

**The Pragma Corporation**  
**USAID Development of the Securities Market/Kazakhstan**  
**Project**  
**Monthly Report**  
**(For the period ending November 30, 1999)**

For the  
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

GENERAL INFORMATION

|                 |                      |
|-----------------|----------------------|
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ALMATY, KAZAKHSTAN

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**I. EXECUTIVE SUMMARY**

This report provides details on the events and activities summarized below, as well as other events and activities regarding the USAID Development of the Securities Market Project/Kazakhstan, as implemented by consultants for the Pragma Corporation ("the Pragma Team" or "Team"), for the month of November 1999.

- INITIATED NEW TASK ORDER
- SUBMITTED FEASIBILITY STUDY ON MORTGAGE-LENDING MARKETS
- SELECTED STANDARD & POORS AS RATING AGENCY FOR LARIBA BANK
- COMPLETED BOND PRESENTATION FOR US AMBASSADOR RICHARD JONES AND USAID MISSION DIRECTOR GLENN ANDERS
- PREPARED TALKING POINTS FOR THE JOINT COMMISSION MEETING TO BE HELD IN WASHINGTON, D.C. IN DECEMBER
- PREPARED DRAFT PROPOSAL FOR DEVELOPMENTAL CREDIT AUTHORITY (DCA) USAID
- CONTINUED DEVELOPMENT OF SECURITIZATION OF SOCIAL OBLIGATION OF MULTI-NATIONAL OIL COMPANIES
- CONTINUED DEVELOPMENT OF KDRs (KAZAKHSTANI DEPOSITARY RECEIPTS)
- SIGNED POIs (PROTOCOLS OF INTENTIONS) WITH "RG" CORPORATION AND ACCEPT PAGE TO ASSIST WITH BOND ISSUES AND RELATED MATTERS
- DRAFTING OF REGULATIONS FOR NSC CONTINUES
- INVITED TO PARTICIPATE IN MORTGAGE WORKING GROUP OF THE NATIONAL BANK OF KAZAKHSTAN

**II. PROJECT DESCRIPTION**

The Pragma Team works with the National Securities Commission ("NSC"), the Kazakhstan Stock Exchange ("KASE"), broker-dealers and the Central Depository in developing Kazakhstan's securities market. To further these goals, the Pragma Team works under a recently signed MOU between USAID and the NSC. Pragma also works with KASE under the auspices of a 1998 Memorandum of Understanding which established the precedent and

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rules of engagement. While these MOUs have expired, Pragma and NSC continue to cooperate in accordance with the pre-existing agreements.

In November 1998, recognizing the changes in circumstances since the Task Order was written, Rick Gurley, the COTR for the AID Mission, signed off on an Action Plan that set forth the priorities of the Project through its completion date. The priorities of the Project for this period are noted in the boxes below in section III. PROJECT UPDATE AND PROGRESS VERSUS ACTIVITIES IN THE ACTION PLAN. In mid-year, 1999, a new action plan was drafted. In November, 1999 a new task order was executed which acknowledged the different emphasis being placed in the development of the securities market such as the design and structure of fixed income instruments and the need for a local ratings agency presence. It also redefined the deliverables to reflect these changes in emphasis.

The project update for this monthly report will correspond to the activities set forth in the action plan described above.

Pension funds (which will attain a capital base of approximately \$1.65 billion in 2003), as well as other potential investors, need products for diversification. Currently, Pension funds are overwhelmingly concentrated in state-issued Treasuries (95%) creating unnecessary risk, especially in light of the recent Russian Treasury default. From both a fiduciary and return standpoint, this concentration relies too heavily on the state to perform on its debt obligations. In developed economies, where taxation functions effectively to replenish national coffers, state issuance merits high credit ratings (usually the highest). In Kazakhstan, sovereign debt issues are still considered to be high risk. Moreover, only a few private corporations merit "A" listings, thus qualifying for pension fund investment. Limitations on investment in highly liquid international equities, while the best option, are limited to 5% of pension fund portfolio investment. Subsequently, new financial instruments are being designed to stimulate the lower-risk bond market. A Kazakhstani Depository Receipt, which can be composed of international securities i.e. equities but recognized as a domestic issue can help pension funds diversify their assets without violating the 5% limitation for foreign investment, is in the exploratory stage. Work is underway to design a pilot mortgage backed security. A mortgage-backed security can offer not only the capital preservation and yield of bonds in general, but also a choice of longer-term maturities. This, in turn, can lead to banks making mortgages and encouraging home ownership, knowing that their portfolios can be securitized and sold.

### **Mortgage-Backed Finance/Mortgage Lending Market**

USAID plans for Central Asia include the development of economic programs which maximizes social impact, while broadening the availability of products in the marketplace. In response to such directives, Pragma has recognized this need to develop more financial instruments with a social dimension in addition to meeting the need for more pension fund diversification. The objective in developing a mortgage pilot is to promote home ownership, giving citizens a stake in the very societies to which they belong. The right to buy, to sell and hold property is endemic to all free societies. The development of a mortgage market will improve living standards and contribute to the growth of state and municipal revenue through the collection of property taxes. This in turn fosters owner responsibility, and builds trust in the financial system, makes local officials more accountable for the delivery of services, all of which allows for greater participation in the democratic process.

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In late October-early November, the Institute for Urban Economics in Moscow delivered its report to Pragma on conditions and prospects for the mortgage market in Kazakhstan.

*(See Attachment I)* This report assessed the current and potential market for mortgage lending in Kazakhstan, examining market size and conditions, bank mortgage lending, the construction market, and the legal basis of mortgage market transactions. After setting the stage through initial analysis and surveys, the report proceeded with a discussion of current problems and impediments to mortgage lending and the mortgage securities market. Lastly, the report concluded with an analysis of means to overcome impediments to mortgage lending. The legal infrastructure to support a mortgage-lending market is already, to some extent, inherent in the Civil Code, but the report stated that effective legislative norms, ambiguous clauses, and lack of institutional underpinnings would create problems at the underwriting, contracting and foreclosure stages. Mortgage certificates need to be converted into genuine securities, thus requiring comparable legal infrastructure for the securities market.

The mortgage-market feasibility study presented the background of the currently existing real-estate market in Kazakhstan, substantiated by a number of surveys. Certain mixed trends emerge. On the one hand, there is a relatively high demand for housing in the two largest metropolitan areas (Almaty and Astana) and regional capitals and industrial areas (Kustanai, Atyrau, Pavlodar, and Ust-Kamenogorsk) (p. 20). On the other hand, the demand for housing in small towns, where high levels of unemployment occur, is low. The decline in population and the number of newly formed households suggests a slight decline in housing demand and lowered price range (p. 18.). Yet in the past 2-3 years, the demand for single-family homes (suburban well-appointed residences) and renovated and enlarged apartments (in multi-family dwellings) have demonstrated sustained growth (p.20). In terms of financing, the mortgage lending market is narrow and sluggish, with banks preferring to extend mortgage loans primarily to employees and most reliable corporate clients (p. 27). At the same time, the private sector is now responsible for nearly 85% of new residential construction (p. 22), mandating the appropriate legislative and securities market reforms.

In order to better understand the current mortgage market and prepare a prospectus for future mortgage-lending, the project analyzed a selected number of Kazakhstani banks involved in residential mortgage lending. Lariba Bank emerged as the most active on the real estate mortgage market, with 40% of its portfolio consisting of two years loans. The bank used two lending schemes, with loans either extended against the mortgage of purchased housing or based on leasing schemes. Currently the bank has on its balance sheet nearly 100 units purchased under financial leasing contracts, with only 3-4 which could be described as "problem loans" (p. 30). While extending its loans primarily to a narrow band of clients, Kaspiisky Bank, Temirbank, Turan Alem, and Centre Credit also issue various types of mortgage loans, as well as savings and deposit programs and loan programs for home improvement (Narodny Bank).

Other institutions are involved in efforts to buoy the housing renovation market and construction industry. In such programs of non-banking housing finance, Basis-A Corporation and Astanafinance Joint Stock Company are two examples. Astanafinance plays a leading role in the implementation of municipal mortgage lending in Astana, where it is currently involved in the design and implementation of a special housing program. The company seeks to create financial, economic, and institutional incentives to animate the housing construction market. Such measures are also of a particular social importance in promoting the flow of qualified work force to the new capital. Initial stages of the program

are financed from the Astana budget (e.g. at the expense of the Administrative Council of the Astana Free Economic Zone), but diversified funding sources are sought through internal funds, proceeds from the sale of housing, mortgage transactions, bank loans, and yields on securities and other revenues (p. 38).

Despite the initiatives of such banks and agencies, however, the loans extended by the aforementioned parties can not be properly defined as supporting a mortgage market as such. Either inconsistencies between lending terms and regulations or insufficient standardized rules of lending inhibit the full realization of a mortgage market. Banks do not meet mortgage lending standards to minimize default risk, which limits the possibility of increasing lending operations (p. 42). Lack of long-term financial resources, the high cost of financial resources, low prices for residential property, the concomitant depreciation of collateral, the absence of independent appraisers, and a poorly developed insurance capacity constrict mortgage market lending. (pp. 42-3). Still, the awareness of the need for mortgage lending, the withdrawal of government finance due to budget deficits, a nascent housing market, and initial bank initiatives all provide impetus for development. The gradual growth of the middle and upper-middle classes, considered to be the main applicants for mortgage loans, will also facilitate this process.

An advanced mechanism of housing finance, augmented by an appropriate legal and institutional framework, will stimulate and support a mortgage market and secondary trade. These measures would also help to make housing more affordable for the general public, expanding effective demand, attracting investment, and mobilizing funds. Different phases, engaged in concurrently or sequentially, should provide the proper environment for this development to occur. **Phase 1** would set the stage for the development of the primary mortgage market. Technical, advisory and training assistance should be provided to banks willing to start operations in the mortgage lending market. Further development of the legislative and regulatory framework should provide for well-articulated mortgage lending operations. Insurance, realty, and property appraisal companies, as well as mechanisms of certification and verification, should accompany this process. **Phase 2** would involve refinancing mortgage lending through issuance of securities by mortgage banks and placement among investors. The reliability of mortgage securities will be enhanced by development of a system of credit rating scores and institutions, requirements to subject bank to mandatory auditing by a foreign company, involvement of foreign investment banks on technical assistance for structuring securities, etc.

**Phase 3**, the final stage, would see the formation of a unified, standardized and liquid market for mortgage-backed securities through the establishment of a secondary market facility. An Agency for Housing Mortgage Lending would be created, with assistance by the government to provide unified standards and procedures for the originating and servicing of mortgage loans, to guarantee lower credit risk and higher reliability. Reliability will be secured by budget-supported guarantees and backing of securities through standardized mortgage loans of high reliability. Partner banks, as well as the provision of insurance, will help to ensure the formation of a broad-based, self-supporting system of mortgage lending. This will also provide the proper environment for the issuance of mortgage-backed securities.

But in order for full-fledged changes to occur, clear and unique legislation needs to create provisions for mortgage lending (transaction, foreclosure and other issues). Terms of issuing certificates need to be revised and designed. Legalization and registration for all contracts and agreements related to the origination of a mortgage loan for an individual borrower need to be

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provided, but designed in such a fashion to avoid a lengthy process. These measures could include clauses on special procedures for the purchase of housing at the expense of borrowed funds; such stipulations could be added to effective legislation or provided by a permit to conclude a tri-partite sale and mortgage contract. Ambiguous legislation regarding guardianship and trusteeship needs to be revised. Measures for timely out-of-court settlement, along with the requirement to registrar and record actions of the mortgager, should be provided. Mortgage loans should be tailored to different market conditions and rates of inflation, to correlate bank and borrower interest. Provisions for underwriting, contracts, servicing and bad loan problems are called for. An established credit rating system will validate mortgage-banks and mortgage loan products. The promotion of mortgage-backed securities mandates methodological profiles for schemes of issuance, economic criteria, and regulatory framework for share issuance and circulation. Guarantees need to be provided, along with means of converting mortgage certificates into genuine securities.

Mortgage-backed securities need to be accessible to long-term institutional investors. Their reliability should be demonstrated, and regulatory approvals given for pension funds to make investments, along with other measures (possible stimulation of foreign investor interest, banking legislation permitting commercial banks to make investments in mortgage-backed securities). The creation of a specialized secondary market facility, if finally approved, would be an optimal measure. This institution could devise mortgage lending standards and requirements, design methods for pricing and risk management, and test mechanisms for assigning of claims and issuing of securities back through a pool of mortgage loans. Mortgage market infrastructure should be further developed through systematized insurance, including individual, property and total. Terms of risk should be defined, along with contract terms and a unified methodology for appraisal of mortgaged property. Lastly, training programs designed for banks and other mortgage market participants need to elaborate the following topics: stages and components of mortgage lending; legal framework, rules and procedures; underwriting; computation of debt service payment; mortgage risk management; global mortgage lending experience; coordination between various mortgage market participants; primary and secondary market component; features of mortgage securities such as issuance and risk; mortgage loan servicing, insurance, pricing and other aspects of the market. These courses should be designed for appraisers, insurance and real estate agents, as well as stockbrokers. In this comprehensive matter, a full-ranged implementation of a functioning mortgage-market will be set in motion.

While the experience in the Russian mortgage market has formed plans to boost the mortgage market here, Pragma and counterpart Kazakhstani organizations have decided against the Fannie Mae model utilized in Russia. It would be premature to foster a national agency (as utilized by Fannie Mae in the US) to buy up mortgages in the absence of a flourishing mortgage market. Rather, Pragma is encouraging origination of mortgages. Once originated, mortgage loans can be packaged as a bond and sold to pension funds, thus releasing money back to banks in order for them to make more mortgages. Profits would be generated on the spread between loans made to buyers in housing market and sold to pension funds i.e. a mortgage pool with a weighed average coupon of 22% and packaged as a security and sold at 17% to pension funds.

### **Pilot Mortgage Project**

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We having been working with Lariba Bank, the sole participant of the mortgage market in Kazakhstan at the present time, to issue a bond collateralized by the mortgages it has been making in the past three years. A ratings agency for the bank, along with further authorization (see draft proposal for authorization from Developmental Credit Authority below) would provide a layer of guarantee for bond issuance. A selection committee composed of Rick Gurley, COTR, USAID, David Lucterhand, Pragma's COP and Alexander Boichenko, President of Lariba Bank chose Standard & Poor's after reviewing proposals from both S&P and FITCH IBC. The committees considered price, service responsiveness, reputation and quality of each firm, and the familiarity of each with the Russian mortgage marketplace. The compelling reason for choosing S & P over Fitch, given that the bids were nearly identical (within \$500) was Mr. Boichenko's comfort with S & P's having a ratings presence in Russia. Further, while the Project was paying the cost of S&P's rating fee, Lariba Bank had also agreed to pay the expenses associated with getting a rating.

### **Development of Fixed-Income Instruments: Bond Market Presentation**

A broadly based framework for the development of mortgage-backed securities depends on an investment environment with various products available to diversify risk and create a liquid market. To this end, Pragma made a presentation to the USAID Mission which described the overall development of the fixed-income market.

The presentation *The Evolution of a Debt Instruments Market in Kazakhstan* was delivered to US Ambassador Richard Jones and USAID Mission Director Glenn Anders (See Attachment 2).

In the presentation, COP David Lucterhand elaborated on the necessity of building up a healthy bond market in Kazakhstan. He acknowledged that the features of an ideal market are 1) transparency, 2) reduction of the cost of capital, 3) efficient allocation of capital, 4) greater participation, 5) ease of trade and settlement, 6) free and flexible market entry, 7) competition, and 8) enforcement. Investors need to know what they are getting, while operating in an environment of reduced risk. Regulatory and legal impediments to new financial products should be minimal, at the same time that enforcement should create a level playing field for all participants. Competition should exist not only between banks and issuers, but also among issuers, types of product, dealers and other market entities.

However, the ideal market is often compromised by impediments, particularly in emerging markets and post-socialist economies. In Kazakhstan, the market has been recently affected by Asian contagion, short-term treasury default from Russia, and low commodity prices. A potentially positive development – pension reform – has created the expansion of a domestic institutional investor base. Further, as corporations and enterprises expand, they seek lower costs of funding. While the banking system in Kazakhstan has been praised for its stability, it continues to struggle with a low deposit base and a population that distrusts banks and continues to rely on “mattress money” (opt. not to mention dollars as a store of value).

Of the approximately \$1.6 billion of debt that has come to the market in Kazakhstan, state borrowing consists of sovereign Eurobonds, Treasury bills and bonds, and National Bank notes (see figures in Attachment 1). Non-state borrowing is comprised by Kazkommertz Eurobonds, Kazkommertz domestic bonds, followed by selected corporate and municipal bonds. However, 92% of bond issuance is generated by the state. Over the next several years, the objective is to have a third or more of the market comprised of non-state issues:

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corporates bonds, municipal bonds, and mortgage-backed securities. Driving this need for diversified and reliable sources of investment are the burgeoning pension fund assets, forecasted to reach approximately \$1.65 billion by 2003.

Corporate bond issuance has provided the most immediate opportunity for diversification and development of the fixed-income market. In the case of the small-to-medium enterprise Vita LTD, accessing the bond market (for borrowing at 15% for 3 months) was able to affect a savings of approximately 8% (or nearly 1/3) of previous borrowing costs retained from bank financing (22-24%). Nevertheless, it is a lengthy and detailed process to provide for bond issuance. Conferring with company management to learn financial objectives, introducing broker-dealers, assisting in the retaining of a financial advisor, meeting with potential investors to establish a likely range of placement, exploring different credit enhancement structures, helping to prepare the prospectus, and working with the company through the listing process are among the necessary steps to complete bond issuance. Even so, short maturities, in untested markets and fledgling companies, are requisites for investors.

To develop the bond market further (opt. in limited market conditions), certain steps are needed. A greater range of fixed-income instruments will provide diversified options for investors, primarily the pension funds which have held 95% of their assets in state issues. The development of a mortgage market, public finance investment/vehicles, and enhanced corporate finance are all means to amplify, broaden and deepen the financial and investor base.

Even as increased options diversify the marketplace, sources of long term capital are necessary. Bonds with longer maturities allow corporations to invest in necessary capital improvements and provide oblasts and municipalities with longer-term opportunities to improve and finance infrastructure investment. The real estate mortgage market will not only provide diversification for investors, but add medium and long term product as well.

While corporate bonds have begun to be issued on the stock exchange, a greater abundance of corporate issues will mean diversification for investors, alternative financing sources for issuers, greater competition to bank borrowing, and a greater use of long-term capital (as maturities increase), and minimized dilution of ownership. In addition, bonds will provide an alternative means to raise capital for corporations, when owners (as often is the case in the former Soviet Union) are often reluctant to dilute ownership through the sale of equity. In order to create credit enhancement for a bond market, it will be necessary to structure asset-backed securities using excess collateralization when necessary (ex. 150% of the value of the loan held in escrow) or guarantees from insurance companies to bolster investor confidence.

Ratings, increased transparency and disclosure, and further legal reforms will go far towards creating a reliable securities market for the debt instruments. Ratings evaluate the risk of default and make it easier to place issues. They also provide issues with standards of comparison to other securities, increasing investor confidence. Adopting new ratings regulations and encouraging the establishment of local affiliates of internationally recognized ratings agencies should help to implement domestic rating capacity. Greater disclosure will also reduce risk premiums and better the business environment in general. This will require a greater degree of exposure of conflicts of interest, attacks on self-dealing, emphasis on improved corporate governance, and, in connection with the aforementioned, broader investigative and enforcement powers of the National Securities Commission. These measures should be accompanied by the legal infrastructure that will provide trust indentures for asset backed securities, a framework for issuing of mortgages/bonds, and a regional tax base for municipalities.



### **Joint Commission Talking Points**

The development of capacity in the securities market, particularly in bond and mortgage markets was highlighted in preparation for Joint Commission discussions between US and Kazakhstan in December 1999. (See Attachment 3) Also for discussion is the privatization of state-packages of shares, municipal and oblast fiscal reform, pension fund asset management, and enforcement issues. Among the requests put forth by Pragma was for the RK government to consider streamlining the foreclosure process and the offering of title. Another proposal was to consider transferring taxation authority to municipalities and oblasts making it possible for them to issue municipal bonds supported by local tax revenues. Also suggested for inclusion on the agenda were prohibitions of self-dealing in pension fund assets by persons with conflicts of interest and the granting of full subpoena power to the NSC to assist them in their enforcement efforts.

### **Draft Proposal for Developmental Credit Authority**

Asset managers of pension funds need access to an array of low-risk investments. But before the market can accept alternative instruments to RK Treasuries for investment, a new type of bond need as many risk reducing factors as possible. One instrument under development is a mortgage back bond. DCA which provides guarantees for principal repayment can help make a bond more saleable in the securities market providing a low-risk alternatives to government securities. The Developmental Credit Agency (a guaranteeing bureau/agency under the auspices of USAID) typically guarantees up to 50% of loan principal to qualifying institutions that meet the unique underwriting standards the agency has in place. In November, a preliminary proposal was submitted to DCA (Attachment 4) as part of a pilot project to establish the viability of a mortgage market in Kazakhstan by structuring an issue that can be successfully placed with pension funds, the country's only source of long term money. The proceeds resulting from the sale would then be used to make new mortgages. Lariba Bank is the only bank with mortgage experience in a position to place such an issue. Its portfolio currently consists of 135 mortgages totaling nearly \$1,000,000, with each mortgage made for a 5-year period, weighted average coupon of 27%, and weighted average maturity 40 months (with no history of default or late payments.) The proposed subsidy costs and borrowers risk for a \$1 million, 5 year amortizing bond with a 50% USAID guarantee of principle are detailed. (See figures in Attachment 4). Should such a guarantee be obtained, these bonds would certainly be seen as low risk (especially by the NSC) and suitable for pension fund investment.

### **Securitization of Social Obligations**

Another product underdevelopment (in a market requiring capital preservation and yield) is the "securitization of social obligation," to be further discussed in December report. This instrument will be designed to satisfy the social obligation costs that multinational firms have as part of their contractual commitments to the RK government. The amount owed to Oblasts over time would be sold as a bond. The proceeds raised through the issue would be directed to the Oblast to fund social projects. Pension funds, with their need to invest in a diversified portfolio, should find this vehicle attractive. Multinational companies will avail themselves of a

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secure and transparent means of accounting for social obligation costs mandated by Kazakhstani production sharing agreements and other contracts. Lastly, the populations of various oblasts will obtain legitimate and guaranteed means of realizing social and infrastructure projects lessening reliance on the RK government for financial assistance.

### **Kazakhstani Depositary Receipts**

At present, securities market legislation prevents pension funds from investing more than five per cent in international securities. Pragma has proposed KDRs as a means to access foreign shares through the KASE. Such vehicles patterned on ADRs (American Depositary Receipts) and GDRs (Global Depositary Receipts) would allow for diversification in shares while simultaneously offering the safety of standardized safekeeping. Most important, these instruments would be regarded as domestic issues and, therefore, qualified for pension fund investment. These financial products would also minimize risk and help to overcome market deficiencies in a nascent stock market supported primarily by government paper and a paucity of local corporate issues. In Kazakhstan, KDRs would be promoted primarily as a way for investors having to obtain a license for the export of capital and to facilitate the ease of buying and settling foreign shares.

Technically, a Depositary Receipt is a negotiable certificate that represents a company's publicly-traded security. A broker-dealer purchases an issuer's securities on their domestic market then delivers them to the local custodian bank to be issued as Depositary Receipts and/or a local broker contacts a foreign broker in the market from which the securities are to be purchased; and the foreign broker would purchase the shares according to the order of the Kazakhstani broker. On the same day that the foreign shares are delivered to the custodian (bank or depository) in the foreign country (e.g. US), the custodian would notify the respective Kazakhstani custodian bank or depository. The underlying shares of the DRs can be held in the foreign country for the account of the Kazakhstani custodian bank or depository, or the underlying shares could be physically delivered to the custodian bank or depository in Kazakhstan. Upon issuance, the DRs would become tradable in Kazakhstan. They could be traded on the KASE and deposited at or credited to the Central Depository or local custodian bank. Settlement, as with transactions of other securities, would take place on the domestic market and in domestic currency (even if priced in dollars). This domestic settlement would not require permission/license to export currency. If, however, the barriers to outright purchase of foreign securities were overcome, then outright purchase of securities might be a more efficient alternative.

In terms of corporate issues, Pragma signed Protocols of Intentions with two different companies, "RG Brands" and "Accept Page" In terms of RG company, we assisted "RG Securities" in structuring and registration of the "RB Brand" bond issue. Pragma met with the company's top management to discuss cash flow projections, the investment memorandum, and the pre-marketing of shares. We also discussed the legal side of the insurance mechanism for the issue, organizing meetings with the NSC lawyer, Pragma legal experts and BTA insurance. We assisted in the issue's registration, and developed a marketing plan for placement, preparing a plan for presentation to potential investors. A list of clients was developed in cooperation with RG Securities, and the bonds were listed on the KASE under the "OTC-1" category. We also worked with "Accept Page" on its marketing of a bond issue, assisting the company in contracting with "IMG" as broker.

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On exchange related matters, we have been asked to comment on making put options (for equity) available for pension fund asset managers to limit downside risk should the stock price tumble. In principal, Pragma has no problems with pension funds purchasing securities and purchasing put options on the underlying securities for protection. But several requirements are necessary. For instance, a pension fund may not purchase a put option without already owning the security nor should the pension fund sell the underlying security without selling the put option (at the same time). The put option must be "A" listed, and the Joint Stock Company law (esp. those clauses involving redemption of stock) must not be violated. If the bank's broker-dealer affiliate sells puts to a pension fund asset manager, the same BD must guarantee repurchase of puts should pension asset managers decide to sell with the purchase price being at fair value. In principle, not a bad idea but in practice very difficult to execute especially given the lack of liquidity in the market.

On legal matters relating to NSC, the rigorous schedule of drafting regulations and commentary on existing or proposed regulations continued. The appropriate amendments to the Joint Stock Company Law, delivered/proposed by the NSC, have been closely scrutinized. Certain amendments remain problematic and should be re-addressed. Among these include provisions that undermine shareholder's voting rights, provide vague specifications for periodic reporting of large companies. Amendments to the Administrative Code seek to give the NSC greater scope to address and challenge securities law violations. The amendments address liabilities such as the following: violations by open public companies of stipulations to submit and publicize financial information (e.g. quarterly and annual balance sheets); the hindering of NSC inspection or concealing of substantial information by professional participant (broker-dealer or registrar); incorporation of inaccurate data or inadequate fulfillment of lawful requirements by securities holder, representative or nominee.

Other corresponding legislation seek to provide the NSC with greater investigative and enforcement powers. Amendments to the Criminal Code would provide more alternatives for remedying securities law violations. These would include the liability of professional participants in the marketplace, whether broker-dealer, registrar or custodian, in failing to follow lawful instructions or intentionally avoiding the registration of the securities emission. Further, the Law on Securities Market amendments/revisions would also aim to prohibit deceitful or fraudulent actions in the case of securities purchase, sale or other services. The relevant amendments in this body of law would also vest the NSC with authority to pass resolutions to carry out investigations of securities market violations and also empower them with the right to resort to a court of law to remedy such violations.

On other matters, Pragma was invited to participate in a National Bank mortgage working group to develop a concept for the development of a mortgage market in Kazakhstan. A meeting on January 25<sup>th</sup> will present a detailed proposal for scheduled action.

**Task 1 - Continued Assistance to the NSC**

| Defined Activity      | Progress Made During the Month  |
|-----------------------|---|
| 1. Draft regulations. | <ul style="list-style-type: none"><li>The Team's Legal Group continued its work on various laws and regulations noted</li></ul> |

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| Defined Activity | Progress Made During the Month   |
|------------------|--|
| (continued)      | <p>below:</p> <ul style="list-style-type: none"> <li>• <i>Amendments to Joint Stock Company Law:</i> We received NSC's draft amendments, but these had too many fundamental deficiencies to be supported as a whole. Within the draft proposals of NSC, certain amendments remain problematic. Among these include the following: 1) Shareholder voting rights are undermined. 2) Periodic reporting for large, widely held companies is not effectively addressed. 3) Too-limited rights to change terms of issuance, in the payment of bond and bond, interest. (The issuer should have the right to pay earlier if possessing the capacity to do so.) The draft custody regulation delivered to IMCC for comment. 4) Some of the efforts to address capital and share valuation problems are not workable. 5) Open companies with unregistered shares are effectively abolished, no matter how few shareholders they have. Last but not least, 6) the power of the state is expanded but with no real connection to protecting shareholder rights.</li> <li>• <i>Amendments to the Administrative Code:</i> These amendments, to be added to NSC Administrative Code changes, deal with NSC's ability to implement large administrative fines for a wider range of securities law violations. They provide for the following range of liabilities: 1) failure to follow an instruction of the authorized body; 2) violations of open and public companies of procedures, terms of publication, and submission to authorized body of financial information, e.g. annual and quarterly balance sheets; 3) hindering of the authorized body's inspection and/or concealment of substantial information or facts at the time of conducting an inspection by the professional participant (broker-dealer, registrar); 4) incorporation of inaccurate data in the registrar, and/or for non-fulfillment or inadequate fulfillment by register-keeper of any lawful requirements of securities holder, representative, or nominee.</li> <li>• <i>Comments and Amendments to NSC Draft Investor Protection Law:</i> Provisions which need to be incorporated into the Draft Investor Protection Law and related statutes were finalized. The main changes proposed include the following: definitions of such terms as "investment in securities", "securities market investor", "open placement of securities", "manipulation of the securities market". In addition, new articles are aimed at the protection of the investor's rights by self-regulated organizations and public associations.</li> <li>• <i>Amendments to the Criminal Code:</i> We prepared amendments which should be added to the Criminal Code to enlarge the range of securities law violations. These provide for the following: 1) liability of the manager of a professional participant (broker/dealer, registrar, or custodian) for a failure to follow lawful instructions of the authorized body (NSC); 2) liability of a professional participant's manager for intentionally avoiding securities emission registration.</li> <li>• <i>Amendments to the Law on Securities Market:</i> Revised changes and amendments were prepared, which basically aim at the following: 1) prohibition of taking deceitful or fraudulent actions in case of securities purchase or sale, or in the case of any other services enacted by a professional participant (broker-dealer, registrar, custodian); 2) vesting the NSC with authority to detect fraudulent and deceitful actions. These include any actions which may result in fraud, deceit, misleading activities or statements. Even if these actions do not result in deleterious consequences, all the same the parties should be held accountable. 3) vesting the NSC with authority to pass resolutions carrying out investigations of violations of securities legislation, or investigations with any fraudulent or deceitful activity connected with the purchase or sale of securities, or the provision of services based on the license issued by the NSC; 4) empowering the NSC with the right to resort to court with claims for the purpose of receiving a court determination in order to a) preclude the breach of law or b) regulate the usage of revenue derived as a result of the offense committed; 5) allowing for an agreement to be concluded between the party committing the</li> </ul> |

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| Defined Activity                                       | Progress Made During the Month  |
|--|---|
| (continued)  | <p>securities market offense and the NSC. This is providing the party commits itself to taking the prescribed correctional measures and assumes obligations with respect to eliminating committed violations or paying fine to the budget.</p> <ul style="list-style-type: none"> <li>• <i>Amendments to the Civil Code:</i> We prepared changes and amendments in the Civil Code in order to bring it into conformity with amendments in the Joint Stock Company Law. Changes have also been prepared to permit legitimate debt-for-equity transactions, and to allow bond issuers to pledge collateral to a trustee on the behalf of bondholders.</li> </ul> <p><i>Other Miscellaneous Activity:</i></p> <ul style="list-style-type: none"> <li>• Submitted memo on cumulative voting to NSC. (See Attachment 5).</li> <li>• Reviewed NSC proposal regarding “puts” for pensions.</li> <li>• Consulted with “AgroPAK” lawyer regarding bond issues: submitting, filling out bond issues conditions, and necessary documents need to register bond issue at NSC</li> <li>• Advised registrar of “Azimut”, open joint stock company in Karaganda oblast, on submission of documents in the case of share issuance.</li> <li>• Held consultations between legal and corporate finance staff regarding the advantages and disadvantages of different forms of legal entities: joint stock company, limited liability partnership.</li> <li>• Forwarded material on commercial secrets to NSC at its request.</li> </ul> |
| 2. Assist in establishing enforcement power of NSC.    | Agenda of enforcement issues prepared for future meeting with Joldasbekov.  |
| 3. Assist NSC in moving off-exchange trading to KASE.  | Virtually all unauthorized off -exchange trading continues to be eliminated although we continue to note that registrars show a substantial volume of shares being traded privately.  |
| 4. Establish NSC Data Warehouse/Trade Reporting System | <p>The Technological Support Group continued its ongoing work with the NSC. During the month the Group</p> <p>Continued working on the NSC reporting system for Pension Asset Management Companies by:</p> <ul style="list-style-type: none"> <li>• Carrying out joint projects in conjunction with custodian banks, in order to launch a reporting system for each bank. This will be accessed by NSC executive employees. Consultations were delivered to bank programmers and custodian department managers, in order to clarify the underlying principles of system construction and information transfer.</li> <li>• Installing software products, providing data on the statements of custodian banks, for computer network of NSC executives. This will enable the analysis of data and proposals relative to reporting forms.</li> <li>• Exposing generated test data to processing, and working on detecting possible errors in software developed by custodian banks. Consultations were provided to custodian banks, in order to enable them to correct data.</li> <li>• Commending the development of analytical reports needed by NSC to supervise pension assets. In this connection, the computerized report, “On Executed Deals of Pension Asset Investment” has been generated.</li> </ul>   |

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| Defined Activity | Progress Made During the Month  |
|------------------|---|
| (continued)      | <p>Provided support for Broker/Dealers' Reporting System by:</p> <ul style="list-style-type: none"> <li>• Adjusting the BD reporting system to reflect necessary changes associated with changing territorial affiliations. A flexible mechanism needs to be created in order to correspond to periodic alterations of administrative and territorial divisions of the Republic of Kazakhstan. (These include renaming the capital, as well as merging and renaming regions.)</li> </ul> <p>Continued work on the internal NSC information system by:</p> <ul style="list-style-type: none"> <li>• Revising and modifying corresponding reference books and accompanying tables, necessitated by NSC's official modification of the list of licensable types of activities.</li> <li>• Working out additional reporting procedures related to the registry of licenses and permits, with members of NSC's licensing department.</li> <li>• Developing computer software framework to maintain autonomous operation of NSC, self-sustainable after the expiration of the Project.</li> </ul> <p>Maintaining <a href="http://www.kazecon.kz">www.kazecon.kz</a> and <a href="http://kase.kazecon.kz">kase.kazecon.kz</a> web sites.</p> <ul style="list-style-type: none"> <li>• Creating a special USAID-funded section in both sites. This was initiated with a draft version of text information for both sites. The documents were incorporated into the sites after their final version was completed.</li> <li>• Continuing to develop USAID web site a self-sustaining entity. Met with Actis Systems Asia in connection with development of the <a href="http://www.kazecon.kz">www.kazecon.kz</a> site and cooperation with Golden Eagle. According to Actis System Asia, there was no practical progress in negotiations with the Golden Eagle Company. Due to its very busy workload, the Golden Eagle Company has been delaying action on this self-sustaining web site. However, the company promised to begin reconstructing and developing the site at the soonest possible date.</li> <li>• Gaining cutting-edge information on web site creation, maintenance and marketing through the second All-Russian Internet Forum, "Internit-99" held in Novosibirsk (November 8-12). During this forum, Pragma conducted meetings with representatives of major informational agencies extending internet services: Prime-Tass, Finmarket, and big Russian exchanges such as RTS and MMVB. Schemes for financing projects based on self-repayment principles were discussed. Seminars and master classes also provided further information for developing NSC site, both in terms of information gathering and organizational technology.</li> </ul> <p>Other:</p> <ul style="list-style-type: none"> <li>• Designing the NSC site for open internet networks. Within the scope of this work is the formation of the final structure of the navigation site, input of the main body of text data, system test for compatibility with all internet browsers and operational information utilized by potential visitors to the site.</li> </ul> |

**Task 2 - Blue Chip Privatization**

| Defined Activity   | Progress Made During the Month  |
|--|---|
| 1. Assist and monitor the privatization of state owned enterprises | <ul style="list-style-type: none"> <li>• Received a list of 78 companies for privatization. The CSPP will first try to privatize them directly, and then may sell the remainder through KASE. (See Attachment VII)</li> <li>• The committee has chosen a Financial Advisor for HSBK Bank, Arthur Anderson.</li> </ul> |

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| Defined Activity   | Progress Made During the Month  |
|--|---|
| shares.  | The government has an 80.4% stake in HSBK's share capital. It was announced that the tender would be conducted on December 10.  |
| 2. Assist and involve Broker/Dealers in working w/GOK privatization. | <ul style="list-style-type: none"> <li>• Pragma has advocated to the Committee on Privatization that sale of 78 small-to-medium enterprises listed as slated for privatization in late 1999-2000 be executed on the Exchange (in which case broker-dealers would be involved.)</li> </ul>   |
| 3. Advocate share listings of blue chip companies w/KASE.            | <ul style="list-style-type: none"> <li>• As a follow up of the October 18<sup>th</sup> meeting held by the Blue Chip Privatization Committee, CSPP selected financial advisors for 4 remaining blue chips (2 companies were chosen for each).</li> <li>• While strategic "blue chip" industries may or may not be privatized through the KASE, the Privatization Committee may sell a portion of 78 companies slated for privatization through the KASE (see Task 2.1 above)</li> </ul> |

**Task 3 - Development of the Markets**

| Defined Activity                        | Progress Made During the Month   |
|---|--|
| 1. Encourage companies to list on KASE. | <p>Promoted listing and issue of corporate securities, consulting the following companies on preparation of listing documents:</p> <ul style="list-style-type: none"> <li>• Met with RG Brand company's top management to discuss cash flow projections, investment memorandum, and pre-marketing of shares. Discussed legal side of insurance mechanism for the issue. Organized meetings with NSC lawyer, Pragma legal experts and BTA Insurance participating. Assisted in the issue's registration. Developed marketing plan for placement and plan for presentation to potential investors. Developed a list of potential clients. Bonds were listed on the KASE under the category "OTC-1."</li> <li>• Worked with "Accept Page" on the marketing of their bond issue. The terms of bond issue are 6 months, with an 18% coupon.</li> <li>• Consulted with "Valut Tranzit Bank" on several different matters: 1) organization of an independent registrar company (affiliate) and 2) preparation of listing documents.</li> <li>• Consulted JSC "Azimut" on their merger and possible listing on the London Stock Exchange. As a prerequisite for listing, the company has to file a report with the NSC regarding the placement/sales status of previous issues. The company is currently working on a merger with two other oil and gas exploration (seismic research) companies. If a merger actually happens, the shares of the company could be a potential candidate for "A" listing of shares.</li> <li>• Met with management of following companies (for preparation towards issuance: "Kazakhlakrytsa", "Tsessna Bank", "Astana Technopark", "Astana Service", "Molochny Soyuz", "Astana Finance", "Petropavlovsky Chlebobulochny Kombinat".</li> </ul> <p>Continued to work with local governments (akimats) on the following issues:</p> <ul style="list-style-type: none"> <li>• Contacted Director of Kazinvest (investment arm of local governments) in Kustanay oblast and agreed on further cooperation to bring the oblast's companies to the securities market.</li> <li>• Met with Erkhat Iskalaev, Atyrau Head of Investment of the Oblast Akimat, to discuss the process of municipal issuance</li> </ul> |

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| Defined Activity                      | Progress Made During the Month  |
|---------------------------------------|---|
| (continued)                           | <p>discuss the process of municipal issuance.</p> <p>Other:</p> <p>Conducted marketing efforts to enlist companies:</p> <ul style="list-style-type: none"> <li>• Contacted the following companies on this matter: JSC "Ural-Arma", "Uralski Mechanical Plant", "Aliya", "Akturbo", "Narodnaya Sobstvennost", "Aktubinsk Obltransgaz", the new Aktobe regional bank "Bank Novy Vek".</li> <li>• Signed POI (Protocol of Intentions) with "RG Brands" and "Accept Page".</li> </ul> <p>****</p> <p>69 companies or with 91 securities issues were listed in KASE, up from last month (64 issuers, 86 issues). New issues/issuers included the following:</p> <p>Bonds issued by "Accept Page" and "RG Brand" listed as OTC-1 on November 5<sup>th</sup>. Common stocks Kyrgyzenergo, Kyrgyztelecom, and KANT Cement Plant were registered as OTC-2.</p> <p>Eight "A" stocks were listed with 13 issues (<i>corresponding with last Oct.</i>)</p> <p>Eleven "B" listings had 20 shares.</p> <p>OTC listings were up, with OTC-1 gaining two new issuers and issue (OTC-1 with 3 issuers and 3 issues) and OTC-2 gaining three issuers and issues (OTC-2 with 47 issuers and 55 issues), putting OTC total at 50 issuers and 58 issues.</p> <p>(These numbers exclude companies placed by the DSPP.)</p> |
| 2. Encourage trading on KASE          | <ul style="list-style-type: none"> <li>• Held conversations with following banks on possible ratings to gain credibility for trading on the exchange: TuranAlem Bank, Almaty Merchant Bank, Kaspiisky Bank, Centre Credit</li> <li>• Developed alternative products for pension fund investment (see new category, Task Order #5 below).</li> </ul>   |
| 3. Assist BDs in working with issuers | <ul style="list-style-type: none"> <li>• Assisted "RG Securities" in structuring and registration of the "RG Brand" bond issue.</li> <li>• Worked JSC "Azimut", introducing them to 5 different broker-dealers.</li> <li>• Helped "Accept Page" to contract with "IMG" as broker.</li> </ul>  |

**Task 4 – Continued Assistance to KASE and the Central Depository**

| Defined Activity  | Discussion of Progress Made During the Month   |
|---|--|
| 1. Support KASE in accepting the SRO responsibilities of the Association of Dealers/Dealers (ARD) | <ul style="list-style-type: none"> <li>• Normative SRO documents – Rules of Fair Practice (Ethics Code) and Disciplinary Code were drafted. Initial drafting for KASE was amended to include recommendations by Pragma. These await approval by KASE Council and Membership, after which time they will be sent to NSC for approval and adoption.</li> </ul> |



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| Defined Activity  | Discussion of Progress Made During the Month   |
|---|--|
| Broker/Dealers (ABD)  | <ul style="list-style-type: none"> <li>• Other normative documents for the KASE, referring to SRO status and compliance with NSC regulations on Market Operators were approved.</li> </ul>   |
| 2. Assist KASE to finalize rules for market-makers/work in conjunction with Broker-Dealers. | <ul style="list-style-type: none"> <li>• Two market makers have been accepted to make markets on the KASE: Kazkommerts Securities (Kazkommerts Bank corporate bonds) and State Pension Funds (treasuries).</li> <li>• KASE proposed the issuance of puts as a hedge for pension funds buying underlying securities by pension funds. Pragma delivered paper stating that puts could be bought, if qualified as "A" listed securities, but also warning of potential violations of securities laws and regulations.</li> <li>• NSC Chairman Joldasbekov held meeting of NSC, CD, KASE and Pragma over concerns of money and manpower needed to run computer equipment. After Pragma/USAID stops providing assistance, the internal NSC network and web site will need maintenance and upgrading. The workgroup includes Pragma staff.</li> </ul>  |
| 3. Improve broker-dealers operational efficiency and transparency.                          | <ul style="list-style-type: none"> <li>• Cooperated with local firm towards the goal of training professional participants of securities markets towards needed NSC certification. Since the local training group finally decided this was economically unfeasible, we have decided to bring in a specialist (Jae Abbitt) in Jan. -Feb. 2000 for training in the fields of front- and back-office techniques, procedures, and operations. Local trainers will be invited, in order to carry on training in areas of future demand.</li> <li>• Uncovered possible infractions of BD and Pension Fund Asset Manager in handling and execution of a pension fund order. NSC sent its inspection teams to the two firms involved in a possible "frontrunning" case and thanked Pragma for input on these inappropriate activities.</li> <li>• Stressed importance of NSC enforcing rules to trade on the KASE with Commissioner Shalgimbaeva. The team presented her with an explanatory paragraph on quoting and eventual execution to be inserted on NSC market operator regulation. Trades are still only reported on KASE; goal is to place bids and offers regularly on KASE with competition for better pricing.</li> <li>• Discussed greater transparency and reporting requirements of issues placed on the KASE with Commissioner Umit Kulinov. This should be accompanied by no overlap in responsibilities between the KASE and the NSC.</li> </ul> |
| 4. Provide assistance to the Central Depository (CD).                                       | <ul style="list-style-type: none"> <li>• Discussed settlement procedures involving the sending of money to Kyrgyzstan (for payment of purchases of Kyrgyz securities) with President Kapushev.</li> <li>• Planned installation of registrar software at the CD, as requested by President Kapushev. Pragma's specialist on registrar software plans to give a demonstration of software prior to installation, after translation of the material into Russian.</li> </ul>  |

**Task 5 - Other Activities: Creation of New Financial Products**

| Defined Activity   | Progress Made During the Month   |
|--|--|
| Develop new sources of investment (primarily fixed-income instruments) for pension funds and other institutional investors | <ul style="list-style-type: none"> <li>• Proposed a new financial instrument, KDRs (Kazakhstani Depository Receipts) as an alternative for bringing foreign security investment into Kazakhstan and increasing market liquidity. These instruments would function as an alternative to Pension Funds Asset Managers buying foreign securities directly, while also providing a new product for the KASE. (See Attachment 6). It is possible that National Bank of Kazakhstan may issue general export of capital licenses to PFAMs to ease the direct purchases of foreign securities. This would allow for the repackaging of foreign securities as domestic instruments to be traded on KASE.</li> <li>• Worked with oil and gas companies on the project of the securitization of social obligation.</li> <li>• Researched issues of direct purchase of foreign securities for use in pension asset management investment. A one-time use of export of capital license was utilized by one pension asset management company, but then the license expired later in 1999. Still, the asset manager apparently purchases foreign securities through an international bank without a problem. Direct purchase of foreign securities for pension funds may be a better option than KDRs (see above).</li> </ul> |

**Task 6 - Miscellaneous**

|   |   |
|---|---|
| Encourage securities market development in neighboring Central Asian countries. | The KASE approved "listing" of 3 Kyrgyz Blue Chip stocks for trading on the KASE. This is the first time the KASE has accepted foreign securities for trading. Quotes have been posted for the buying and selling of these shares, but there are still no trades. |
|---|---|

**IV. ADMINISTRATIVE ISSUES**

**V. PROJECT STAFFING**

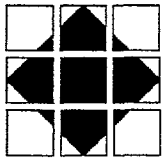
The following personnel were engaged in project activities this month:

Richard Dvorin, Senior Capital Markets Advisor

Kevin Fogarty, Senior Legal Advisor

David Lucterhand, Chief of Party

Timothy Smith, Senior Technical Advisor



**The Pragma Corporation**  
**USAID Securities Market Development Project**  
**Monthly Report**  
**(For the period ending December 31, 1999)**

For the  
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

GENERAL INFORMATION

|                 |                      |
|-----------------|----------------------|
| PROJECT MANAGER | Mohammad Fatoorechie |
| TEAM LEADER     | David Lucterhand     |
| COTR USAID/CAR  | Rick Gurley          |

ALMATY, KAZAKHSTAN

**The Pragma Corporation**  
**USAID Securities Market Development Project**  
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**I. EXECUTIVE SUMMARY**

This report provides details on the events and activities summarized below, as well as other events and activities regarding the USAID Securities Market Development Project, as implemented by consultants for the Pragma Corporation ("the Pragma Team" or "Team"), for the month of December 1999.

- PREPARED DRAFT OF "SECURITIZATION OF SOCIAL OBLIGATION" PROJECT IN CONCERT WITH ABN-AMRO BANK
- MUNICIPAL BONDS PLACED FOR ALMATY AND ASTANA
- FIRST ISSUE OF SMALL-MEDIUM ENTERPRISE CORPORATE BOND (VITA) REDEEMED
- FIRST INSURED CORPORATE BOND ISSUE (RG BRAND) SUCCESSFULLY PLACED
- RECEIVED A GROUP RATING PROPOSAL FOR BANKS FROM FITCH-IPCA
- LARIBA BANK RECEIVED A RATING PROPOSAL FROM STANDARD AND POORS
- BEGAN PREPARING FOR BROKER-DEALER SEMINAR IN FEBRUARY
- TWO SECURITIES (BANK TURAN ALEM COMMON STOCK AND KAZKOMMERTS CORPORATE BONDS) ACTIVELY QUOTED ON THE KASE
- TOTAL TRADING VOLUME IN DECEMBER (\$9,703,709) NEARLY DOUBLED YEAR-TO-DATE TRADING VOLUMES
- PURCHASED GENERATOR ON BEHALF OF KASE, CD AND NSC TO PROVIDE BACKUP POWER NECESSARY TO ELIMINATE ANY Y2K DISRUPTIONS

**II. PROJECT DESCRIPTION**

The Pragma Team works with the National Securities Commission ("NSC"), the Kazakhstan Stock Exchange ("KASE"), broker-dealers and the Central Depository in developing Kazakhstan's securities market. To further these goals, the Pragma Team works under a recently signed MOU between USAID and the NSC. Pragma also works with KASE under the auspices of a 1998 Memorandum of Understanding which established the precedent and rules of engagement. While these MOUs have expired, Pragma and NSC continue to cooperate in accordance with the pre-existing agreements.

In November 1998, recognizing the changes in circumstances since the Task Order was written, Rick Gurley, the COTR for the AID Mission, signed off on an Action Plan that set forth the priorities of the Project through its completion date. The priorities of the Project for

this period are noted in the boxes below in section III. PROJECT UPDATE AND PROGRESS VERSUS ACTIVITIES IN THE ACTION PLAN

The project update for this monthly report will correspond to the activities set forth in the action plan described above.

As discussed in preceding reports, Pragma continued in its efforts to create new financial instruments which would enhance, broaden and deepen securities market capacity. We continue to encourage corporate listings that would eventually boost investor confidence, both for institutional investors and individual clients. The successful issuance of small-medium enterprise bonds (see below) potentially provides alternative instruments in the face of stalled privatization of key blue chip enterprises. At the same time, these small-medium enterprise listings alone are not sufficient to encourage a flourishing marketplace.

The necessity for creating a series of reliable financial instruments gains momentum in the face of pension fund accumulation, reaching \$402.92 million (KZT 56.41 million) as of October 1999. The amount held by private investment funds has accelerated to reach 43% of the total. While some government representatives have argued that this year's funds should be invested in the "real economy" (infrastructure), the stock market should play a part in such developments by enhancing shareholder value and creating worth.

At present, most pension money is invested in state and NBK securities: T-bills, Eurobonds and NBK notes. Currently, the domestic stock and bond market (whether municipal or corporate) is in not in a sufficiently secure position to offer quality investment products. The lack of company information and low transparency limit investor confidence. Moreover, the relatively high cost of raising funds on the capital market as opposed to the banking system also constricts the number and type of transactions that take place on the securities market. Other institutional barriers also create inadvertent structural impediments for effective investment: the low quality of credits, legal restrictions on investment products for pension funds, and the ceiling on foreign security investment to 5%. These constraints limit the horizon for burgeoning pension funds, in search of new investment territory.

One means of increasing worth and enhancing credibility of investment is to involve respected and profitable multi-nationals in the creation of debt-instruments. Despite the urgent need for local regions to be responsible for providing infrastructure development or revitalizing the lagging social sector, much-needed financing is difficult to obtain. In response to the need social/infrastructure developments, in tandem with new high quality, fixed-income instruments Pragma proposed a bond issuance that would involve the securitization of social obligation. (See November report for introduction to this issue.) This product, sharing properties of both municipal and corporate issuance, would allow pension funds and other institutional investors to diversify investments. It would offer institutional investors, such as pension funds, a high-grade investment vehicle because of note structure (issuance guaranteed by the creditworthiness of the multinational). This product would potentially fulfill, in a systematic and open way, the obligations incurred by multi-nationals to invest in the social sector and infrastructure projects. In the terms set forth by profit-sharing agreements, the parent company and/or its local subsidiary acquired the responsibility to invest in or revitalize regional social and infrastructure projects. The project proposed by Pragma would attempt to implement social programs desired by akimats, while satisfying part or all of social obligation costs incurred by the foreign multi-nationals.

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In coordination with ABN-AMRO, Pragma proposed a financial product in which selected companies (whether foreign multinational, in-country subsidiary, consortium or JV) would issue bonds secured by contractual obligations. (See *Attachment 1.*) In co-authoring with us the proposal for the social obligation project, ABN-AMRO asked if they could include their logo with ours on the masthead of the proposal. We agreed with these terms, concurring that it added value to the seriousness of the proposal.

The benefits of this "securitization of social obligation" issuance would satisfy the needs of both domestic and foreign actors and address some of the concerns put forth by both parties. The public and the government often expect that wealthy multinationals should regularly contribute to the national coffer. From their side, foreign companies invariably complain of being approached in an ad hoc fashion to supply contributions for social costs.

This new financial instrument would address the concerns of both foreign and local parties in several different ways. It would institutionalize social obligation in accordance with specific time limitations and cost, thus limiting potential dependence on foreign multinationals. By providing a steady stream of revenue flow to social and infrastructure projects, the bond issuance would follow predictable payment obligations, absolving the company of future debt. In accordance with the proposed financial instrument, the akimat would receive financing for social and infrastructure projects through better rates than it could receive on its own. Thus the local populace would be provided with social benefits (community projects, infrastructure systems) that the central state budget is ill equipped to provide. Simultaneously, multinationals and/or their subsidiaries would be given a transparent means to fulfil social obligation costs incurred as a part of the original contract or subsequent agreements. The proposed financial vehicle could serve as an alternative to periodic "raids" by regional agencies, which sometimes seek in-pocket profits in the guise of social obligation costs.

With the introduction of this proposed financial instrument, both foreign and local parties (akimats) would have an active voice in the projects to be chosen. Efficient financing would be ensured by the presence of an independent trustee, which would allow project monitoring to a third-party entity, while insuring appropriate applications of funds for project finance.

While several different structures were discussed with National Bank's Grigori Marchenko, the best alternative would be issuance by the multinational or its local subsidiary, preferential to issuance through a special purpose vehicle or the akimat itself. In consultation with this issuer, the akimat would chose viable projects and then select a contractor through a tender committee. This committee could include representatives not only from the akimat and issuer/parent company, but representatives of local government, the State Investment Agency or other regulatory authority, technical advisor, legal counsel and financial advisor. The notes would be registered with the NSC and prepared with proper legal documentation and authorization, receiving A-listing for quoting and trading on the exchange (KASE).

Upon making arrangements with a registrar, custodian, Central Depository, and broker-dealers, the notes will be issued and sold to pension funds and other investors. The trustee would function as the party to control funds and apply them to specific social/infrastructure project requirements. The parent company and akimat, respectively, would make payments of the principal and interest to the Trustee in accordance with note repayment schedule, whereupon the Trustee would make interest and principal payments to note holders (pension funds and other investors.)

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Earlier efforts to create new financial instruments involved the introduction of municipal debt issuance. Following the Central Asian Fixed Income Conference (organized by Pragma in the spring), interest in municipal borrowing burgeoned. Since that time, almost every akimat in Kazakhstan in one form or another expressed its interest in accessing this newly created source of financing for municipalities. In particular, our consultants provided advice on the organization and conditions for municipal issuance for Almaty and Astana. These recommendations included advice on structuring, budget planning and technical matters. In later December, Almaty and Astana city bonds were placed. In January, Pragma compiled information charts on these two municipal debt issues (*Attachment 2*).

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

In addition to its goal of creating new financial instruments, Pragma also continues to advise a number of small-and-medium enterprises with the eventual goal of boosting the issuance of corporate securities. Once smaller corporations gain market strength, they will set an example to the ailing industrial giants that have not recovered from the Soviet era. Small-to-medium enterprises have made progress as viable businesses which can expand profitability and credibility through listing on the stock exchange. The proliferation of new entrants and potential entrants towards trading on the Exchange was worthy of note in December. The first-ever issue of Small-to-Medium corporate bonds, the "Vita" company specializing in vegetable oils, was redeemed on December 29<sup>th</sup>. The enterprise issued bonds for the amount of 10,000,000 Tenge which after devaluation equaled approximately \$71,000 (face value of 100 T, which a coupon rate of 15% annually). While the issue in US dollar terms is modest, this issuance is very significant for the Kazakhstani market for several reasons. The successful issuance and redemption indicates that small-to-medium enterprises, and not only prominent domestic corporations, are able to issue and place bonds. This will increase the creditworthiness of SMEs, allowing subsequent issues to be placed more easily. This issuance also paves the way for other instruments in the fixed-income market in general. Finally, Vita was able to borrow at significantly below comparable banking rates saving approximately 8%. A second issue of \$200,000 is planned by Vita for March 2000.

"RG" Securities successfully placed the first tranche of the "RG Brand" bond issue in the amount of \$250,000. (See *Attachment 3* for letter of thanks to Pragma for its assistance.) The trade was registered on the KASE as OTC-2. "Accept Page", which Pragma had aided in marketing its bond issue, succeeded in selling its bonds for \$15,000.

Several companies – "Geotex" and "International Energy Service" – agreed to list their shares on OTC-2 to gain experience and make several transactions.

The Mortgage Working Group (initially mentioned in the November report), comprised of several Kazakhstani banks, USAID, Pragma, and National Bank of Kazakhstan, continued to work on proposals regarding mortgage lending activities development and support. (See *Attachment 4* for Mortgage Working Group Proposals.) Group goals and objectives include various deliverables in the mortgage lending market. These concern legislative and regulatory frameworks, establishment of a mortgage loan market, creation of a rating system, tax breaks, and other features. More specifically, the legislative and regulatory environment should

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adequately set forth conditions and possibilities of banks' involvement in the mortgage lending transactions in an environment of lowered risk. New types of securities should be created and backed by relevant legislation, thus enabling mortgage-backed, long-term loans. A unified primary market should develop and introduce into banking practice uniform mortgage lending standards and procedures. The credibility and attractiveness of mortgage loans and mortgage-backed securities (for pension funds in search of new instruments) would be enhanced by attaching ratings to banks involved in mortgage lending. The market could be further stimulated by encouraging tax breaks to those intending to apply for mortgage loans, as well as the banks involved.

Transparency for mortgage market participants (whether individuals provided with loans or investors in the asset-backed securities) and economic viability and profit for banks are key features of a reliable mortgage lending program. The generation of relevant regulatory framework and the revision of preexisting legislation – regarding conclusion of transactions, right of foreclosure in case of default, and other issues – is mandatory. The terms for registration of agreements and contracts for issuing mortgage-backed loans to individual borrowers, as well as the conditions of special procedures dealing with purchase of real estate for account of borrowed funds, need to be worked out and reduced. Eliminating ambiguity on legislative provisions relating to guardianship and trusteeship is necessary, especially the safeguarding the rights of minors. Measures to adjust the terms of out-of-court settlement of claims on mortgaged property and revisions of requirement to register all actions of a defaulter on a mortgage loan should be revised. Consistency in the courts' approach to cases of foreclosure or forced expulsion of a defaulter from living quarters should also be actively promulgated.

**Task 1 - Continued Assistance to the NSC**

| Defined Activity      | Progress Made During the Month  |
|-----------------------|---|
| 1. Draft regulations. | <p>The Team's Legal Group continued its work on laws and regulations noted below:</p> <ul style="list-style-type: none"><li>• <i>Final Comments on Joint Stock Company Law Amendments:</i> Pragma wrote comments to changes to JSC Law proposed by NSC. These comments were delivered together with a summary of past comments and a Russian-language appendix of specific textual changes. In addition, Pragma participated in several internal NSC legal working sessions. It became evident that while some of our recommendations would be accepted, most would be ignored. It is likely that the NSC will engage in wholesale and in many respects ill-advised rewrite of this fundamental law. The final product would likely be one that Pragma would strongly oppose.</li></ul> <p><i>Other Relevant Activities:</i></p> <p><i>Research on Obtaining a No-Action Letter for the Central Depository</i></p> <ul style="list-style-type: none"><li>• Responding to an NSC request, Pragma looked into the possibility that the US SEC staff might, through a "no-action letter, recognize the Depository here as an "eligible foreign custodian" (under SEC Rule 17f-5) for American investment fund assets. Should Kazakh securities be owned by such a fund, they would be maintained exclusively in book entry form with the Depository as first level holder. The Depository would need to fulfil the requirements of acting as an eligible foreign custodian. However, investigations and inquiry with SEC reveal that such a Rule is in the process of changing; the SEC prefers to no longer provide such "no action" letters to foreign depositories. The new policy indicates that each fund manager</li></ul> |



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| Defined Activity  | Progress Made During the Month   |
|---|--|
| (continued)   | <p>should determine for himself whether the foreign depository is an appropriate one under the rule.</p> <p><i>Other Matters:</i></p> <ul style="list-style-type: none"> <li>• Reviewed materials presented by Central Asian American Enterprise Fund concerning a fraud claim they were making against a company in which they had invested.</li> <li>• Provided assistance to Chief of Party on recent tax law developments.</li> <li>• Advised the Corporate Finance team regarding impact of NSC enforcement and inspection powers on a recent law to protect and promote small businesses.</li> <li>• Worked on collecting and summarizing past recommendations and framing specific textual wording for amendments other than the Joint Stock Company Law, in order to allow the NSC to make use of Pragma's past work.</li> </ul>   |
| 2. Assist in establishing enforcement power of NSC.     | NSC continued to review recommendations previously submitted.  |
| 3. Assist NSC in moving off-exchange trading to KASE.   | Virtually all unauthorized off-exchange trading i.e. trades not executed by broker-dealers continues to be eliminated.   |
| 4. Establish NSC Data Warehouse/Trade Reporting System. | <p>The Technological Support Group continued its ongoing work with the NSC. During the month the Group:</p> <p>Continued working on Pension Asset Managers' reporting systems:</p> <ul style="list-style-type: none"> <li>• Reporting system test data has been received and processed with the aim of detecting logical or methodological errors in the submission of financial statements. Currently 7 banks have been sending their statements on a daily basis in the real-time mode without any significant problems or system failures.</li> <li>• Efforts are underway to create a "customer spot" for analysts. This centralized, automated software workplace will enable analysts to retrieve information from custodian banks. This will also allow for sophisticated and flexible means of accessing and processing inquiries and data, ranging from tables to activity progress reports.</li> <li>• A software package (database kit and program components kit) for reports on pension assets structure, to be submitted to NSC, was generated. This software was donated to the new custodial HSBC Bank, and advisory assistance was rendered. This will enable them to keep daily reports using this new software package.</li> <li>• As of December 15<sup>th</sup>, all custodial banks (excluding new HSBC), have been sending their reports in operational working mode. The receipt and processing of these reports has been carried out successfully.</li> </ul> <p>Continued work on the internal NSC information system:</p> <ul style="list-style-type: none"> <li>• An analytical system was generated to enable efficient means to trace down detailed or larger-scale changes in data relating to market professionals or any component of professional securities market activity.</li> <li>• Additions to the informational structure of the internal web-site have been added in order to facilitate users' operation.</li> </ul> |

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| Defined Activity | Progress Made During the Month   |
|------------------|--|
| (continued)      | <ul style="list-style-type: none"> <li>• Upon the request of NSC Chairman Joldasbekov, changes were incorporated into the NSC internal information system. Such changes included bringing corporate trade names into compliance with current legislation, more precisely specifying types of professional securities market activity, and removing abbreviations used in the original version from the current system of operation.</li> <li>• The registry of licenses and permits of securities market activity was consolidated electronically. However, since no legislation in Kazakhstan yet provides for legitimizing information electronically, this registry is being made available on hard copy.</li> <li>• Pragma discussed the design of the new version of the corporate securities state registry with the KASE President Karassaev. The second version will correspond to legislative revisions and new conditions of the securities market. The new version will also facilitate gathering more detailed information on data related to issuers, including economic indices and major investors. The data model has been approved by Mr. Karassaev.</li> <li>• On December 7<sup>th</sup>, the continued maintenance of Pragma-created internet systems following expiry of the project was discussed with NSC, the KASE and the CD management. The cost of maintenance in the face of perpetual and rising costs was discussed. A work group set up at the proposal of Mr. Joldasbekov (consisting of NSC, the KASE, the CD, and Pragma representatives) will study the most efficient and inexpensive scheme for the maintenance of the NSC informational system with the help of the KASE and the CD.</li> <li>• On December 14<sup>th</sup>, the aforementioned working group discussed the organization of NSC informational projects upon the expiration of Pragma's Securities Market Development Project. During this meeting, various options of technical arrangement of computer network systems maintaining operational capacity were discussed. The working group assessed all the possible systems for maintaining the NSC system upon the project's completion.</li> <li>• The development of an open web site for NSC (to be designated as <a href="http://www.nsc.kz">www.nsc.kz</a>) is 80% complete. However, the entire completion of the project has been delayed due to the failure of NSC employees to provide complete, essential information. They have also been unable, as of yet, to formulate a dual-directed task of "news" and "law enforcement" information. Due to this, work on the website has been temporarily suspended.</li> </ul> <p>Maintained and revised <a href="http://www.kazecon.kz">www.kazecon.kz</a> and <a href="http://kase.kazecon.kz">kase.kazecon.kz</a> websites.</p> <ul style="list-style-type: none"> <li>• The team has been interacting with Golden Eagle Company to draft an outline organizing and redesigning the <a href="http://www.kazecon.kz">www.kazecon.kz</a> site. The information contained within the site will be subjected to this reorganization. New informational products will be distributed via this updated server.</li> </ul> |

**Task 2 - Blue Chip Privatization**

| Defined Activity   | Progress Made During the Month   |
|--|--|
| 1. Assist and monitor the privatization of state owned shares. | <ul style="list-style-type: none"> <li>• Prepared information on Blue Chip privatization history and its current status for Joint U.S./Kazakhstan Commission talks.</li> <li>• A 30% stake in Halyk Savings Bank was privatized.</li> <li>• Following a meeting on November 30 of the First Deputy Chairman of State Property</li> </ul> |

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| Defined Activity   | Progress Made During the Month   |
|--|--|
| (continued)  | and Privatization Dept. and the representatives of the former Investment Privatization Funds, issues related to Privatization Investment Coupons and stated in Resolution #1208 were discussed. The issues are as follows: 1) repayment or utilization of Privatization Investment Coupons remaining after the last coupon auction (standing for the logical finalization of coupon privatization); 2) liquidation of Investment Privatization Funds which failed to transform themselves into JSCs (joint-stock companies); 3) simplification of the procedure for transforming Investment Privatization Funds into JSCs by transferring the requirements to decisions of shareholder meetings. |
| 2. Assist and involve Broker/Dealers in working w/GOK privatization. | Involvement of broker-dealers awaits further decisions on blue chip and second-tier privatization.   |
| 3. Advocate share listings of blue chip companies w/KASE.            | <ul style="list-style-type: none"> <li>As a follow up of the October 18<sup>th</sup> meeting held by the Blue Chip Privatization Committee, CSPP selected financial advisors for 4 remaining blue chips (this decision was taken in November.) 2 companies were chosen for each.</li> </ul>  |

**Task 3 - Development of the Markets**

| Defined Activity                        | Progress Made During the Month  |
|---|---|
| 1. Encourage companies to list on KASE. | <p>Promoted listing and issue of corporate securities:</p> <ul style="list-style-type: none"> <li>Food Master worked towards eventual listing on the KASE. Pragma analyzed Food Master's financial statements for listing requirements compliance and additional debt servicing ability. The recommendations and analysis were sent to DB securities. Polled Asset Management companies on required yields for Food Master bond, ranging from 14% to 16%.</li> <li>"Geotex" and "International Energy Service" received a series of consulting session on accessing capital markets from Pragma. They agreed to list their shares on OTC-2 to gain experience and make several transactions.</li> <li>"Randi DC" received a series of consultations which would eventually result in listing. Current consultations dealt with registrar selection.</li> <li>Pragma met with the management of the following companies towards listing and issue on the exchange: "Asia Business Consulting", "Akturbo", "Narodnaya Sobstvennost", "Aktubinskglavsnab", "Bank Novy Vek" (Aktobe regional bank).</li> </ul> <p>Conducted marketing efforts to enlist companies:</p> <ul style="list-style-type: none"> <li>Pragma contacted JSC "Taldykorgan Battery Plant", "Atyrau Balyk", "Atyrau Uzen Port"</li> <li>Contacted the following companies on this matter: JSC "Ural-Arma", "Uralski Mechanical Plant", "Aliya", "Akturbo", "Narodnaya Sobstvennost", "Aktubinsk Obltransgaz", the new Aktobe regional bank "Bank Novy Vek"</li> </ul> <p>.....</p> <p>Other:</p> <p>.....</p> <ul style="list-style-type: none"> <li>Listing manual was submitted for the KASE President's approval.</li> </ul> <p>.....</p> <p>69 companies with 89 securities issues were listed in KASE.</p> |

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| Defined Activity                                      | Discussion of Progress Made During the Month   |
|---|--|
|   | included.  |
| 4. Provide assistance to the Central Depository (CD). | <ul style="list-style-type: none"><li>• Registrar software has been completely translated, as of the end of December, for use by the CD.</li><li>• The translation of the user's manual is scheduled to be completed in January.</li></ul> |

**Task 5 - Other Activities: Creation of New Financial Products**

| Defined Activity   | Progress Made During the Month  |
|--|---|
| Develop new sources of investment (primarily fixed-income instruments) for pension funds and other institutional investors | <ul style="list-style-type: none"><li>• Continued to negotiate with oil and gas companies on the project of the securitization of social obligation (See <i>Attachment 1</i>). Pragma coordinated with ABN AMRO to update the project and enhance the structure of the financial instrument.</li><li>• Discussed development of mortgage market and related securities in Mortgage Working Group (See <i>Attachment 4</i>).</li></ul> |

**Task 6 - Miscellaneous**

|   |  |
|---|--|
| Encourage the presence of rating agencies | <ul style="list-style-type: none"><li>• Surveyed and held conversations with following banks on possible rating of TuranAlem, Almaty Merchant Bank, Kaspiiksy Bank, Bank CentreCredit banks</li><li>• After consultations with Pragma, BankCentreCredit sent a Request for Proposal to Standard &amp; Poors.</li></ul> |
|---|--|

**IV. ADMINISTRATIVE ISSUES**

None

**V. PROJECT STAFFING**

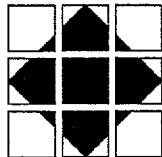
The following personnel were engaged in project activities this month:

Richard Dvorin, Senior Capital Markets Advisor (away from December 15)

Kevin Fogarty, Senior Legal Advisor (away from December 15)

David Lucterhand, Chief of Party (away from December 28)

Timothy Smith, Senior Technical Advisor



**The Pragma Corporation**  
**USAID Securities Market Development Project**  
**Monthly Report**  
**(For the period ending January 31, 2000)**

For the  
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

GENERAL INFORMATION

|                 |                      |
|-----------------|----------------------|
| PROJECT MANAGER | Mohammad Fatoorechie |
| TEAM LEADER     | David Lucterhand     |
| COTR USAID/CAR  | Rick Gurley          |

ALMATY, KAZAKHSTAN

**The Pragma Corporation**  
**USAID Securities Market Development Project**  
**Monthly Report**  
**(For the period ending January 31, 2000)**

**I. EXECUTIVE SUMMARY**

This report provides details on the events and activities summarized below, as well as other events and activities regarding the USAID Securities Market Development Project, as implemented by consultants for the Pragma Corporation ("the Pragma Team" or "Team"), for the month of January 2000.

- "RG BRAND" BONDS, FIRST INSURED BOND, IS REDEEMED
- PRAGMA ASKED FOR CLARIFICATION OF IMF POSITION ON PENSION FUND INVESTMENT IN FOREIGN ASSETS
- TAX ISSUES PRESENT A POTENTIAL OBSTACLE TO SECURITIES MARKET DEVELOPMENT
- ENFORCEMENT ISSUES CONTINUE TO BE A PRIORITY FOR LEGISLATIVE AGENDA
- ADVISOR SELECTED FOR SELLING STATE BLOCK OF SHARES OF MANGESTAUMUNAIGAZ (BLUE-CHIP PRIVATIZATION PROGRAM)

**II. PROJECT DESCRIPTION**

The Pragma Team works with the National Securities Commission ("NSC"), the Kazakhstan Stock Exchange ("KASE"), broker-dealers and the Central Depository in developing Kazakhstan's securities market. To further these goals, the Pragma Team works under a recently signed MOU between USAID and the NSC. Pragma also works with KASE under the auspices of a 1998 Memorandum of Understanding which established the precedent and rules of engagement. While these MOUs have expired, Pragma and NSC continue to cooperate in accordance with the pre-existing agreements.

In November 1998, recognizing the changes in circumstances since the Task Order was written, Rick Gurley, the COTR for the AID Mission, signed off on an Action Plan that set forth the priorities of the Project through its completion date. The priorities of the Project for this period are noted in the boxes below in section III. **PROJECT UPDATE AND PROGRESS VERSUS ACTIVITIES IN THE ACTION PLAN**

The project update for this monthly report will correspond to the activities set forth in the action plan described above.

The development of new financial instruments occupy center-stage in Pragma's efforts to provide impetus to the domestic securities market. One potential instrument to legitimize new home ownership, while simultaneously creating new opportunities for institutional investors, would be mortgage-backed securities. To this end, Pragma has engaged Standard and Poor's to conduct a rating for Lariba Bank, one of the main banks involved in mortgage- and real estate financing. (See *Attachment 1*.) The bank currently is a licensed primary dealer of

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Kazakhstani government securities and has established correspondent relationships with leading international banks: Citibank, Deutsche Bank, Commerzbank, and Dresdner Bank. Still, a rating by a prominent agency would facilitate the bank's issuance of mortgage bonds. We negotiated with Standard & Poor's to provide a reduced fee agreement, on the basis of working with more than one bank at the same time. This was to encourage local banks to take advantage of this fee structure of \$20,000 per transaction, a much reduced cost from general fees of rating agencies.

However, issuance of mortgage-backed securities depends on a well-established primary and secondary mortgage market, along with a well-functioning institutional framework for mortgage lending. The proposed Mortgage Market project continued in conjunction with a mortgage working committee meeting held at the National Bank, where several issues were discussed (*Attachment 2*). It was agreed that the European model would be used, in which banks would be more important players than the government. However, several points have still not been resolved. The National Bank prefers to use a fixed interest rate in tenge, but obviously banks will not approve this issue. The accuracy of real estate appraisals remains problematic, since there is no appropriate organization dealing with this issue. The absence of a life insurance industry also makes it difficult to assign proceeds to pay off mortgages adding a further barrier to lending. Last, the regulatory base is insufficient for banks to begin mortgage lending, and many participants in the Mortgage Market project think we need time to solve such issues. The National Bank is eager to implement this project and wants it to begin as soon as possible. However, the legal and commercial infrastructure is necessary to carry out this program, or the industry will not develop properly. A second meeting of the working group was planned which would be chaired by the governor of the National bank, Gregori Marchenko, to discuss these issues.

To supplement other strategies of market development, the corporate bond market is a priority for developing a diversified portfolio of investment possibilities for pension funds and other institutional investors. Last month the issue of the first corporate placement of a small-to-medium size enterprise, Vita Corporation, was fully redeemed. Because of this successful placement, a second issue of \$200,000 is planned by Vita for March 2000. (See December report for details on this issuance.)

A second success story in small-and-medium corporate issuance was RG Brands (*Attachment 3*). This domestic producer of non-alcoholic beverages, with a capitalization of about \$4,000,000, issued \$250,000 worth of three-month bonds (face value of \$100, annual coupon rate of 17%) on October 29 of last year. What makes this issue significant is that it represents the first successful placement of an insured bond; the issue was 50% insured by BTA Insurance, a subsidiary of TuranAlem Bank. On January 26, 2000, the issue was fully redeemed. The RG Brands issue was also important for securities market development since it is the largest SME (small-to-medium size enterprise) issuance to date and the second issuance bonds to be quoted and placed on the Exchange. This issue adds to the liquidity of the marketplace, demonstrating that the VITA issue was not an isolated incident. The redemption in late January increased the company's creditworthiness and makes it possible for the company to consider a second issue, planned for late February.

In addition to municipal bond and corporate bond issues, the proposed fixed-income instrument of the securitization of social obligation (discussed in detail in the December report) continues to occupy high-priority status. In mid-January COP David Lucterhand met with Texaco finance manager Paul Farrelly and president of Tengizchevron Philip Meek, as

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well as representatives of the National Bank, to discuss this project. The meeting at the National Bank was held with Gregori Marchenko, who endorsed the concept, and encouraged us to identify some oil companies who would participate. Pragma also updated the akimats on the proposed methodology for the financing social projects. We requested assistance on the level of social obligations of each oil company operating in the particular oblast, as well as a list and description of regional social projects in order of priority (*Attachment 4*, Letter to Akims).

The Chairman of the NSC requested our assistance in clarifying conflicting press reports regarding the IMF's position s of pension fund investment in foreign capital sources. Pragma asked the IMF for clarification on its position on pension fund asset allocation in Kazakhstan. Some IMF Directors had questioned whether or not it was appropriate to raise the ceiling for pension funds' investments in foreign assets. Other directors, however, noted that because of domestic capital market limitations, the lagging blue chip privatization program, and inefficient allocation of savings, it might be necessary to raise the ceiling of foreign asset investments in order to realize overall capital market development. (opt. *Attachment 5*, Letter from IMF's Assistant to Executive Director.)

Pragma also noted several developments that may reduce incentives to investment and trade in securities, November and December amendments in the Tax Code (*Attachment 6*). The first amendment eliminated a tax subsidy for bond interest, formerly taxed only once – at the course – and at 15%. Now the 15% withheld only creates a credit against the corporate investor's overall 30% rate.

Other amendments involving VAT (Article 5, item 46b and Article 56-6) also may be interpreted in ways to inhibit equity investment. The definition of financial services now exempt from VAT does not cover securities trades, possibly meaning that capital gains (for instance the sale of a stock) may be saddled with VAT at 20%. Lastly, the Law on Changes [to the Tax Code] dated December 10 also introduced rules of a "turnover" rule that treats a loan received by a debtor against collateral as if it were a sale subject to VAT. This amendment, in our opinion, can be interpreted to tax loans received against collateral, which would negatively affect a liquid market in mortgage loans and, by extension, securities. Another issue potentially affecting the development of the mortgage market mechanism is the requirement that banks pay VAT on collateral liquidation based on the amount of the secured loan, not the amount realized by liquidation. In addition to increasing the cost of funds to the debtor, market risks may be increased for the lender as well.

Pragma's legal department also addressed enforcement issues that are of immediate and more long-term concern (*Attachment 7*). These concerns are aimed at developing a National Securities Commission that is able to effectively expose and challenge non-disclosure, self-dealing, and other securities market violations that are rife in developing markets. As to ongoing enforcement matters, NSC is apparently unable or unwilling to adequately challenge what appeared to be questionable practices by several affiliates of the Kazkommerts Group: the possible unloading of shares by one affiliate in order to pay for a large loan amounting to a large portion of bank capital, while within several days Kazkommerts Securities purchased similar shares at a substantially lower price. The pension fund Ak Niet, an affiliate of the Kazkommerts group, used pension funds for the purchase of Kaztelecom from Kazkommerts Securities at inflated prices. The NSC argued that there had been no way to establish a true market price due to the paucity of trades. Still, the trades that had taken place (in Berlin and elsewhere) were sold at decidedly lower prices (\$10-\$19) than those unloaded on the pension



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funds at \$29 dollars a share. Pragma questioned whether the NSC was unable to find any violation of fiduciary duty, in terms of the responsibility of investing money wisely for the beneficiary's benefit. Whether or not these are isolated incidents, setting a precedent for similar problematic trades (involving price discrepancies or the affiliated persons issue) will make it easier for potential violators to penetrate the marketplace once trading in pension assets becomes more liquid.

Other ongoing enforcement issues involve dividends of Aluminum Kazakhstan and Kaztelecom. In the former, NSC managed to take this case to the prosecutor to obtain a judgment against the issuer (now on appeal). This result indicates that companies with informal or formal pull in the government are, in some instances, able to be brought to court. Still, the question remains as to why NSC does not or cannot bring such cases to court on its own. Does payment of court fees constitute sufficient reason? In the case of Kaztelecom dividends, the company has agreed to pay dividends in arrears. It has apparently paid most of them, but it is necessary to access what portion of the outstanding arrearage has been paid so far.

The last pending enforcement issue concerns public company disclosure. The process for requiring the issuers of widely held and exchange-quoted shares to file periodic reports with the NSC is defective. Companies are expected to apply for "public company" status, a process that forestalls filing reports as soon as companies meet the relevant criteria. As a result, to date only nine companies are recognized as subject to "public company" reporting, and four of these have not filed report. Pragma questions what NSC is doing to remedy the matter. (At one point, NSC had planned to contact companies that had met these criteria but had not filed to receive this status. This has evidently not received a follow-up.)

Pragma legal staff has given recommendations on general structural issues involving the enforcement capacity of NSC (*Attachment 7, cont.*). The NSC is planning to seek law amendments augmenting its power to obtain fines from securities law violators. But in the meantime, Pragma recommends that NSC could use its existing powers to impose remedies heavier than censure but lighter than license revocation. In some cases, a violator could agree to accept censure, implement remedial internal controls, and/or pay for an inspection by an auditor of the NSC's choice or the NSC itself (with expenses paid by violator). Legal provisions allow for settlements short of revocation of license but more than a slap on the wrist; Article 24-1 of the Securities Market Law allow for the issuance of "binding orders". Pragma legal staff questions why the NSC is not willing to implement these measures more fully. Pragma also recommends that enforcement capabilities could be more efficacious by designating staff as full-time enforcers. The NSC has declined to form an enforcement division, citing financial considerations. We recommend that the NSC could simply reorganize the existing staff, designating some members as full-time enforcers, while allowing temporary assignments to new enforcement cases. This should not demand any extra money from the budget.

Questions of privatization continue to be pending, as Pragma continues to monitor developments in both strategic and secondary industries and state properties (*Attachment 8, Blue Chip Privatization Update*). The government continues to plan to implement the privatization of both "blue chips" and "second-eschelon" enterprises (the latter listed on the web site created by Pragma, kazecon.kz.) Still, some progress towards the end of privatization of both first and second tier enterprises was made. (See *Attachment 8, "The Work with State Property and Privatization Committee"*). IDEY Ltd. Co. was selected as an

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advisor for selling the state block of shares of Mangystaumunaigaz JSC. A tender for evaluating the 26 second tier enterprises was held (as augmented from previous 17-18 enterprises). As of late January, an evaluation of 8 enterprises is now complete (ibid.)

Since the beginning of 1999, the Department for State Property and Privatization has managed to raise approximately 21 billion tenge. Still, privatization has not proceeded at the pace originally projected, as monitored by Pragma on a formal and informal basis. Decisions have been made to transfer the major portions of state packets of shares to municipal governments in the case of smaller enterprises and to ministries in the case of large enterprises. (*Attachment 8, "Operations of the Department of State Property and Privatization"*) 90% of state property is scheduled to be transferred to municipal governments, with the central government not retaining more than 10-15 companies in outlying oblasts (with none remaining in Almaty oblast hands). State shares of large enterprises will be relegated to the ministries in charge of the respective industries involved: 1) Ministry of Transport and Communication or 2) Ministry of Power, Industry and Trade. These will then become two "superministries" involved in the privatization of key industries. (This will consolidate a process begun in Spring 1999, which relegated the transfer of over 200 industries to relevant branch ministries; (*Attachment 8, "Stages Preliminary to Blue Chip Program; see also "List of Resolutions of the RK Government" in same).*)

However, different problems can potentially complicate the privatization process. In order to achieve more efficient privatization, Resolution #405 (April 1999) relieved the State Property and Privatization Committee of the burden of small enterprises and companies of provincial significance, assigning the properties and the responsibility of privatization to the regional authorities (*Attachment 8, "Stages Preliminary to Blue Chips Implementation"*). However, in the transfer of properties to the regional level, there is some concern that the gaining of economic control by the oblasts could result in abuse of power regional akimats. Ultimately, fiscal and governmental decentralization will release direct responsibility from the hands of the central government and its budgetary constraints. Yet the legal, fiscal and administrative infrastructure is not yet in place to ensure that funds released from privatization will be managed in an efficient matter. Ultimately the central government is not equipped financially or administratively to manage the entire burden of privatization of small regional enterprises. Another concern is that strategic privatization, to be relegated to the various ministries, has previously gone forward without taking into consideration "industrial integrity" (*Attachment 8, "Operations of the Department for State Property and Privatization"*). That is to say, property has been sold to domestic and foreign investors alike without consideration of overall development of the specific sectors to be privatized. The integrity of the supply chain, for instance, may be compromised if some element of the industry remains in state hands, while the other is privatized.

Privatization has proceeded along with concern according to legal provisions, but contradictions regarding appropriate and efficient methods of privatization have yet to be resolved. There are plans to sell some of the second-tier enterprises at auction, following a decision of the Government to conduct privatization tenders only upon special authorization. Different conditions for sale on the Exchange or through other means have not yet been resolved. The Exchange requires the transactions conclude settlements within 3 days. However, the Law on State Property presents a contrary position which allows 30 days for a transaction to be settled, a position more convenient for foreign investors in major transactions. Moreover, the government has deemed that there is a problem of assessment of

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the real sale value, which would complicate sale on the Exchange (where liquid trading and price discovery is not yet established). The dilemma is whether to start from the face value of the share or the market price of the share, keeping in mind that the market price is difficult to establish on the Exchange.

Despite unresolved decisions by the State Property and Privatization Committee on the sale of state property, Pragma continues to maintain contacts and cooperation with this government body. Currently a new candidate for Committee Chairman, Maksutbek Rakhonov, is in the course of being approved. The selection of financial advisors was also prepared and submitted for the Government's approval and is still pending. When the new committee chairman is approved, the pending plans to contract an advisor for the sale of Aktobemunaigas will go forward. Under the leadership of Mr. Rakhonov, the Committee expects to expedite state property privatization and complete it by late 2000.

Task 1 - Continued Assistance to the NSC

| Defined Activity     | Progress Made During the Month  |
|----------------------|---|
| 1. Draft regulations | <p>1) <i>Joint Stock Company Law and Changes Proposed by NSC.</i> The Team's Legal Group continued its work on amendments to the Joint Stock Company Law. The January version of the NSC Joint Stock Company Law amendments represented an extensive and in many respects ill-advised rewrite of this fundamental law. Pragma met with individual commissioners to point out some of the most serious flaws with the proposal. Among other problems:</p> <ul style="list-style-type: none"><li>• Opportunities would be increased for making fundamental corporate changes without adequate shareholder notice or consent.</li><li>• The NSC would be given unrestricted authority to limit purchases of shares in open companies, "in the interests of the state".</li><li>• Express liability for violation of conflict-of-interest rules would be dropped.</li><li>• The open form of joint stock company would be effectively abolished for companies with few shareholders.</li></ul> <p>2) <i>Licensing Regulation</i></p> <ul style="list-style-type: none"><li>• Pragma staff assisted with further work on regulations on the licensing process drafted (by Pragma) for the NSC earlier this year. These regulations concern qualifications and disqualifying factors for obtaining licenses to conduct business in the securities field.</li></ul> <p>3) <i>Proposed Amendments to the Securities Market Law.</i> Pragma delivered a compendium of proposed amendments to this law and the rationale for each. Comments on various individual topics addressed in the past year and the conclusions of our overall assessments of capital markets regulation were delivered to NSC. (A document on conclusions of capital market regulations was previously sent to USAID in April 1999.)</p> <p>The salient features of the proposed amendments were to</p> <ul style="list-style-type: none"><li>• Broaden the NSC's investigative powers to reach all potential defendants, witnesses and evidence, not just NSC licensees and securities issuers.</li><li>• Increase the range and flexibility of enforcement remedies available to the NSC when faced with securities law violations; clarify remedies available to private parties.</li><li>• Assure the right of adequate notice and opportunity to defend for anyone accused of</li></ul> |

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| Defined Activity  | Progress Made During the Month   |
|---|--|
| (continued)   | <p>violations.</p> <ul style="list-style-type: none"> <li>• Add antifraud provisions and permit the NSC to define fraudulent practices.</li> <li>• Better define and regulate insider trading.</li> <li>• State procedural requirements for public notice and comment when a new regulation is adopted.</li> <li>• Recognize competition as a goal of securities regulation but allow the NSC to reconcile possible conflicts between the antimonopoly law and the existence of sole, centralized securities market institutions such as the exchange or depository.</li> </ul>  |
| 2. Assist in establishing enforcement power of NSC.     | <p>Pragma worked on a number of issues related to enabling greater enforcement powers of the NSC, in addition to those detailed above (in connection with the Securities Law amendments proposed). Other measures include</p> <p>1) <i>Draft Pension Investment Rule.</i> Conflict-of-interest features of this rule (delivered to the NSC in September) were discussed in January 14<sup>th</sup> meeting with NSC Directorate. (The full rule also addressed ceilings on different types of investment.) Lack of more specific rules has been cited by the NSC as a reason for weak enforcement effort in the pension area.</p> <ul style="list-style-type: none"> <li>• The head of the NSC pension office agreed that it would be good to revise the rule to specify that asset management should be aimed exclusively toward the welfare of pensioners, that pension asset managers should be forbidden from prearranging affiliated-party stock exchange trades and that the definition of affiliated persons should be clarified to include affiliates of pension funds and their sponsors as well as of the asset managers. (But a specific date of action on these matters could not be promised.)</li> </ul> <p>2) <i>Draft Pension Law Amendments.</i> Pragma drafted needed changes to the Pension Law covering a number of topics. Most notably</p> <ul style="list-style-type: none"> <li>• Legislation aimed at expanding protection against conflicts of interest in the management of pension assets.</li> </ul> <p>3) <i>Draft Amendments to the Administrative Code.</i> At NSC's suggestion, we prepared a draft of Administrative Code amendments that we believed would strengthen NSC enforcement power. The NSC indicated that these could be sent to the Ministry of Justice as a supplement or alternative to preexisting ones (commented on by Pragma in 1999).</p> |
| 3. Assist NSC in moving off-exchange trading to KASE.   | <p>Pragma continues to advocate active quoting and bidding on the Exchange. The broker-dealer seminar planned for February will strongly advocate to professional market participants that only through active trading can real price recovery take place. Moreover, profits are best made with active trades on narrow margins. Foreign investors will think of entering the Kazakhstani market only in the case of actively traded financial products and companies.</p>   |
| 4. Establish NSC Data Warehouse/Trade Reporting System. | <p>The Technological Support Group continued its ongoing work with the NSC. During the month the Group.</p> <p>Continued working with the reporting system of pension asset managers:</p> <ul style="list-style-type: none"> <li>• With the official request from a custodian bank, we added an option of removing erroneously received information from the system and a module for processing</li> </ul>   |

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| Defined Activity | Progress Made During the Month   |
|------------------|--|
| (continued)      | <p>additional information from corrected reports.</p> <ul style="list-style-type: none"> <li>• Began efforts to set up an analysts' workplace, enabling a more efficient analysis of the changing dynamics of pension fund assets' structure.</li> <li>• Visited offices of custodian banks such as Kaspyiski, Kazcommertzbank and Temirbank, assisting them in solving problems that occurred in sending reports. Pragma detected errors in the banks' informational systems made by the system administrators. Errors were eliminated and report delivery resumed, based upon our recommendations.</li> <li>• Introduced bank login names and passwords into the system. Beginning from January 15<sup>th</sup>, the system has been working. Accounts are being steadily received, with no informational glitches.</li> <li>• Software required for the receiving and processing of information has been installed on computers of NSC employees responsible for information retrieval.</li> </ul> <p>Continued work on the internal NSC information system:</p> <ul style="list-style-type: none"> <li>• Installed additional customer site maintained by the Licensing Department for access to information on the registry of licenses and permits, to be utilized by stock market participants. Trained a specialist of the Licensing Department to use this new site.</li> <li>• Reinstalled the latest software versions on NSC's internal server. These updates are required to ensure the stable and reliable operation of the internal information system.</li> <li>• Upon the request of the NSC Chairman, made efforts to develop the mechanism of efficient modification of internal contact information (employee information, participating companies) on the internal information server.</li> <li>• Designing a new version of the state registry for registration of registered corporate share and bond issues.</li> <li>• Began efforts to elaborate technical documentation for all software databases and products designed by Pragma. The effort is required to allow the systems to be self-sustained by NSC upon the expiration of our project. Commenced developing documentation structure, the implementation of program modules, script installation principles, and the creation of a CD that would contain all the necessary information and software products required for a working system.</li> </ul> <p>Other:</p> <ul style="list-style-type: none"> <li>• Continued technical support and maintenance of <a href="http://www.kazecon.kz">www.kazecon.kz</a> and <a href="http://kase.kazecon.kz">kase.kazecon.kz</a> web sites</li> </ul> |
|                  |  |

**Task 2 - Blue Chip Privatization**

| Defined Activity   | Progress Made During the Month  |
|--|---|
| 1. Assist and monitor the privatization of state owned shares. | <ul style="list-style-type: none"> <li>• Pragma staff prepared a memo on Blue Chip Privatization progress (See <i>Attachment 8</i>).</li> <li>• State Property and Privatization Committee concluded an agreement with only one financial advisor; IDEY Ltd. The company was selected on January 31 as an advisor to the sale of the state block of shares of Mangistaumunaigas JSC.</li> </ul> |

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| Defined Activity   | Progress Made During the Month   |
|--|--|
| (continued)  | <ul style="list-style-type: none"> <li>• Plans are proceeding for the relegation of 90% of state shares of smaller enterprises to municipal governments; larger state enterprises will be reallocated to the respective ministries. It is likely that the privatization of key industries will be implemented by two “superministries”: 1) Ministry of Transport and Communication and 2) Ministry of Power, Industry and Trade. (See <i>Attachment 8</i>.)</li> <li>• A tender for evaluating 26 second-tier enterprises was held. As of late January, an evaluation of 8 enterprises is now complete (See <i>Attachment 8</i>). It is not yet determined where and how sale of enterprises will be conducted. Such decisions await the establishment of the new privatization committee chair.</li> <li>• The new candidate for Chair of the reformulated Privatization Committee, Maksutbek Rakhanov, is being approved.</li> </ul> |
| 2. Assist and involve Broker/Dealers in working w/GOK privatization. | The role of the Exchange and BDs in implementing privatization remains limited at this juncture.   |
| 3. Advocate share listings of blue chip companies w/KASE.            | <ul style="list-style-type: none"> <li>• IDEY Ltd. Company was selected as an advisor to the “blue chip” Mangystaumaigas JSC (see above).</li> <li>• Plans to contract an advisor for the sale of Aktobemunaigas will proceed, pending the approval of the new Privatization Committee Chair.</li> </ul>   |

**Task 3 - Development of the Markets**

| Defined Activity                        | Progress Made During the Month  |
|---|---|
| 1. Encourage companies to list on KASE. | <p>The team continued to advise regionally-based companies and Almaty-based companies for listing on the Exchange:</p> <ul style="list-style-type: none"> <li>• Almaty Kus, Open JSC, presented the package of documents to be submitted for the listing procedure. The financial consultant is Kazcommertz Securities, and the auditor is Arthur Anderson.</li> <li>• Randi DC continued to cooperate with Pragma, providing a number of consultations on the registrar selection. Pragma met with the President of Randi Distribution and came to an agreement that we should review their balance sheet.</li> <li>• Financial documents pertaining to FoodMaster Company have been gathered and processed. Pragma interacts with DB Securities on an on-going basis for the purpose of making the right decision, should the company proceed with its bond issue as hoped.</li> <li>• Pragma conducted a series of consulting sessions with “Geotex” and “International Energy Service” with respect to their accessing capital markets.</li> <li>• Pragma contacted “Yuzhpoly metall” JSC (Shymkent), “Astana Technopark” (Astana), “Atyrauuzenport” (Atyrau), “Tsesna” Bank JSC (Astana) towards efforts of eventual listing on the exchange.”</li> <li>• Pragma began discussions with RG Securities Re: “PRG Bottlers” Project. (PepsiCo) The Project’s consultants reviewed the company’s business-plan and came up with comments and answers.</li> </ul> |

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| Defined Activity            | Progress Made During the Month   |
|-----------------------------|--|
| (continued)                 | <p>As of 31 January 2000, 68 issuers were listed on the Exchange, with 90 issues.</p> <p>8 "A" listings with 13 issues.</p> <p>10 "B" listings with 17 issues</p> <p>50 OTC I &amp; II with 60 issues (4 OTC I issuers with 4 issues and 46 OTC-II issuers with 56 issues.)</p> <p>New issues/issuers include:</p> <ul style="list-style-type: none"> <li>- "Astana-Finance" common stock with a "B" listing</li> <li>- "Komirbank" bond with a "B" listing</li> <li>- "Geotex" common stock with an OTC-2 listing</li> <li>- "Voskhod" common stock with an OTC-2 listing</li> </ul> <p>Delistings include a "VITA" bond delisted from OTC-2 because of maturity; "Khimpharm" (common and preferred) and "Karagandy-Nan" (common) delisted from OTC-2 due to lack of active trading.</p> <p>(These numbers exclude companies placed by the CSPP.)</p>   |
| 2.Encourage trading on KASE | <ul style="list-style-type: none"> <li>• Pragma agreed to list shares of "Geotex" and "International Energy Service" on the OTC-2 to gain some experience and make several transactions.</li> <li>• "Astana-Finance" Open JSC's shares were B-listed on January 17<sup>th</sup>. The subsequent plan is to get shares A-listed. The company's auditor is Arthur Andersen. Preliminary negotiations with S &amp; P ratings agency are being held. Upon having the stock listed on the exchange, two transactions were made on January 28 for \$487,900 and on January 31 for \$229,600.</li> <li>• RG Securities' second tranche of its bond issue amounting to \$250,000 has been distributed. Negotiations are being held to have this transaction registered through the Exchange.</li> <li>• Pragma commenced making arrangements in cooperation with the VITA Company for the issue of bonds for the amount of \$350,000 with the circulation term of four months. Work is underway to complete the investment memorandum. The company's presentation to investors is also being arranged.</li> <li>• Pragma organized and held meetings with Komir Bank management, after which Protocol of Intentions was executed. During the meeting, S &amp; P's rating service explained and management indicated their interest in getting rated. The bank issued bonds denominated in Dollars for the amount of \$2 million at a face value of \$10. The coupon is 12% with a circulation term of one year.</li> </ul> |

**Task 4 – Continued Assistance to KASE and the Central Depository**

| Defined Activity   | Discussion of Progress Made During the Month  |
|--|---|
| 1. Support KASE in accepting the SRO responsibilities of the Association of Broker/Dealers (ABD) | <ul style="list-style-type: none"> <li>The normative SRO documents are being revised once again, with guidance by Pragma. The translated changes, following final comments, will be presented to the KASE council in February for discussion. After adoption by the KASE membership, they will be presented to the NSC for acceptance.</li> </ul>   |
| 2. Assist KASE to finalize rules for market-makers/work in conjunction with Broker-Dealers.      | <ul style="list-style-type: none"> <li>Following the results of a Council Meeting, KASE decided to delay requirements for Market Makers in "A" and "B" listed securities until January 1, 2001.</li> </ul>  |
| 3. Improve broker-dealers operational efficiency and transparency.                               | <ul style="list-style-type: none"> <li>Pragma met with Damir Karassaev, President of the KASE, to determine requirements needed to increase quoting and trading on the KASE. (Pragma continues to repeatedly lobby for these changes to replace the historical trade reporting that exists now.) A memo is being drafted to the NSC concerning regulations and rules needed to require quotes on "A" and "B".</li> <li>Pragma prepared its seminar on training broker/dealers, which will take place in February under the leadership of Jae Abbitt. This 4 day training course will supply information to BDs, as well as the KASE, the NSC, Pension Fund Asset managers, and local training groups of professional participants. In addition to front and back-office technique training, the seminar will feature presentations on effective trading and market making and on the relationship between corporate finance and trading on the stock exchange.</li> <li>The KASE decided to eliminate trade volume requirements for "A" and "B" listings, a decision taken following its Council Meeting.</li> <li>The trading volume in January 2000 was more than \$21 million, which was slightly more than the entire year of 1999. This is a good development, except for the fact that trade was negotiated off the exchange and only reported through KASE.</li> <li>The NSC would like to restrict secondary trading of Treasury Bills to the KASE. Perhaps an experiment will take place, encouraging broker/dealers to try this.</li> </ul> |
| 4. Provide assistance to the Central Depository (CD).  | <ul style="list-style-type: none"> <li>The Central Depository is planning to issue 10 million Tenge in new shares. Currently, the CD has a paid in capital of 8 million, all held by broker/dealer firms. The new shares, it is planned, will be bought by broker/dealers (3 million Tenge), the KASE (2 million Tenge) and the National Bank of Kazakhstan (5 million Tenge). However, this may be obstructed by the fact that the CD is at present a closed company. This means that any new shares should be first offered to preexisting shareholders, e.g. broker/dealers. However, assuming that BDs accept the plan of the CD, the eventual ownership of the CD should be constituted as follows: 20% KASE, 30% BDs, and 50% NBK. Since KASE is owned by broker-dealers, the effective ownership will be 50% BDs and 50% NBK. This plan awaits approval by the CD board.</li> </ul>  |



**Task 5 - Other Activities: Creation of New Financial Products**

| Defined Activity  | Progress Made During the Month   |
|---|--|
| Develop alternative product for Pension Funds (and other institutional investors) | <ul style="list-style-type: none"> <li>• Continued work on Securitization of Social Obligations project. Updated the project and coordinated with ABN AMRO in order to enhance the structure of the instrument. The Bank's management informed their clients (major oil companies) about this Securitization Project.</li> <li>• Wrote letters to akims providing them with the draft copies of the methodology of social obligations. Requested information from akims on 1) level of social obligations belonging to each oil company operating in the region and 2) a list and description of regional social projects requiring funding, specified in order of importance</li> <li>• Participated in the National Bank's discussion of mortgage issues. Sent them some information relative to the US mortgage market.</li> <li>• Communicated with the IMF on clarifications involving investments of pension funds in foreign assets (<i>Attachment 5</i>).</li> <li>• Compiled information on the placement of the two latest municipal bond debt issues in Kazakhstan and detailed Pragma's involvement.</li> <li>• Continued to engage S &amp; P in performing the rating of Lariba Bank, the primary bank to be involved in asset-backed (mortgage) securities.</li> </ul> |

**Task 6- Miscellaneous**

|              |   |
|--------------|---|
| Misc. Topics | <ul style="list-style-type: none"> <li>• Continued Assistance to Morgan Stanley Dean Witter in their efforts to have the National Bank participate in their long dated gold hedge product-tasked by Ambassador Richard Jones.</li> <li>• On behalf of the KASE, requested and received a ratings proposal from S&amp;P (see Attachment 9).</li> </ul> |
|              |   |

**IV. ADMINISTRATIVE ISSUES**

None

**V. PROJECT STAFFING**

The following personnel were engaged in project activities this month:

Richard Dvorin, Senior Capital Markets Advisor (January 10)

Kevin Fogarty, Senior Legal Advisor (January 12)

David Lucterhand, Chief of Party (January 3)

Timothy Smith, Senior Technical Advisor