02	10,000,000	Payments every quarter. 1-4 coupons - 17%, then yield will be defined by issuer.	728 days	18.12.02 - 25.12.02	15.12.04	UAH	Book-entry form. Underwriter - Ukrsotsbank. Offers to buy-out when 4 and 6 coupons are paid.
Raiffeisen bank								
	21.06.01	23,000,000	The coupon rate: 17 %; coupon period: payments each quarter.	372 days	21.06.01	27.06.02	UAH	Book-entry form. Investment & Structured Financial Products - underwriter. ITT-Invest - market-maker.
Darnytsky ZBK								
Series A	01.02.02	200,000	The coupon rate: 36%; coupon period: coupon is paid at repayment.	90 days	01.02.02	29.04.02	UAH	Book-entry form. ITT Invest - underwriter and market-maker.

Series B	08.02.02	200,000	The coupon rate: 42% annually; coupon period: payments each quarter.	120 days	08.02.02	29.07.02	UAH	Book-entry form. ITT Invest - underwriter and market-maker.
Series C	28.01.02	437,000	The coupon rate: 96% annually; coupon period: payments each quarter.	1095 days	28.01.02	11.01.05	UAH	Book-entry form. ITT Invest - underwriter and market-maker.

The differences between series are starting date, maturity date, duration and yield, the last of which actually depends on duration. In reality, the series is one of way to avoid registration procedures with the Securities Commission. Instead of registering different issues, issuers register one issue with a series. The only thing that different series have in common is the same starting dates, or they are very close[d]. Sometimes they are used to differentiate between series for external investors (series A, B of Darnytsky ZBK) or for affiliated investors (series C of Darnytsky ZBK), with higher yields but longer duration.

The bonds are not really indexed. Minimum yields in dollars means that there is a hedging factor built in. For instance, if the inflation rate in UAH is lower than the announced yield in dollars, owners of bonds will get their money in UAH but according to the US dollar rate. The UAH/US$ exchange rate is measured based on the official National Bank of Ukraine (NBU) rate. However, this is not really meaningful in the end to sophisticated investors because the par value of bonds is not adjusted and the NBU rate is always lower than the market rate. Rather, this feature is intended to make regular investors who really do not understand very much about the market feel more secure about investing.

Even indexation in US$ is not really hedging. The draft version of the new regulation on bond registration issues makes it possible for issuers to have banks guarantee or provide insurance for the issue (from an insurance company). This is the only real hedging feature that can be spoken of in today's legal environment.

Ukrsotsbank bonds are supposedly convertible into gold. The idea is similar to the dollar protection mentioned above. It does not affect the price of bonds. However, if the investor is not feeling secure about UAH exposure, he/she can go any time to Ukrsotsbank and change the bonds into gold. This occurs on a possession of certificate ("bearer") basis, but the investor can get physical gold as well.

NAME OF THE ISSUER	SIZE OF THE ISSUE, UAH	YIELD, %	IPO DATE	MATURITY DATE	CURRENCY	FEATURES
Municipality of Odessa	61,000,000	50%	01.05.97 - 15.06.97	01.05.98 - 15.06.98	UAH	Issue guaranteed by Odessa municipality. Undewriter - Bank "Potro-franko" (Odessa). Documentary form.

As for municipal issues, unfortunately, Odessa is today the only municipal bond issuer, and it has only issued one bond. Kyiv is planning to issue eurobonds in 2003, and possibly a domestic issue as well. Lviv is also thinking about issuing domestic bonds, but not for at least three to four years.[3]

The Odessa municipal bond issue was the first municipal issue of a big city, and the result was default. This largely explains why the market has not developed since. There are weak prospects for domestic municipal bond market development in the next 1-2 years, largely due to the budgetary transfer requirements imposed by the Ministry of Finance. While Kyiv or Donetsk eurobonds may be plausible, this is because they are comparatively well off cities with budget surpluses that go to the state budget. Their incentive to issue eurobonds is actually to reduce the amount of money that goes to the state budget, not to raise new funds for expenditure purposes.

Characteristics of issuance and underwriting process

As a rule, the underwriting process runs on a best-efforts basis. But bank underwriters promise issuers that they will buy all bonds not placed in the market. So it is not purely best efforts or firmly underwritten. Only one firmly underwritten issue has been done in the market. This was by ITT-Invest for Darnytsky ZBK (reinforced concrete construction plant).

Public placements for Ukraine are when there are 3-5 legal entities as buyers, which is different from the general understanding of a public placement. They are pretend to be public placement. These issues are public in terms of goals because they are trying to get capital on the market.

Private placements in Ukraine have been done for two purposes: (i) so called “tax optimization”, which are the special financial schemes when different holdings trying to reduce their taxable profit and take real profit to their subsidiaries; and (ii) a type of regulatory arbitrage, whereby loans are designed as bond issues.

Concerning the regulatory issue, it is easy sometimes for banks design their loans as bonds and still comply with National Bank of Ukraine regulations. First, according to NBU regulations, banks can give loans only if the borrower has collateral (pledge) for this loan, and the collateral (pledge) is significantly more than the loan. If the issuer does not have enough collateral (pledge), or if the collateral (pledge) is already used for other loans, the bank cannot provide the loan to the borrower. Under such circumstances, assuming the bank knows the client well, the bank designs a loan as a bond issue. Second, banks should build reserves to protect against asset losses and borrower default. The same is true for bonds, but the reserve ratio for bonds is smaller. Third, general regulations of the NBU are stricter for giving loans than for issuing bonds. For example, banks cannot give loans to borrowers if the borrower’s “own /borrowed assets” ratio is less than 50 percent. The same restriction does not apply for bonds. In the end, these are not public placements. Rather, they are more like special issues for special purposes.

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[3] Brovary, a very small town, has raised the possibility of a municipal bond, although it is not likely to be feasible, and discussions to date have not been public or transparent. Rather, “administrative power” was used to have the biggest enterprises of the town to buy the issue. The proceeds from the bond issue were put on deposit with a bank, with the rate on the deposits being higher than the bond’s yield.

It is very difficult to answer questions about the length of offering time. According to Ukrainian regulation, an issuer can issue an IPO until maturity. Thus, it is very difficult to understand whether this should be viewed strictly as a primary market, or if there is already overlap with a secondary market. However, in general, market practice has shown the offering time can be from 2-5 days to about one month.

There are no international rating agencies with a permanent base of operations in Ukraine. Some banks have ratings, but these are banking ratings and have been done outside of Ukraine. There are some structures that pretend to be rating agencies, but nobody uses their ratings. PFTS, in cooperation with other legal entities, is going to provide special corporate bond ratings starting in 2003.

B. PROSPECTIVE ISSUERS AND INVESTORS OF DEBT INSTRUMENTS

Description of likely candidates for issuance

It is currently impossible to describe candidates because issuers in Ukraine do not have strategic financial planning. Even today, some issuers do not know if they will issue bonds this year, let alone next year or thereafter. Issuers that have already made the decision will do so within two months, equivalent to the minimal life cycle of a bond issue from the decision to IPO.

Candidates likely to issue will be small- or medium-sized enterprises. They are more than likely to be newly created private companies, rather than privatized ones. Banks are very likely candidates.

<u>Description of likely candidates to purchase the issues (pension funds, insurance companies), banks, other corporations, individual investors, foreign investors, etc.</u>

Likely candidates to purchase bond issues will certainly be banks and some of the broker/dealers. It is also possible that purchasers will include some insurance companies, mutual funds and individuals, but this will depend on legal reform. For instance, a real Mutual Funds Law and Law on Physical Person Income that provides for equal treatment on income from bonds and deposits will serve as a catalyst for bond market development.

Key market development goals should be:

- Have as many buyers as possible (not 3-5 buyers, but hundreds).
- Have different types of investors, especially individuals.
- Do IPOs through an organized market to define yields through real market mechanisms.
- Have secondary markets only on organized markets with real prices and competition.
- Have market-makers on secondary markets that will hold buy/sell quotes/orders with small spreads.

If this approach is pursued, Ukraine would then have real liquid market instruments. Conversely, there is no justification for providing assistance if only 3-5 buyers subscribe to IPO issues.

Types of instruments that might be offered

The market would benefit if instruments issued were not less then UAH 1 million in terms of value, and preferably as large as possible (e.g., UAH 100 million). The market would also benefit if issues were not less than three years in terms of maturity. If denominated in

Ukrainian currency, it would help. Otherwise, such instruments might be considered foreign investments with respect to currency regulation. In the case of foreign investments, investors should be required to have a license from the National Bank of Ukraine to buy foreign securities. Currently, it is very difficult to get such a license. One of the possibilities being discussed between the securities markets and the National Bank of Ukraine is changing currency regulations so that Ukrainian residents (including legal entities) could issue and buy bonds without any license, even if the securities are denominated in foreign currency.

Issues should be simple in terms of conditions, including hedging features, etc. Outstanding issues are generally too complicated for regular investors. Only sophisticated buyers can really understand all features. This is one of the reasons there is such a limited number of buyers, of which almost all of them are banks. In theory, hedging can be done, though the UAH/$ exchange rate has been stable in recent years.[4]

Collateral is less important in developing the market because, according to Ukrainian regulation, it is not transferable to other individuals without relinquishing the collateral agreement, REPO (the same situation), etc. In reality, the relevance of collateral is also undermined because the secondary market is not liquid, largely because investors hold bonds until maturity.

In terms of hedging features, the following would help:

- Pre-time buy-out offers by issuers (e.g. every 3 or 6 months).
- Market-makers that must keep up buy/sell quotes on PFTS with certain spreads (e.g., 1%; this worked for Kyivstar GSM).
- Maybe insurance or bank guarantees.
- Simple yield calculations, to be understandable to regular investors.

Pension funds will be allowed to buy foreign securities, but not those with less than A ratings (S+P, Moodys, Fitch), or securities that are listed on NYSE, NASDAQ, LSE, Tokyo SE, and Frankfurt SE. Again, they should get license from NBU to buy these securities.

Characteristics of issuance and underwriting process

This should be public placement. There are enough private placements in Ukraine. Even Ukrainian “IPOs” are in reality private ones in terms of the number of buyers. It will not be possible to find underwriters who will agree to firmly underwritten intermediation. Thus, it is likely to be best efforts intermediation.

Underwriters should not have to take responsibility to buy all unplaced bonds. Rather, the process should be real IPOs with real results. For example, in the case of Kyivstar, the two underwriters[5] bought 90% of the issue. This is very typical, and reflects poorly on how the market functions. It is not because they have inside information. Rather, it reflects the nascent stage of market development. Fundamentally, banks have surplus liquidity and can buy all issues by themselves. However, they are playing the game as underwriters to eventually build business and market. The market price cannot go down because there are just five players on the market, with no real competition. This will change in the future. However, for now, there is little market depth.

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[4] Ukraine even had deflation in 2002.

[5] ING and Ukrsibbank

There is no initial pricing of the security set by the regulator, nor is this needed. First, underwriters are trying to sell bonds to outside investors. The basis for setting prices is preliminary orders from potential buyers. Based on these orders, underwriters define the price.

The market is just developing. The Kyivstar issue, which was the first public one, was 90% of the market for a while, and is still nearly 30%. Underwriters are buying unsold bonds because they have promised this to the issuers. In this sense, it is partly firmly underwritten.

There is also the consideration for underdeveloped ("emerging") markets that firmly underwritten intermediation or responsibility to buy all bonds (but not to necessarily place all bonds) in reality means that the underwriter will define yields keeping in mind that it can be the possible owner of these bonds. This means the issuer could possibly benefit from a much higher yield than in the case of competition on the free market.

Nonetheless, despite partial benefits under current circumstances, the Ukrainian market would benefit if it had hundreds of buyers. This would result in real competition during IPOs, and a liquid secondary market, as opposed to the status quo of 3-5 buyers, no real IPOs, and an illiquid secondary market. The objective should be to increase as much as possible the number of corporate bond market participants. The key points here are size of the issue (as big as possible) and number of buyers during the IPO (as more as possible).

C. BACKGROUND ON INVESTOR DEMAND

Investment funds were created in Ukraine for privatization purposes as an instrument for mass privatization. Investment funds have collected privatization vouchers from people, and exchanged them for shares of the companies that have been privatized. According to the new Law on Mutual Funds, these Investment Funds are to be closed or reorganized into mutual funds. So it is not possible consider them as institutional investors for private debt issues.

The Law on Mutual Funds was adopted by the parliament in 2002, followed by all necessary regulations that were created by the Securities Commission. At the moment, there are no active mutual funds in Ukraine, although some are in the process of creation. One mutual fund recently got its license from the Commission to manage the assets of mutual funds. It is legally allowed to invest in private debt issues. So mutual funds are potential players in the domestic corporate bond market, which should occur soon.

Pension Funds are also potential players in domestic corporate bond markets. As of today, Ukraine has a state pension system, with the state pension fund only allowed to invest in T-bills (government bonds). However, the Law on Private Pension Funds is in the Ukrainian parliament now. Expectations are for the Law to be adopted in the first quarter of 2003. According to draft Law on Private Pension Funds, this will permit the third pillar of a more modern architecture for pensions to emerge, that being privately managed voluntary contributions. They will be legally allowed to invest in private debt issues. So private pension funds are potential players in corporate bond markets in the near future, although it remains to be seen what resources they can mobilize on a voluntary basis. Meanwhile, according to a draft of the Law on State Pension Funds, the state fund will be legally allowed to invest in private debt issues.

The Law on Insurance was adopted by parliament in 2001. There are many insurance companies in Ukraine, and they are permitted legally to invest in private debt issues. Unfortunately, most of these companies are created for "tax optimization" purposes. Consequently, they are not interested in investing in publicly offered corporate bonds.

However, there are some real insurance companies. They mostly invest their assets in deposits, foreign currency, and real estate. They offer potential for market development, as they are liquid and looking at corporate bonds for investment purposes.

2. Capital Market Setting for Bond Markets

A. Legal and Regulatory Setting for Debt Issuance

Laws and regulations

According to the Company Law, joint-stock companies cannot issue bonds bigger than 25% of their authorized capital. It is necessary to understand that authorized capital is different from market capital of the issuer in Ukraine. Authorized capital is capital of the company that is declared by the company during state registration of the company. Authorized capital does not depend on the market value of shares. For instance, the authorized capital of Ukrnafta (the biggest Ukrainian oil production company) is $2.5 million, whereas its market capitalization is $250 million. Ukrnafta could not issue bonds of more than $0.625 million as a result of this legal restriction.

There are some plans to change the Law, but nothing tangible has yet occurred. For instance, there is no draft Law in parliament to redress this constraint. Moreover, the very basis of valuation is suspect. Authorized capital for most privatized companies was defined as the value of their fixed assets when they started the process of privatization (it can be even 10 years ago). Thus, the Company Law serves as a major constraint to domestic bond market development.

Tax issues related to the issuance and trading of securities

Issuers must pay 0.1% of the size of the issue as state duty. There is no difference on this; banks and non-banks pay equal rates. For companies, income from bonds is considered part of the total income of the company, and is taxable at a 30% rate. However, the situation is different for individuals' earnings from bonds as compared to bank deposits. The income from bonds is part of total income, and is taxable at a progressive rate from 10-40% of income. The threshold of the 40% tax rate starts from the amount of $300, a very low level of earnings. Bank deposits are not taxable at all. That is why individuals place their funds in banks as opposed to the bond market. The exception to the bond market is Government bonds, which are not taxable at all. In the end, the tax rules discriminate against investment in corporate securities.

Accounting/audit standards that apply to debt issues

Ukraine has its own national accounting and audit standards. In principle, they are similar to IAS (85-90%), but still not totally compliant. As elsewhere, there are differences between financial accounting and tax accounting. While this is a complicated issue, almost all bond investors in Ukraine are sophisticated, and accounting issues are not perceived to be a big problem. Some companies present their statements according to IAS (Kyivstar GSM or AVK), but this is for internal use because they have western owners.

Regulatory/Supervisory oversight

The Securities Commission has all the necessary power it needs to regulate. However, it is not as strong as it should be in terms of enforcement. This should be corrected prior to development of the corporate bond market, rather than waiting until scandals occur.

B. INFRASTRUCTURE

Depository system, clearance and settlement

There are three depositories in Ukraine. The National (central) Depository of Ukraine, which is owned by the state (86%), does nothing and exists only because one of the Commission members would like to create own business. A second one is the NBU depository for government bonds. The main depository is the MFS (Interregional Securities Union), which is the depository for corporate securities. Custodians and the trading system created this Depository as an open joint-stock company. PFTS is the biggest shareholder of MFS. MFS can do Delivery versus Payment (DVP) as well as free delivery. DVP is not used very much in Ukraine because almost all money settlement is done offshore. Unfortunately, MFS cannot do clearing because it does not have such license from the Securities Commission. As with the National Depository of Ukraine, this is a political question rather than a technical or technological one. Almost all public offering bonds are issued in book-entry form and settled through the MFS depository.

Trading systems

There are seven stock exchanges and two trading systems in Ukraine. The differences between stock exchanges and trading systems are: (i) stock exchanges are created as open joint-stock companies using "trading on floor" techniques; vs. (ii) trading systems, which are created as open joint-stock companies or subsidiaries of SROs and use electronic trading systems.

However, these differences are not the reason for the market to not function effectively in terms of reporting, disclosure, etc., as is typically and mistakenly assumed by western experts. The real reason is that, apart from PFTS, they were all created for privatization purposes.[6] They do not have any primary or secondary market trading. In reality, they just have a license, and the State Property Fund periodically conducts auctions for them.

By contrast, PFTS has 97.4% of the organized market. All other organized markets (seven stock exchanges and one trading system) have 2.6%, and this is only resulting from privatization. Thus, re PFTS, there are no serious problems with respect to the functionality of the trading system.

PFTS was created in a manner similar to NASD and NASDAQ. The PFTS Association is a self-regulatory organization that is the owner of the PFTS trading system. PFTS is an electronic real-time market and has a number of trading floors:

- Dealers (quote-driven) market.
- Government bonds (T-bills) market.
- Order-driven market with possibility of internet trading.
- Auctions: regular, closed, and "Dutch" auction.
- Trading floor for veksels.

As a rule, underwriters use auctions for IPO's, and the "Dutch" auction was recently created for corporate bond IPO's. The secondary market for bonds goes through the dealers market.

PFTS has all the necessary rules to trade corporate bonds, as well as other securities:

[6] The stock exchanges will disappear as soon as privatization is finished.

- Access of broker/dealer to the market rules.
- Listing and de-listing rules.
- Trading rules for each type of trading floor, primary and secondary markets.
- Enforcement and surveillance rules, etc.

Reuters distributes PFTS information in real-time.

PFTS volume in 2002 was UAH 6.27 billion, or $1.18 billion. This is 97.4% of all organized markets in Ukraine.

Corporate bond volume was UAH 790.73 million (US$ 148.81 million), or 12.6% of total PFTS volume in 2002. This volume figure increased more than six times (638%) when compared to 2001 figures.[7] This was the first time in PFTS history that equity share value (10.78%) of total PFTS volume was lower than that of corporate bonds. Most of the activity is found in the secondary market. In 2002, corporate bond primary market volume was UAH 40.98 million, less than 6% of secondary market volume of UAH 749.75 million.

Trade information and transparency/timeliness of information dissemination

Trade information and transparency/timeliness of information dissemination is done according to general principles. There has been no evidence of fraudulent reporting. Auditors verify information for accuracy.

Role of enhancements

The Ukrainian market has not developed "enhancements" like insurance or guarantees. There are a few examples of guarantees, usually provided by parent companies to their subsidiaries. These guarantees are included in the investment memorandum. There is no market evidence that guarantees have been called.

Margin trading restrictions do not exist. There is no collateral because, so far, nobody has needed it. REPO agreements are the most widely used instrument. The problem is that there is no regulation in terms of using collateral for bond issues. For example, a building could be used as collateral for a bond issue. However, there are no clear procedures for how the collateral should be assigned to bondholders (e.g., several bricks, one room, etc.). Also, there are problems with basic infrastructure related to the signing and transfer of collateral agreements. It is possible to do this for the primary market. However, there is no clear procedure for doing so in the secondary market, where about 95% of bond trading activity occurs. The Law on Collateral in Ukraine is designed in such a way as to address relations between two entities, such as creditor and debtor in a banking relationship or buyers-sellers in the primary securities markets. However, the Law does not make adequate provisions thereafter. It is also the author's views that the Law will not be changed any time soon. Parliament has more important problems, even in terms of securities market. For this reason, collateralized bonds are not likely to be of any particular importance to near-term market development. Enhancements will likely be limited to insurance, or possibly some kind of bank guarantee, the latter of which is actually questionable.

[7] Corporate bond volume in 2001 was only about $23 million-equivalent. This explains the significant increase, as it was off of a small base.

Role of regulators and self-regulatory organizations

The Securities Commission is the regulator for all market participants including trading systems, depository, broker/dealer, mutual funds, custodians, transfer agents, etc. Self-regulatory organizations, trading systems and depositories must submit their rules to the Commission for approval.

It is unclear how liquidity can be improved by regulation. Regulations can increase transparency by concentrating trades on organized markets and increasing requirements to disclosure. Regulations can increase confidence by providing secured (collateral, guaranteed) issues. However, in Ukraine, the problem of the Commission is that instead of improving market characteristics, it is trying to regulate technology (e.g., how to do trades, settlement, etc.).

There are 11 SROs in Ukraine (one for asset management companies, two for transfer-agents and custodians, and eight for broker/dealers). This problem resulted from the Securities Commission due to the legal requirement that all professional market participants (asset management companies, transfer-agents, custodians, broker/dealers) must be members of an SRO. On the other hand, the Commission gave SRO licenses to all types of participants. As result, Ukraine has far too many SROs. However, among these, there are only two real SROs: PFTS and PARD (transfer-agents and custodians). Others are so-called "chip" SROs that do not perform SRO functions, but function simply to meet the Commission's requirement on obligatory SRO membership. There are no membership fees in chip SROs, and there is no de facto regulation, let alone self-regulation.

In reality, the licensing problem is one of the biggest problems facing securities markets in Ukraine. The Securities Commission provides a license to everybody, without having meaningful professional certification requirements in place. There are 800 broker/dealers in Ukraine, half of whom have no trades at all. They have been created for one operation. There are also so-called "pocket" transfer-agents for one issuer. The same is true for trading systems and stock exchanges. As one example, one regulated (organized) market has had no trades for the last three years.

Notwithstanding the problems with nine of the 11 SROs, PFTS is a self-regulatory organization that is licensed by the Commission. PFTS acts as a genuine self-regulatory organization, and has all necessary rules, procedures and institutions in place to provide for a stable and liquid market, and orderly trading. Rules and procedures include professional behavior code, a disciplinary code, trading rules, and back-office standards. Institutions are composed of (i) a Supervisory Board (15 representative of PFTS members who are elected from banks/brokers/dealers that hold the first 50 positions in PFTS rating); (ii) an Arbitration Court; (iii) a Trading Committee (representative of PFTS members who are approved from banks/brokers/dealers that hold the first 50 positions in PFTS rating by the Supervisory Board); (iv) a Settlement Committee (representative of PFTS members who are approved by the Supervisory Board); (v) a Bank Committee (representative of PFTS members who are approved by the Supervisory Board); (vi) an Expert Council for Corporate Governance (representative of PFTS members and non-PFTS institutions who are approved by the Supervisory Board); and (vii) an Expert Council for Financial Instruments (representative of PFTS members and non-PFTS institutions who are approved by the Supervisory Board).

Role of credit rating agencies, and their capacity/competence

There are no international rating agencies in Ukraine (i.e., S+P, Moodys, Duff Fitch IBCA). Some banks have ratings, but these are banking rating and done outside of Ukraine. There are some local structures that call themselves rating agencies. Unfortunately, their capacity and competence are very low. This is a very important part of the market problem in Ukraine. For this reason, PFTS is going to provide corporate bond ratings this year.

Research capacity

Research capacity is strong in Ukraine. There are good professionals and institutions.

C. ACTIVITY

Size of the equity market: market capitalization and turnover of listed companies.

As of October 31, 2002, there were 257 publicly registered companies with a Supervisory Board that were listed, about 10 percent of the total number of such firms. Market capitalization was UAH 12.35 billion, or about $2.3 billion, and equivalent to about 7 percent of GDP for 2002 annualized. There is a high degree of concentration in market value, as the top 10 listed firms account for about 45% of total market value. This has been true since 2001, and is consistent with the average from 1999-2002.[8] However, market turnover as a whole is low. In 2002 (after 10 months), there was only $75 million-equivalent in trading, about 0.2% of GDP. (See appended Table 2.)

Size of the debt market

Total commercial paper value in 2002 was UAH 68.6 billion ($12.9 billion-equivalent), spread across 17 outstanding issues. This comes to an average of UAH 4 million, or about $760,000 per issue. There were 47 outstanding corporate note and bond issues as of end 2002, up significantly from 11 in 2001 and only one in 2000. The 2002 year-end value of these notes/bonds was UAH 580 billion ($109 billion-equivalent), or an average of $2.3 million. By contrast, there was only one such corporate note/bond in the private placement market, valued at $235 million. It is unclear if this suggests a shift away from private placements to publicly traded vehicles. Rather, as the private placement market includes all non-registered corporate and bank debt with maturities of one year and over excluding bank loans, it may simply mean that companies are currently more liquid and/or able to access bank credit more readily.[9] Meanwhile, as noted above, there is no active sub-sovereign or municipal bond market in Ukraine. (See appended Table 3.)

All together, Government-issued debt still accounts for 82% of the total debt market in Ukraine. This is down from nearly 100% from 1997-2000. Corporate notes and bonds account for 16% of total, most of it publicly traded. The small balance is generally commercial paper. (See appended Table 7.)

3. Macroeconomic and Financial Sector Setting

Economic growth:

GDP growth in real terms was reported to be about 4.2% in 2002, the third consecutive year Ukraine has experienced real growth after about a decade of steady decline. The CPI inflation

[8] There has been fluctuation. The 10 largest firms were 40 percent of market cap in 1999, and 52 percent in 2000. However, they have been about 45 percent of total since 2001.

[9] Bank lending has increased significantly in Ukraine in the last two to three years.

rate showed a deflationary scenario, with CPI at negative 3.5%. Against this backdrop, the NBU reduced the interest rate it charges to banks to 7%, down from 12.5% at end 2001 and 27% at end 2000. This has reduced borrowing costs to enterprises, and served as a substitute for some of the financing companies may have otherwise tried to mobilize in the domestic debt markets. Interest rates are still high, at 21% (year-end 2002), although nominal rates have come down substantially and steadily since 2000. Meanwhile, there are no data for savings rates in Ukraine. (See appended Table 4.)

Government debt market: size and turnover.

There were 61 total sovereign debt issues outstanding as of end 2002. They were valued at UAH 2,948 billion, or $553 billion-equivalent. This averages $9.1 billion, and accounts for the vast majority of debt market activity in Ukraine. It also represents a sizeable increase from 2000-2001, when outstanding sovereign debt was only $375 billion and $237 billion, respectively. However, the year-end 2002 figures is far smaller than totals in the late 1990s when Ukraine's fiscal and debt management problems culminated in crisis and default. Turnover figures were not available. (See appended Table 5.)

As noted above, Government-issued debt still accounts for 82% of the total debt market in Ukraine. This is down from nearly 100% from 1997-2000. (See appended Table 7.)

Banking:

While year-end 2002 figures are still being prepared, September 30, 2002 figures show that banking assets as a percent of GDP have shown steady growth since 1997. September 2002 figures were 23.9%, up from 19.3% at year-end 2001 and only 13.3% at year-end 1997. This is largely based on the continuing increase in lending by the banks, which increased to more than 19% of GDP from less than 15% in 2001. Meanwhile, nominal interest rates continue to decline, with the "prime rate" for local currency loans declining from 32.3% at year-end 2001 to 23.5% at September 30, 2002. Nonetheless, net spreads remain high (good for banks, bad for borrowers) at nearly 16%, although this is less than half the net spread in 1999. (See appended Table 6.)

4. Challenges, constraints, and prospects for development of the domestic bond market

Challenges and constraints for issuers

- The biggest problem is the 25% value restriction on bond issuances for joint-stock companies. Of course, some issuers find ways to avoid this problem by creating subsidiaries in form of limited liability companies that have no limitation in terms of authorized capital. In this case, the parent company guarantees the obligations of its subsidiaries (e.g., Galakton-Galaktis, Arkada Bank-Arkada Fund).
- Long-term registration procedure of issues. It is not applicable, especially for short-term bonds.
- Investors are not ready to buy long-term bonds. This may soon change, but it will take time to develop the market for even 2-3 year instruments.
- There are a limited number of buyers on primary and secondary markets. In reality, this means that yields are not very good for issuers. Underwriters define the yield without using market mechanisms due to the relative lack of market participants.

- There are no qualified financial directors and accounting specialists working for issuers. They do not know how to account for bonds, let alone strategic financial planning, etc.
- Psychology of the issuers is more used to bank credit than market-based securities. Thus, there is the issue of market practice and familiarity.
- The corporate bond market also depends very much on banks. Banks now have surplus liquidity in terms of UAH, and limited investment opportunities despite their increasing lending in recent years. This could change rapidly. However, for now, yields are lower than deposits for some issues. The reason for this is due to low interest rates in the inter-bank credit market, reflecting surplus liquidity. Banks are closely regulated by the National Bank of Ukraine. For instance, the money they receive from bond issues cannot be used to make investments in office buildings or other similar kinds of investments. These are temporarily free resources. That is why they are often using REPO agreements. These are short-term investments. Banks generally keep their assets in short-term and liquid investments in case they need additional funds to meet NBU prudential requirements. That is also why the inter-bank market is so important to banks. If they have good interest rates and buyers on the inter-bank market, they have little incentive to go to the corporate bond market. However, with a more stable macroeconomic environment, the situation is changing. This has affected the corporate bond market in two key ways: (i) issuers understand that it is possible to get money from the capital markets and they will do it; and (ii) investors understand that this is working instrument, and while they do not have much market experience, they do know that the range of financing instruments is limited, and that bonds are cheaper and easier to access than loans.

Challenges and constraints for investors

- Taxation of individual investors. It is better to invest in deposits.
- Issues are too complicated for regular investors. Only sophisticated investors can sometimes understand the real features of the issues. For example, issues may claim that bond yields are secured by dollars, although this is not really the truth.
- The corporate bond market depends very much on banks. Yields are lower than on deposits for some issues because of the inter-bank credit market. On the other hand, banks are big buyers and can buy the whole issue without any problems. Sometimes, issuers are prepared to sell at lower yields. However, for market development purposes or other reasons, the whole issue may then be bought by a small group of investors, even if they pay a little bit more.
- Book-entry form is too expensive for individual investors.
- The secondary market is not very liquid. The reason again is the limited number of participants on the primary market. Another reason is that almost all deals on the primary market have been done using REPO agreements.

Challenges and constraints for market infrastructure (the exchange and regulators)

The PFTS and MFS do not have problems in terms of technology, rules, etc. They have other problems. The major constraints on market infrastructure in general are as follows:

- There are a limited number of buyers on the primary and secondary markets.
- There are no privileges to trade on the organized market (e.g., short-term bonds which are traded on the organized primary and secondary market should not be registered with the Securities Commission, and they should have some tax benefits). This is very important

for emerging markets to stimulate market development with adequate volume top ensure transparency and disclosure.

- Only book-entry form can be traded on the organized market. In general, this is not bad. But documentary form is better for individuals because it is cheaper. That is why they cannot use the organized market for their purposes.
- MFS does not have a clearing license from the Securities Commission.
- The depository system is inefficient. MFS can be reorganized into a central depository by merging with the National Depository of Ukraine. It is not a real problem but it will take time.
- There are no rating agencies.

Summarize prospects for the development of the bond market for corporations and banks

The corporate bond market should grow significantly from 2003 on. According to predictions, some market participants will seek to issue bonds valued at more than UAH 1 billion via public offerings.

The corporate bond market is likely to be the only corporate securities market in Ukraine in next five or so years. Secondary equities trading will likely decline, with periodic IPOs (primarily private). This is largely due to the psychology of emerging markets' new owners that has obtained assets via privatization and buying equities from small shareholders. They do want take the risk of losing their property. That is why they want to have 75% plus one share. But they agree to take capital through bonds even if they should pay in this case par value and yields. That is strange because share issues are cheaper. However, they prefer to pay more and take less risk. Investors are also more willing to invest in fixed income securities than in equities because everybody remembers the 1998 crisis, and Ukraine has not had success with the issue of dividends.

There will be new market participants from 2003 on: individuals, mutual funds, insurance companies, and maybe pension funds. So the number of buyers on the primary market will grow, as will liquidity and volumes on the secondary market.

PFTS as SRO will create standards for corporate bond issues.

PFTS will provide corporate bond ratings.

New underwriters and types of fixed income securities will appear in the market.

The forecast for municipal bonds is rather negative for two reasons: (i) negative experience with the Odessa municipality; and (ii) the Ukrainian budget will be under big pressure in 2003 and 2004 because of payments due on government eurobonds. The Ministry of Finance will not agree to take on the risk of municipalities defaulting on debts under such payments pressures. Of course, Kyiv or Donetsk can issue bonds, but these are more likely to be eurobonds.

Mortgage bonds should still be considered in perspective. Arkada Bank remains the one exception, largely based on the special "experimental" Law that directly applies to Arkada Bank and its Kyiv construction company.

TABLE 1

INSTITUTIONAL INVESTORS

ASSETS HELD BY INVESTMENT, MUTUAL, AND PENSION FUNDS, AND INSURANCE COMPANIES

	1997	1998	1999	2000	2001	2002
Insurance companies:						
Number of the insurance companies	241	233	254	263	328	N/A
Insurance premiums, UAH mln.	408,401	789,159	1 164,126	2 136,000	3 030,507	N/A
Insurance reserves, UAH mln.	159,838	447,692	537,041	959,000	1 185,156	N/A
Authorized capital, UAH mln.	118,656	150,595	327,872	511,000	1 036,877	N/A
Volume of the insurance market as a % of GDP	0,44	0,76	0,92	1,2	1,5	N/A
Insurance payments, UAH mln.	129,182	177,845	360,919	407,000	424,205	N/A
Level of insurance payments, %	32	23	31	19	14	N/A
Pension fund of Ukraine						
Annual income**, UAH mln.	N/A	11 894,146	13 099,371	14 160,111	16 452,277	22 264,315

** planned rate

TABLE 2

EQUITY MARKET FOR LISTED COMPANIES - SIZE AND ACTIVITY

	1998	1999	2000	2001	2002 (10 M)
Number of Public ** Companies Registered with Supervisory Body	N/A	33019	2779	22504	N/A
Listed Companies					
Number	135	432	249	286	257
Market Capitalization Local Currency, mln	12494	12774	9479	8123	12349
Market Capitalization US$ Equivalent, mln.					
Market Cap/GDP (as a percent)	5101	3093	1742	1512	2330
Number of Trades					
Volume in Local Currency, UAH mln.	12.2	9.8	5.6	4.0	7.1
Volume in US$ Equivalent, $ mln.	—	—	—	—	—
Market Turnover/GDP (percent)	177	578	1310	998	396
Market Capitalization of 10 largest listed	72	140	241	186	75
companies, UAH mln	0.2	0.4	0.8	0.5	0.2
** Registered	—	5183	4935	3575	5492

TABLE 3

NON-STATE DEBT MARKET - SIZE AND ACTIVITY

CORPORATE COMMERCIAL PAPER, NOTES, BONDS AND SUB-SOVEREIGN DEBT

	1997	1998	1999	2000	2001	2002
Total number of commercial paper* issues outstanding	-	-	-	4	15	17
Total value of commercial paper issues outstanding						
Local currency (UAH mln.)	-	-	-	7,100	73,600	68,600
US $ equivalent (mln.)***	-	-	-	1,305	13,700	12,915
* All corporate debt under one year excluding bank loans, accounts payable, deferred payments, and other current liabilities that are not in the form of securities						
Total number of registered (e.g., public) corporate note and bond issues outstanding.*	-	-	-	1	11	47
Total value of registered corporate note and bond issues outstanding						
Local currency (UAH mln.)	-	-	-	10,000	124,850	580,257
US $ equivalent (mln.)***	-	-	-	1,838	23,240	108,928
Total number of corporate notes and bond issues outstanding that are private placements (including longer term veksels, IOUs, and any other liabilities that have been privately securitized)**	-	7	29	13	15	1
Total value of registered corporate note and bond issues outstanding						
Local currency (UAH mln.)	-	4,539	316,899	45,751	97,368	1,254
US $ equivalent (mln.)***	-	1,853	76,724	8,410	18,124	0,235
*All registered corporate and bank debt with maturities of one year and over excluding bank loans						
** All non-registered corporate and bank debt with maturities of one year and over excluding bank loans						
Total number of Sub-sovereign and Municipal Issues Outstanding	1	1	-	-	-	-
Total value of Sub-sovereign and Municipal Issues Outstanding						
Local currency (UAH mln.)	61,000	61,000	-	-	-	-
US $ equivalent (mln.)***	32,766	24,903	-	-	-	-

***US $ equivalent is calculated according to Official Exchange rate 1 UAH / 1 US $ (average per period) /NBU data/

TABLE 4

MACROECONOMIC INDICATORS

ECONOMIC GROWTH, INFLATION, INTEREST, SAVINGS RATES

	1997	1998	1999	2000	2001	2002 (8M)	SOURCE
Nominal GDP, UAH mln. :							
	93 365	102 593	130 442	170 070	201 927	136 292	International Centre for Policy Studies (ICPS)
	93 365	102 593	127 126	175 010	208 191	N/A	World Bank through 2000; EBRD projection for 2001
GDP Annual Growth, %:							
Real GDP, annual percentage change	- 3,0	- 1,9	- 0,2	5,9	9,1	4,2	ICPS
Real GDP	-2,99	-1,90	-0,40	6,00	7,00	N/A	World Bank to 2000; EBRD projection for 2001
Inflation Rate, %:							
CPI annual percentage change	10,1	20,0	19,2	25,8	6,1	-3,5	ICPS
CPI annual average	15,94	10,58	22,68	28,20	12,5	N/A	World Bank to 2000; EBRD projection for 2001
Interest Rate, %:							
Discount Rate (End of Period)	35,00	60,00	45,00	27,00	12,50	7 (end of year)	IMF IFS (Basic rate at which NBU lends comm banks), 2002 – NBU
Loan interest (average annual), yearly %	49,1	54,5	53,4	40,3	31,9	20,9	ICPS (commercial bank loans, UAH)
Savings Rate as a % of GDP							
Savings/ nominal GDP	6,74	5,83	6,23	4,83	5,55	N/A	*Calculation from ICPS data*
Savings Rate/GDP	18,74	19,10	N/A	N/A	N/A	N/A	*Calculation from IMF data*

TABLE 5

NATIONAL/SOVEREIGN DEBT MARKET *
SIZE AND ACTIVITY

	1997	1998	1999	2000	2001	2002	SOURCE
Total number of National/Sovereign Debt Issues Outstanding **	N/A	N/A	N/A	N/A	44	61	2001-2002 NBU
Total value of National/Sovereign Debt Issues Outstanding Local currency (UAH mln.)	11 216,704	14 223,869	4 735,435	2 038,875	1 271,122	2 947,920	NBU, MFU
US $ equivalent (mln.)***	6 024,979	5 806,846	1 146,483	374,779	236,611	553,392	*Calculation from NBU data*
* Strictly sovereign/central government issues, but excluding sub-sovereign issues guaranteed by the central government. Sub-sovereign issues should be reported in Table 3							
* * Please add as a footnote the different maturities and their market yields for the outstanding issues as of the most current period.							

***US $ equivalent is calculated according to Official Exchange rate 1 UAH / 1 US $ (average per period) /NBU data/

TABLE 6

BANKING SECTOR

SIZE, CREDIT PROVIDED, LENDING RATE, INTEREST RATE SPREAD

	1997	1998	1999	2000	2001	2002	SOURCE
Banking assets as percent of GDP	13,25%	14,97%	16,48%	17,82%	19,30%	23.85%	
Domestic credit provided by banks (as % GDP)	10,31%	10,74%	11,10%	12,43%	14,88%	19.18%	
o/w: credit to Government*	1,94%	1,49%	0,89%	0,46%	0,71%	1.38%	
o/w: credit to state enterprises*	5,94%	1,4%	1,4%	1,5%	1,64%	1.82%	
o/w: credit to private enterprises and households*	2,42%	7,85%	8,81%	10,47%	12,53%	15.97%	
Lending interest – prime rate	49,12%	54,50%	54,95%	41,53%	32,30%	23.46%	September 2002 – Calculation from IFS data
Interest rate spread (lending rate minus deposit rate for comparable maturities, e.g., one year loan minus one year deposit rates)	30,91%	32,24%	34,25%	27,81%	21,30	15.88%	September 2002 – Calculation from IFS data
** percentage of GDP such that the total of the three sub-categories = the aggregate figure for bank domestic credit as a % of GDP*							

TABLE 7

PROPORTION OF TOTAL DEBT MARKET: STATE, SUB-SOVEREIGN (MUNICIPAL), COMMERCIAL PAPER AND CORPORATE

	1997	1998	1999	2000	2001	2002
% of total value of total debt issues which is national government issued	99,46	99,54	93,73	97,01	81,12	81,93
% of total value of total debt issues which is short-term (e.g., commercial paper) excluding bank loans, accounts payable, deferred payments, and other current liabilities that are not in the form of securities	-	-	-	0,34	4,70	1,91
% of total value of total debt issues which are corporate notes and bonds issued with maturities of one year or more, excluding bank loans, accounts payable, deferred payments, and other current liabilities that are not in the form of securities	-	0,03	6,27	2,65	14,18	16,16
% of total value of total debt issues which is sub-sovereign and municipal issued	0,54	0,43	-	-	-	-