

The Pragma Corporation

Lithuanian Capital Market
Development Project
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MEMORANDUM

November 12, 1998 12:37PM

To: Aldas Kriauciunas
USAID - Vilnius, Lithuania

From: Nijole Maskaliuniene,
The Pragma Corporation, Vilnius

Re: **STATUS REPORT FOR THE MONTH OF OCTOBER, 1998**
Lithuania Capital Markets Development Project
CONTRACT EPE-I-95-00040-00, Task Order 05

CC: Beverly Loew/ Ieva Veidemanis: USAID - Washington, D. C.
Kevin O'Hara: Pragma Corporation - Falls Church, Virginia
The Pragma Corporation: Vilnius Office File (Diana Sokolova)
The LSC, the NSEL, the CSDL, the NAFB

PROJECT DESCRIPTION

The Pragma Corporation ("Pragma") is implementing the Lithuanian Capital Markets Development Project ("Project") funded by the United States Agency for International Development ("USAID"). The Project is to provide legal and regulatory development assistance to the Lithuanian Securities Commission ("Commission") and organizational development assistance to the National Stock Exchange of Lithuania ("NSEL"), the Central Securities Depository of Lithuania (CSDL), and the National Association of Finance Brokers of Lithuania ("NAFB"). In addition, the Project is providing assistance in the procurement of software and operations capabilities to support an order-driven, continuous trading stock exchange.

PROFESSIONAL STAFFING

In October 1998, the "Pragma" team of local advisors were working together with expat consultants, Mr. James Ryan and Mr. Donald Buddenbohn, who joined the team on September 10 and September 28, respectively. Mr. Kevin O'Hara of the Pragma Corporation was visiting the Project through October 13 - 22, 1998.

PRIMARY AREAS OF FOCUS

Among many undertakings pursued by the Pragma team, areas provided below were identified as of primary need of expert legal assistance by the LSC and the NAFB. Mr. James Ryan was working on the Rule on Hypothecation, the Rule on Lending and Borrowing, and on the Code of Procedure for the implementation of the Code of Ethics of Financial Brokers. The latter assignment was based on the request of the

NAFB to assist in their efforts to enforce the Code of Ethics that was adopted last spring. (Mr. James Ryan had assisted in drafting its final version.) Mr. Ryan's Trip Report is attached. (Attachment "A")

Mr. Kevin O'Hara provided technical and administrative assistance for the Pragma team as well as coordinated further assignments of the Project with its counterparties. He had meetings with the Chairman of the LSC Mr. Poderys, President of the NAFB Mr. Matiukas and Director of the NAFB Mr. Godelis, Mrs. Saladžienė of the NSEL, and the Trading System Selection Committee. Critical tasks involving NSEL hardware assistance were determined. (See Attachment "B")

At the request of the Securities Commission Mr. Donald Buddenbohn reviewed the rules on reporting requirements for financial brokerage firms and requirements for internal controls in a financial brokerage firm. He also drafted an inspection program to supplement the Rule on Financial Brokerage Firm's Inspections. All these regulations relate to issues of compliance, internal controls, internal audit and supervision of all aspects of the financial brokerage firm activities. The expert had numerous meetings with employees of the Market Regulation Department of the Securities Commission and provided expert advice and training to them. He also took part in one of the inspections on site, which resulted in drafting an inspection program to facilitate the examination procedure carried out by the LSC inspectors. Mr. Donald Buddenbohn will be working with the Pragma team until November 13.

The task of the Pragma's consultant Mr. Skirmantas Rimkus for the last few months has been to draft forms of financial statements and principles of accounting for open-end and closed-end investment funds and investment management and consulting firms. The task is of high importance for further development of the accounting system in Lithuania as today all financial institutions, except banks, complete the same forms of financial statements as manufacturing companies. The statements are the same for regulatory purposes and for taxation authorities. And they do not reflect any investment activity of a firm as there is not any in a manufacturing company. The Project was challenged to prepare accounting requirements for financial brokerage firms and all types of other companies providing investment services. The procedure of approving of any changes in accounting requirements is rather complicated and is the matter of the Government policy.

Draft forms of financial statements and principles of accounting for financial brokerage firms were prepared by Mr. Rimkus and submitted for approval of the Ministry of Finance in August already. On October 22, a meeting was held at the Ministry of Finance to discuss these drafts. The meeting was attended by specialists of the Ministry of Finance, the LSC, independent auditors and consultants. It was resolved to submit the said project for approval of the Government of the Republic of Lithuania. The Accounting rules are projected to come into effect from January 1, 1999, but the new financial statements will be required no sooner than January 1, 2000.

Forms of financial statements and accounting requirements for open-end investment companies have been prepared too. They were discussed at the meeting of the

Securities Commission. (See Attachments "D" and "E"). Additionally, Skirmantas Rimkus prepared Rules on Recognition of Income and Expenses in Financial Brokerage Firms. Upon the request of the Securities Commission, the expert reviewed and wrote comments on the General Accounting Rules of Securities and their Circulation.

Investment holding companies are the only type of investment companies functioning in Lithuania today. Yet, the forms of financial statements for them, although prepared by Dr. Paškevičius last winter, have not been passed into effect either. At the beginning of October, Dr. Paškevičius met Mr. Dudutis of the Methodological Department of the Ministry of Finance and discussed the accounting issues of investment holding companies. He has also prepared supplementary materials that the Ministry of Finance requested on the issue. Last month Dr. Paškevičius' other tasks included the analysis of the trading volume on the central market. It covers the trading volumes of the largest equity transactions during the last five years, trading volumes on the central market and block trades off-the-exchange. Market analysis is an attempt at systematization of the developments in the Lithuanian capital market. It is significant for the Securities Commission, being a regulator, as an indication of the effect that its decisions exercise on the market. It is also important to know the extent of the impact of the Russian crisis and other factors of economic character upon investments in Lithuania.

In October draft amendments and supplements to the Law on Investment Companies were finalized by the legal advisor Evaldas Valčiukas. They were presented for the discussion at the Securities Commission. The draft amendments aim at improving the legal and regulatory basis for investment companies and mutual funds. When adopted, these amendments will eliminate contradictions between the Law on Investment Companies and the Law on Public Companies that showed up after the latest amendments to the latter. The amendments are to bring the Law in harmony with the requirements of the European Union Directive 611/85/EEC, too. As a result, conditions for appearance of local investment funds will be created on the basis of the European standard. Many provisions of the effective Law that caused controversy will be amended (e.g. governance of the fund will be simplified, etc.). (Attachment "F")

Mr. Rečiūnas was working on the final draft of the Rule on Securities Registration and Public Offering prepared by the Department of Corporate Finance of the Securities Commission. He also started drafting the rule on securities lending and collateralization of such loans. This issue was also addressed by expat advisor, Mr. James Ryan, who prepared a draft rule on hypothecation. These are related issues. They will have to be addressed in the future, when the joint rule on lending and borrowing is drafted.

MAJOR ACHIEVEMENTS

Completion of the Rule on Concluding the Agreements Between Financial Brokerage Firms and Their Clients (Attachment "G") can be considered an event of utmost importance for the regulatory environment of the Lithuanian securities market. The Rule was prepared by the legal advisor Gediminas Rečiūnas, adopted by the Securities Commission on October 16, 1998 (Resolution No 31). The Rule sets forth the general requirements for agreements between the financial brokerage firm and its clients and

special requirements for the agreements on custody of clients' securities, contracts on placement and execution of clients' orders and contracts on discretionary accounts. The rule aims at protecting investor rights against possible abuse from the side of financial brokerage firms. It also contains client asset protection provisions covering both clients' monies and securities.

WORKSHOPS/SEMINARS

On October 6 - 8, 1998 a three-day seminar was held on Internal Controls and Risk Management conducted by the Pragma consultants Mr. James Ryan and Mr. Donald Buddenbohn. The seminar attracted much attention and was attended by over 30 people each day. (See Attachment "C". Lists of participants). The participants of the seminar were staff members of the Lithuanian Securities Commission, the Stock Exchange, the Central Securities Depository, brokers and managers of brokerage firms and brokerage departments of banks. They all noted a very lively presentation (video material and Power Point slides were used to illustrate the material) and a very thorough substantive preparation. The speakers answered the questions and provided practical examples of risk management and good internal controls. Mrs. Liucija Naudžiūnienė, head of Market Regulation Department of the LSC, stressed the timeliness of training on the issues that were discussed in the seminar. In view of the Russian financial crisis and capital crisis in Asia, risk management is becoming more and more significant for each company participating in the securities business. Good internal controls ensure better risk management. Having adopted capital adequacy requirements early this year (they were also prepared by experts of the Pragma team), requirements for risk management were set forth. The requirements for internal controls in the brokerage firm that were drafted by Mr. Donald Buddenbohn last spring are undergoing final discussions at the LSC.

During October, members of the Pragma team participated in a number of meetings and seminars held by other institutions. On October 26 - 30, Dr. Paškevičius took part in the workshop "Taxation of Financial Institutions and Financial Operations" organized by the World Learning Vilnius. He also delivered a lecture "Financial Ratios: Liquidity, Profitability, Assets Utilization, and Market Value Ratios" for candidates to take broker's qualification examination. Mr. Rimkus participated at the discussion with representatives of the Barents Group and the USAID who are working on the study of fiscal reforms in Lithuania.

UPDATE ON PREVIOUS REPORT

COMPLETED:

- ☆ Recommendations for Financial Accounting of Investment Funds

- ☆ Rule on Agreements between Financial Brokerage Firms and their Clients

- ☆ Draft Amendments to the Law on Investment Companies

- ☆ Rules on Recognition of Income and Expenses in Financial Brokerage Firms

All documents were passed to the Securities Commission.

IN PROGRESS:

- Rule on Securities Registration and Public Offering

- Rule on Registration, Offering, and Redemption of Investment Fund Shares

- Memo on the Compliance Function, Internal Audit and Independent audit and the Impact of Internal Controls upon them as they relate to Financial Brokerage Firms

- Audit (Inspection) Programs

PLANS FOR NEXT MONTH AND ANTICIPATED ISSUES

In November, Mr. Donald Buddenbohn will work with Market Regulation Department of the Securities Commission on internal controls, the compliance function, internal audit and independent audit as well as the impact of internal controls upon them as they relate to FBFs. He will also finalize a sample audit (inspection) program and review the accounting principles of investment funds prepared by Mr. Rimkus.

Mr. Rečiūnas will be working on the Rule on Registration and Public Offering of Securities he is currently working on. Mr. Rimkus will continue work on principles of financial accounting for investment companies. Mr. Valčiukas will be working on the Rule on Registration, Offering and Redemption of the Investment Fund Shares. Dr. Paškevičius will continue with the capital market analysis according to the schedule approved by the Securities Commission. Minor tasks will be addressed when they come due.

ATTACHMENTS:

ATTACHMENT A: JAMES RYAN'S TRIP REPORT

ATTACHMENT B: CRITICAL TASKS INVOLVING NSEL HARDWARE

ATTACHMENT C: LIST OF PARTICIPANTS AT THE SEMINAR ON INTERNAL CONTROLS

ATTACHMENT D: FINANCIAL STATEMENTS FOR INVESTMENT FUNDS

**ATTACHMENT E: DESCRIPTION OF PRINCIPLES (METHODS) OF FINANCIAL
ACCOUNTING APPLIED FOR INVESTMENT FUNDS**

**ATTACHMENT F: AMENDMENTS AND SUPPLEMENTS TO THE LAW ON
INVESTMENT COMPANIES OF THE REPUBLIC OF LITHUANIA**

**ATTACHMENT G: RULE ON CONCLUDING THE AGREEMENTS BETWEEN FINANCIAL
BROKERAGE FIRMS AND THEIR CLIENTS**

The Pragma Corporation
U.S.A.I.D. Capital Markets Consultants
Vilnius, Lithuania
Phone/Fax: (370 2) 72 49 42

Trip Report
Lithuanian Capital Markets Project

Name of Consultant: James P. Ryan

Date of Visit: September 10, 1998 through October 9, 1998

Clients: Lithuanian Securities Commission ("the Commission"), the National Stock Exchange of Lithuania ("the Exchange"), the Central Securities Depository of Lithuania ("the Depository") and the National Association of Finance Brokers ("Brokers Association").

Purpose of the Trip: To advise the above clients as a Capital Market Specialist. The specific tasks were to advise the Commission regarding margin lending rules, to advise the Brokers Association on its Code of Procedure and to present seminars on Internal Controls and Risk Management.

Deliverables:

1. To conduct a seminar on the subject of Internal Controls;
2. To conduct a seminar on the subject of Risk Management;
3. Draft of the Code of Procedure for the Brokers Association;
4. Draft of a memo on the Rules on Books and Records of Financial Brokerage Houses for the Commission;
5. Draft of a memo on the proposed Hypothecation Rule;

Description of Attachments:

Attachment A: James Ryan/ Vilnius Disc-98;
Attachment B: Power Point Presentation;
Attachment C: Wall Street Wizard video;
Attachment D: Red Flags video;
Attachment E: Cooking the Books video;
Attachment F: The Code of Procedure;
Attachment G: The Hypothecation Memorandum;
Attachment H: The Books and Records Memorandum;
Attachment Q: The Time Report for James Ryan

Contact Persons: Virgilijus Poderys, Chairman of the Commission;
Edmundas Mikuciauskas, Deputy Chairman of the Commission;
Arvydas Jalinskas, Commissioner
Liucija Naudziuniene, Head of Market Regulation Department;
Rimantas Busila, Director of the Exchange;
Arturas Keleras, President of the Depository;
Romas Matiukas, President of the Brokers Association;
Jacques DeFay, Vice President of the Pragma Corporation
Kevin O'Hara, Project Manager for the Pragma Corporation

Next Steps: Both the Commission and the Brokers Association have made progress in the writing and the adoption of rules. To continue the process of providing assistance in this area, the following will require attention:

- the Brokers Association's Code of Procedure should be implemented;
- the Commission should adopt a Books and Records Rule;
- the Commission and the Brokers Association must continue to develop an experienced staff;
- the Commission should adopt a Margin Rule;
- the Commission should adopt a Hypothecation Rule.

THE NATIONAL ASSOCIATION OF FINANCE BROKERS OF LITHUANIA

THE CODE OF PROCEDURE

Contents

Article I: Application and Purpose of Code

- Section 1. Purpose
- Section 2. Definitions
- Section 3. Interpretation
- Section 4. Communications relating to grievances

Purpose

Section 1. (a) This Code of Procedure will apply to proceedings related to disciplinary actions involving members and persons associated with a member and to any other proceeding that the National Association of Financial Brokers deems appropriate.

(b) Persons associated with a member ("associated persons") will have the same rights as members and will be subject to the same duties and obligations under this Code.

Definitions

Section 2. (a) The term "Committee" used in the Code of Procedure shall mean the Ethics Committee, which is authorized to exercise powers assigned to it by the Board in connection with disciplinary and other matters.

(b) The term "Market Surveillance Committee" means the committee of the Association which is responsible for handling alleged violations of applicable rules of the Association involving trading practices and insider trading as well as other matters assigned to it by the Board.

(c) A "Hearing" is a hearing under Article II, Section 4 of the Code of Procedure that is so designated by the Ethics Committee or the Market Surveillance Committee.

(d) A "Hearing Committee" is a committee constituted as provided in the Code of Procedure to sit as a hearing panel for a Hearing.

Interpretation

Section 3. (a) The provisions of the Code of Procedure will not be construed to limit the By-Laws or Rules of the Association.

Communications Relating to Grievances

Section 4. (a) Communications received by the Association from any person regarding any grievance against a member or person associated with a member need not be considered privileged communication and may be dealt with by the Association as it considers to be fair and proper.

Article II: Disciplinary Action by the Ethics Committee

- Section 1. Issuance of complaints by committees
- Section 2. Form, content, notice and withdrawal of complaints
- Section 3. Answer to complaints
- Section 4. Request for Hearing
- Section 5. Hearing Panel
- Section 6. Evidence and procedure in committee hearings
- Section 7. Decision of the committee
- Section 8. Minor Rule Violation Procedure
- Section 9. Settlement Procedure
- Section 10. Complaint Docket

Issuance of Complaints by Committees

Section 1. (a) If the Committee believes that the nature and extent of the probable violations require disciplinary action, the Committee may issue a complaint as set forth in Section 2 of this Article.

Form, Content, Notice and Withdrawal of Complaints

Section 2. (a) All complaints will be made in writing, on the form designated by the Board of Governors, and will specify in reasonable detail the nature of the charges and the rule, regulation or statutory provision allegedly violated. The parties making the complaint will be termed the complainant and the party against whom the complaint is made will be termed the respondent. If the complaint consists of several allegations, each allegation will be stated separately. All complaints must be signed by the complainant. A copy of the complaint will be sent to all respondents and to the member of the Association with whom any respondent is presently an associated person.

(b) After prior approval by the Committee, a complaint may be withdrawn by a Committee at any time prior to the issuance of a written decision. Withdrawal of a complaint will not preclude a Committee from filing a complaint at a future date involving the same allegations.

Answers to Complaints

Section 3. (a) All answers to complaints will be in writing on the form designated by the Board of Governors, and shall be submitted to the Committee within twenty calendar days

from the date of the complaint sent to the respondent. The Committee may extend the twenty calendar day period for good cause.

(b) If a complaint is amended, the time period for filing an answer or amended answer will be extended for ten calendar days from the date of the amended complaint. If an answer has already been filed, a respondent will have ten calendar days from the date of the amended complaint within which to file an amended answer.

(c) If no answer is received by the Committee within the time period required, the Committee will send a second notice, on a form designated by the Board of Governors, to the respondent requiring an answer within ten business days from the date of the second notice, stating that failure of the respondent to reply within the period specified may be treated by the Committee as an admission of the allegations of the complaint. If no answer is received by the Committee within the time required by the second notice, the Committee may consider the allegations of the complaint as admitted by the respondent.

(d) In complaints involving multiple respondents, copies of the answers submitted by each respondent will be mailed promptly by the Association to all other respondents.

Request for Hearing

Section 4. (a) Upon the filing of an answer and a due notice thereof to the complainant, either the complainant or the respondent may request a hearing before the Committee having jurisdiction to hear the complaint. If a request is made, a hearing will be granted. In the absence of a request for a hearing, the Committee may order any complaint to be set for hearing. A notice stating the date, time and place of the hearing will be mailed to both complainant and respondent at least ten calendar days before the hearing, unless extraordinary circumstances require a shorter notice period, or unless the notice period is waived.

(b) Upon consideration of the length of expected testimony, the volume and complexity of documentary evidence, and other factors it may deem material, a Committee may determine that a complaint will be set for an Extended Hearing. Notice of an Extended Hearing will be given as provided in Section 4(a).

Hearing Panels

Section 5. (a) The Ethics Committee may sit as a hearing panel, or it may appoint a hearing panel of two or more persons, all of whom are associated with members of the Association, at least one of whom will also be a member of the Ethics Committee unless otherwise directed by the Ethics Committee.

(b) In the event of an Extended Hearing, the Committee will appoint an Extended Hearing Committee of three or more persons, all of whom previously shall have served as members of a Ethics Committee; provided, however, that the Chairman of the

Ethics Committee will have the discretion to appoint to an Extended Hearing Committee one or more current members of the Board of Governors or other Committees and to compensate members of the Extended Hearing Committee at a reasonable rate of compensation.

(c) The requirements of the composition of the hearing panel contained in Sections 5(a) and 5(b) above, may be waived by mutual consent of respondent and complainant.

(d) If respondents waive hearing, and the Committee does not order a hearing on its own motion, the panel will consider the matter on the record, which will include all evidence submitted by the respondents and the complainant, all of which will have been previously tendered by each party to each other.

(e) If a panel is appointed, as provided in 5(a) and 5(b) above, the hearing panel will, after the hearing or upon its consideration of the record, present its recommended findings and sanctions to the full Committee, which will make the final determination by a majority vote of those present and voting at a duly constituted meeting.

Evidence and Procedure in Committee Hearing

Section 6. (a) The Committee staff, or the complainant, will upon make available to respondents and their counsel any documentary evidence and the names of any witnesses the staff intends to present at the hearing no later than five (5) business days prior to the hearing.

(b) Respondents will submit to the Committee staff or the complainant, any documentary evidence and the names of any witnesses respondents intend to present at the hearing no later than five (5) business days prior to the hearing.

(c) If a hearing is held, both the complainant and the respondent will be entitled to be heard in person and by counsel. Formal rules of evidence will not be applicable. Notwithstanding paragraphs (a) or (b), the parties may submit any additional evidence at the hearing as the hearing panel, in its discretion, determines may be relevant and necessary for a complete record. A record of the hearing will be kept in all cases.

Decision of the Committee

Section 7. (a) If the Committee determines that a violation alleged in the complaint has occurred, it will issue a written decision which sets forth:

1. the act or practice which the respondent has been found to have engaged in or omitted;
2. the rule, regulation or statutory provision which such act, practice or omission to act is deemed to violate;
3. the basis upon which the findings are made; and
4. the sanction(s) imposed and the reasons supporting the sanction(s).

(b) If the Committee determines that no violation charged in the complaint has occurred, it will dismiss the complaint in writing.

(c) The decision of the Committee will become final on the next business day following the expiration of a 45 calendar day period from the date of the decision, unless called for review under Article III, Section ~~xxx~~ of this Code.

(d) A copy of the written decision will be sent to all respondents and the complainant named in the complaint and to each member of the Association with whom a respondent is presently an associated person.

Minor Rule Violations

Section 8. (a)(1) Notwithstanding Article II, Section 1 and 2 of the Code of Procedure, the Ethics Committee may, subject to the requirements set forth herein, may impose a fine (not to exceed-----) and / or a censure on any member or person associated with a member with respect to any rule violation listed in the Appendix to this Section.

(2) If the Committee has reason to believe a violation has occurred, the Committee may suggest that the member or person associated with a member submit a Minor Rule Violation Letter specifying in reasonable detail the nature of the violation(s), including the rule, regulation or statutory provision and consenting to the imposition of a specific sanction(s) for the violation(s) and agreeing to waive the member's or person's rights to a hearing before a hearing panel, and all rights of appeal to the Securities Commission of Lithuania and to the courts or to otherwise challenge the validity of the Letter if the Letter is accepted.

(3) The Letter will be submitted to the Committee and, if accepted, the Association will report the violation to the Securities Commission of Lithuania as required by the Commission. If the Committee rejects the Letter, the Committee may take appropriate disciplinary action with respect to the violation(s).

(4) If it becomes necessary for the Committee having jurisdiction to file a complaint against a member or person associated with a member under Article II, Section 2 of this Code, the member or person associated with a member will not be prejudiced in any way by the submission of a Minor Rule Violation Letter under paragraph (2) of this Subsection (b) and the Letter will have no effect and be given no consideration in any determination of the issues involved in the complaint.

Settlement Procedure

Section 9. (a) A respondent in a proceeding before a Committee may at any time propose in writing an Offer of Settlement of the complaint to the Committee.

(b) Offers of Settlement must be made in conformity with the provisions of this Section and they should not be made frivolously or propose a sanction inconsistent with the seriousness of the violations to be found.

(c) Every Offer of Settlement will be in writing and will contain in reasonable detail:

(1) the act or practice which the member or person associated with a member is alleged to have engaged in or omitted;

(2) the rule, regulation or statutory provision which the act, practice or omission to act is alleged to have been violated;

(3) a statement that the respondent consents to findings of fact and violations consistent with the statements contained in the Offer required by paragraphs (c)(1) and (c)(2);

(4) a proposed sanction to be imposed; and

(5) a waiver of all rights of appeal to the Securities Commission of Lithuania and the courts of or to otherwise challenge the validity of the Order issued if the Order of Settlement is accepted.

(d) If an Offer of Settlement is accepted by the Committee, it will propose an order of Acceptance of an Order of Settlement. The proposed Order will make findings of fact, including a statement of the rule, regulation or statutory violated, and impose sanctions consistent with the terms of the Order of Settlement.

(e) The Order of Acceptance of an Order of Settlement will constitute the Committee's decision and will conclude the proceedings as of the date the Order is issued. If the Order includes a penalty of suspension, the suspension will become effective on a date to be set by the President of the Association. Any other sanctions imposed will become effective immediately.

(f) If the Offer of Settlement is rejected by the Committee, the Offer of Settlement will be deemed withdrawn.

(g) Where there is more than one respondent in a proceeding and one or more of the respondents submit an Offer of Settlement, the Offer may be accepted or rejected as to any one or more or all of the respondents submitting the Offer. The proceeding will thereafter be terminated as to those respondents whose Offers of Settlement have been accepted, but their participation may be required at any hearing. The Committee will thereafter proceed pursuant to the regular disciplinary procedures provided for by this Code as to those respondents which did not submit Offers of Settlement.

(h) If an Offer of Settlement is not accepted and it becomes necessary for the Committee to follow the regular disciplinary procedures against the respondent, the respondent will not be prejudiced by the prior Offer of Settlement and it will not be given consideration in the determination of the issues involved in the pending or any other proceedings.

Complaint Docket

Section 10. (a) Each Committee will promptly notify the Association of all complaints issued, and the Association will record all complaints so reported in the Complaint Docket. Committees will promptly notify the Association of changes in the status of every complaint filed including respondent's answers, respondents' request for or waiver of hearings, and the decision of the Committee, which notification will be entered in the Complaint Docket.

Sanctions

Section 11. (a) In any proceedings relating to disciplinary action involving members or associated persons, the Committee may impose any sanction it deems appropriate.

Costs of Proceedings

Section 12. (a) In any disciplinary action, the member or associated person will bear part of the cost of the proceedings as the Committee deems fair and appropriate.

MEMORANDUM

To: Chairman Virgilijus Poderys (Lithuanian Securities Commission)
Commissioners of the Lithuanian Securities Commission

From: James Ryan (The Pragma Corporation)

Cc: Aldas Kriaucinas (USAID)
Rimantas Busila (National Stock Exchange)
Arturas Keleras (Lithuanian Central Depository)
Romas Matiukas (National Association of Finance Brokers)
Jacques DeFay (The Pragma Corporation)
Diana Sokolova (Office File)

Re: The Hypothecation Rule Proposal

Date: September 23, 1998

The purpose of the memorandum is to explain the proposed Hypothecation Rule.

The Hypothecation Rule has the following definitions:

1. "customer" is not the Financial Brokerage Firm (FBF or Brokerage Firm), a general partner of the FBF, a director or officer of the FBF. A customer is not another Brokerage Firm participating in a joint, group or syndicate account or any partner, director or officer. Most accounts including other Brokerage Firms are customers under this definition.

2. "securities carried for the account of a customer" are securities received for the account of the customer. Securities sold to a customer (as principal) and appropriated to a customer, usually on an order ticket or the entries to the customer's ledger account, fit this definition. Securities sold to a customer (as principal) and not appropriated to a customer who has made payment in the usual course of business fit this description.

However, if the securities are subject to an existent lien at the time they would be "securities carried for the account of customers," then the securities would not be "securities carried for the account of a customer" until the prompt release of the securities from the lien.

The proposed hypothecation rule has three prohibitions:

1. Section 1(a) does not allow the commingling of securities carried in the account of a customer with securities carried for the account of another customer without the written permission or consent of each customer. The written permission or consent is usually part of the customer margin agreement. Commingling of securities is the holding in a collateral account the securities of margin customers.

2. Section 1(b) does not allow the commingling of securities carried for the account of a customer with securities of persons or entities that are not customers under its definitions of a customer. These would be the Brokerage Firm itself, its partners, directors or officers and it includes other FBF in a joint, group or syndicate account. It may however include another FBF that is a customer under the definition. The FBF would not be part of a joint, group or syndicate account. The securities of customers may be commingled under a lien for a loan to the Brokerage Firm.

Under this prohibition, the pledgee does not have the right to rehypothecate customer securities unless the pledgee is a FBF, and the FBF itself is subject to the proposed rule. A pledgee is usually a bank that lends money secured by marketable securities.

3. Section 1(c) does not allow the hypothecation of securities in a way that the loans from the banks exceed the aggregate indebtedness of all margin customers, whose securities are pledged as security for the loan. The amount of the loan to the FBF may not be greater than the amount lent by the FBF to its margin customers.

Under this section, the FBF must ensure that the pledgee, usually a bank, cannot have a general lien or a "cross lien" on customer securities for another loan made to the FBF for any other reason. However there may be "one-way liens" in which securities that belong to the FBF may be used as collateral for the loans against customer securities.

This section recognizes that a reasonable period of time, usually one business day, is necessary for the clearance of uncollected items. Further, in the cases where there are both long and short positions, the aggregate indebtedness should include the market value of the short positions of the customers.

The proposed hypothecation rule has the following exemptions:

1. Section 2.3 is the exemption for cash accounts. Purchase transactions by customers are fully paid for by the customer and are not meant to be margin transactions. These securities may be hypothecated until the completion of the transaction, usually the receipt of payment, provided that the customer receives written notice that discloses that the securities are or may be hypothecated along with other customer securities. The important element is that the FBF will act to remove the securities from the collateral account on settlement date or payment date, whichever is later.

2. Section 2.4 is an exemption for clearing house liens, which are day loans only and are necessary for the operation of the Central Depository.

3. Section 2.5 is an exemption to allow the pledging of non-customer securities under a one way lien and for loans made and repaid on the same calendar day.

The proposed hypothecation rule has notice and certification requirements Section 2.6 in which the FBF must give written notice to the pledgee that the securities are carried for the account of a customer(s) and that the hypothecation is in compliance with this rule. If an omnibus arrangement is used, the introducing FBF gives the carrying FBF a signed statement that the securities are carried for the account of customer(s) may be

hypothecated. The hypothecation will not violate this rule. The notice and certification requirements of this section does not apply to a loan made and repaid on the same calendar day.

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October 21, 1998 2:50PM

MEMORANDUM

To: Aldas Kriauciunas
USAID-- Vilnius

From: Kevin J. P. O'Hara
Project Manager

Cc: The Selection Committee
Beverly Loew
Ieva Veidemanis

Re: Critical Tasks Involving NSEL Hardware Assistance

This memorandum is in response to your facsimile wherein you request a list of "critical tasks" concerning the purchase of hardware for the National Stock Exchange of Lithuania ("NSEL").

After our meeting with the Selection Committee last Thursday, I sat down with Arminta Saladziene and discussed a basic time framework for the purchase of the hardware.

Mindful that time is somewhat of the essence, we arrived at the following schedule:

- (1) On or about November 9, 1998, the Selection Committee will draft the "hardware specifications" required for the tender and forward them to me (Kevin O'Hara) at Pragma (USA). Additionally, at this time, the Selection Committee will target those vendors that satisfy the U.S. source requirements to whom they intend to send the tender. (Like the tender for trading system software, this tender will not be "public," but instead will be directed to multiple vendors that appear to manufacture product that meet the specifications.) I will forward the tender documents to the targeted vendors as soon as I receive them from the Selection Committee;
- (2) The deadline for submitting eligible responses from targeted vendors will be 4 weeks after the date of their receipt by the vendors, or on or about December 8, 1998;

- (3) The Selection Committee will carefully review the vendor responses in collaboration with the information technology experts ("techies") at the NSEL. After a thorough evaluation, the Selection Committee will formally make a decision on the merits within 4 weeks of the receipt of the vendor responses, or on or about January 8, 1999;
- (4) After receiving the Selection Committee's formal decision, USAID and Pragma will initiate the process of negotiations with the vendor(s); and,
- (5) Sale, delivery, and installation of hardware to begin at NSEL in March/April 1999.

This critical tasks schedule, of course, is subject to minor changes. However, I believe that all parties concerned understand that time is running quickly so that it is in the interests of all to heed this schedule.

If there are any questions regarding this schedule or the tender process in general, they should be directed to me as soon as possible.

Seminar on Internal Controls, conducted by Jim Ryan,
1998 October 06

List of participants

	Name	Organization
1.	Yreua Cepaitė	UAB PMJ "VB Vilnius"
2.	Viklė Krečiūtė	LCVPD
3.	Laimudas Kelautis	FMI "Klaipėdos VP"
4.	Romualda Venckuvienė	Šiaulių banko FMS
5.	Skirmantas Bumblys	FMS Hansabank Markets
6.	Olga Jarema	AB Bankas "SNORAS"
7.	Loeta Pškevičiūtė	FMI "Vilnius kapitalo rinka"
8.	Nielta Tracijonienė	FMI "Ulaugnilda"
9.	Ričardas Elpidius	FMS "Jisų kognitivus"
10.	Onucija Maudžiūnienė	NPK
11.	Doliz Jaruševytė	NVPB
12.	Giedrus Šteponius	FMS "JMK"
13.	Mulija Gerka	FMI "Sinterus"
14.	Rasa Garnevičienė	VPK
15.	Edita Jelskaitė	DPK
16.	Jolanta Laurienė	
17.	Saulius Malinauskas	NVPB
18.	Česlovas Atkočiūnas	VPK
19.	Alvidas Nicaura	NVPB
20.	Eimutis Veselka	FMI "Alterra Invest"

Seminar on Internal Controls, conducted by Jim Ryan,
1998 October 06

List of participants

Name	Organization
1. Rita Blezyte	UPK
2. Tomas Dubnikovas	"Jūsų tarpininkas"
3. Tomas Pukas	"Jūsų tarpininkas"
4. Karys Adomavicius	daktaras zemes ūkio bankas
5. Skarste Petraslavici	NVPB
6. Rita Butkute	NVPB
7. Dalis Skarstas	FMS, Finasta
8. Sigita Gedeli	NFMA
9. Jevina Uelickaitė	Medicinos 6-ko FMS
10. Justina Alina	LTB FMD
11. Arvydas Paškevičius	Pragma Corporation

Open-End Investment Fund XYZ

Statement of Assets and Liabilities

The end of the accountable period _____

No	Name of the Item	Amount
	Assets	
1.	Investments in securities (acquisition cost _____)	
2.	Cash	
3.	Amounts receivable:	
3.1.	dividends and interest	
3.2.	securities sold	
3.3.	capital stock sold	
4.	Other assets	
5.	Accrued income and deferred charges	
6.	Total assets	
	Liabilities	
7.	Amounts payable:	
7.1.	investment securities purchased	
7.2.	capital stock redeemed	
7.3.	other amounts payable	
8.	Short-term liabilities to banks	
9.	Accrued charges and deferred income	
10.	Dividend for distribution	
11.	Total liabilities	
	Net Own Assets	
12.	Net own assets (____ units of capital stock outstanding the current value of which is _____ litas)	

Notes to Financial Statements are an integral part of these financial statements.

Open-End Investment Fund XYZ

Statement of Operations

The end of the accountable period _____

No.	Name of the Item	Amount
	Investment Income	
1.	Dividends	
2.	Interest	
3.	Total Investment Income	
	Expenses	
4.	Investment advisory fee	
5.	Interest	
6.	Custodian and transfer agent fees	
7.	Distribution expenses	
8.	State and local taxes other than income taxes	
9.	Remuneration of directors and employees	
10.	Other expenses and commissions	
11.	Total expenses	
12.	Net investment income (expenses) (3-11)	
	Realized and unrealized gain (loss) on investments in securities	
13.	Realized gain (loss) on investments in securities	
14.	Unrealized appreciation (depreciation) of value of investments in securities	
15.	Net gain (loss) on investments in securities	
16.	Net increase (decrease) in net assets resulting from operations (12+15)	

Notes to Financial Statements are an integral part of these financial statements.

Open-End Investment Fund XYZ

Statement of Changes in Net Assets

The end of the accountable period _____

No.	Name of the Item	Amount
	Change in net assets resulting from operations	
1.	Net investment income (expenses)	
2.	Realized gain (loss) on investments to securities	
3.	Change in unrealized appreciation (depreciation) of value of investments into securities in a year	
4.	Net increase (decrease) in net assets resulting from operations (1+2+3)	
5.	Result of equalization	
6.	Distributions to shareholders from:	
6.1.	net investment income	
6.2.	net realized gain (loss) on investments	
7.	Increase (decrease) in capital share	
8.	Change in net assets during the period (4+5+6+7)	
9.	Net assets at the beginning of the accountable period	
10.	Net assets at the end of the accountable period	

Notes to Financial Statements are an integral part of these financial statements.

Open-End Investment Fund XYZ

Statement of Investments in Securities

The end of the accountable period _____

Arrange securities by industries or other groupings with regard to diversification requirements for the investment fund's securities portfolio, i.e. amounts of investments in concrete securities and compare its volume with net asset value (NAV). Also, specify the share that investment takes in the whole capital of the issuer. Show the nominal value and the fair value of these securities in respective columns. Investments into securities may be grouped according to the branches of industry, sectors, etc.

A sample Statement of Investments in Securities is provided below:

Name of Investment	Nominal Value of Securities	Fair Value of Securities
1. Common shares		
Vilniaus Bankas - 3 % (NAV)		
2 % ordinary shares purchased on Sept. 10, 1998	10,000	225,000
2.23 % ordinary shares purchased on Sept. 14, 1998	11,000	240,000
4 % ordinary shares purchased on Sept. 22, 1998	35,000	680,000
Hermio Bankas - 5 % (NAV)		
...		
2. T-bills - 10 % (NAV)		
T-bills 5 % due		

Description of Principles (Methods) of Financial Accounting Applied for Investment Funds

Open-end investment funds (further - investment funds), based on the circumstances of their establishment, may have no hired employees, therefore the management of securities portfolios, securities offering, accounting and reporting as well as custody of securities shall be delegated to other firms. The investment fund and firms providing these services shall sign appropriate agreements concerning these services. However, the use of services of said enterprises in handling accounting and other administrative functions shall not exempt the Board of Directors (or other managing body of the fund) from the responsibility against the shareholders of the fund concerning the reliability of the fund's accounting, guarantee of proper functioning of internal controls and accuracy of the fund's financial accounting.

This recommendation presents a description of the characteristic features of financial accounting in investment funds. The main principles of internal controls in the investment fund are also provided.

1. Investment Accounts

1.1 The securities portfolio of an investment fund (investment assets) is the main account in the Assets section of the Statement of Assets and Liabilities. The scope of investment of the investment fund depends on the legal basis of the investment fund. If the investment fund is established as an entity holding without the rights of a legal person, it will hold no other assets. An investment fund which is a legal entity may also have other types of assets (long-term, short-term assets), but the share of those types of assets should be insignificant, otherwise gain generating assets would be too small for the fund to gain profit. Securities earn such income as dividend, interest, and profit on investments into securities as long as they are in possession of the fund.

Investment Goals and Investment Policy

1.2 The composition of an investment fund's portfolio mainly depends on the investment goals of the fund and its strategy to attain those goals. Naturally, the composition of the investment portfolio shall meet the diversification requirements as provided in the Law on Investment Companies. Prior to offering its securities publicly, the fund has to disclose its investment goals, the strategy to attain those goals, restrictions in attaining those goals (no investment into real estate, no investment into certain securities on the local market or foreign stock markets, etc.)

1.3 If an investment fund changes its investment policy (goals), the approval of its shareholders is required.

Requirements for internal controls of an investment fund

- 1.4 In order to carry out the accounting of the investment portfolio, the fund must have the following registers: (a) register of investment operations in which all transactions with securities shall be recorded, their sale and purchase, their entering or writing off, receipt or payment of cash for securities; (b) register of each security which would reflect the name of the security, amount, price and aggregated value after each transaction with securities in which securities are recorded by the trading day; (c) register of each item of the securities portfolio in which all trade orders on behalf of the fund and the status of these orders shall be recorded.
- 1.5 Where the accounting of an investment fund is handled by a custodian, underwriter, or other similar institution, the fund must conclude an agreement with its account operator (custodian) in order to have the latter maintain all the required registers and prepare reports within certain regular intervals.
- 1.6 An investment fund must transfer its securities into custody of an institution licensed to engage in this type of activities. The securities custodian must be approved by the general meeting of the fund's shareholders. The agreement between the fund and the custodian shall, among other things, contain the following: (a) the fund's securities shall be segregated from the assets of the custodian (they have to be recorded in off balance accounts); (b) the securities custodian shall not be entitled to use or take advantage of the securities in its custody in any way, except for execution of the investment fund's or its authorized enterprise's orders; (c) in case of lien (attachment?) on the assets of the custodian, the investment fund's securities shall not be subject to lien; employees of the Securities Commission or auditors shall have a facility to inspect securities in custody of the custodian at any time.
- 1.7 the proceeds of the investment fund received after the sales of securities shall also be kept in custody separately from the investment fund's assets. An investment fund may only have in hand small amounts necessary for redemption of its shares (capital stock) in small quantities or for other expenses. All other funds shall be kept in a special account opened with a bank, the purpose of which is to ensure safekeeping of the investment fund's cash. The requirements for safekeeping of securities shall be also binding in case of cash.
- 1.8 the investment policy of the investment fund which is usually provided in the prospectus of the fund shall be formed by the Board of Directors which is also in charge of its implementation. Routine operations, however, are usually delegated to the investment committee, investment manager or consultant, or the like. Investment decisions are usually realized by placing orders to buy or sell securities with a brokerage firm. In order to ensure adequate controls of all these segments, the following procedures shall be used:
 - 1.8.1. when placing a buy order with a broker, a person responsible for the confirmation of orders and their placement must record that operation by entering into the books the name of the security, their number, price, date and time when the order is placed and when it is executed, the rate or the amount of the commissions, the name of the brokerage firm and the reasons why this particular firm was

selected. the execution of the transaction must be confirmed by phone and then in writing;

- 1.8.2. upon entering into securities transactions the investment fund shall notify the custodian about those transactions and give detailed instructions in writing to enter or write off the securities and cash. These instructions shall specify the name of the brokerage firm, the name of the security and their amount, trade day and settlement day, the amount of cash which must be received or paid. The instruction shall be signed by one or several authorized persons, the signature samples of which must be delivered to the securities custodian. Where instructions are given on the phone, later they must be confirmed in writing;
- 1.8.3. a financial brokerage firm, upon executing the order of the custodian, must issue a confirmation about the execution of the order which is promptly checked as to its execution according to all conditions set forth in it. the confirmation must contain all information specified in item 1.8.1;
- 1.8.4. the securities custodian, in its turn, shall issue a confirmation for the investment fund about the monetary settlement and writing off or entering of securities. Information contained in this confirmation shall be compared with the information in the records of the investment fund. Any discrepancies must be promptly corrected;
- 18.5 at the end of each reporting period the securities custodian must prepare the statement of changes in cash and securities accounts. The balances of all securities and cash may be shown following the chronological list of transactions. The investment fund must compare the contents of these reports with the records in its books of accounts and discover all discrepancies if there are any.

Net Asset Value Per Unit of Capital Stock (Per Share)

- 1.9 all investment funds must, on each trading day in the National Stock Exchange, calculate and publicly announce the net asset value per share. Where an investment fund does not offer or redeem its shares on a daily basis, their price shall not necessarily be announced every day. It is recommended, however, that the price of the fund's shares, i.e. the net asset value per share, be calculated in the fund every day.
- 1.10. the main part of the investment fund's assets, the securities portfolio, shall be accounted at the market value or fair value. In order to accurately reflect the value of the fund's shares, the fund's securities portfolio must be reevaluated and income and expenses accrued each time when net asset value per share is calculated or when capital stock is issued or redeemed. To sum it up, the following operations shall be carried out when calculating net (own) asset value per share:
 - 1.10.1. revise the value of securities. Changes in securities positions shall be established on the following day after purchase / sale of securities;

- 1.10.2. establish the changes in stock capital: establish the number of outstanding shares, allocate investment income to the shares, etc. These changes shall be entered no later than on the following working day of the transaction;
 - 1.10.3. expenses shall be accrued to the date of calculation;
 - 1.10.4. interest and other income shall be accrued to the date of calculation;
 - 1.10.5. dividend for equity securities in the securities portfolio shall be recognized from the day of the general shareholder meeting that approved payment of dividends;
 - 1.10.6. other operations to be discussed below.
- 1.11. As establishment of net (own) asset value per share is very important both for the fund's share holders and for the investment fund itself, the authorized persons of the fund shall carry out an independent checking of the fair value of securities comprising the investment portfolio. It is recommended that the procedure of this valuation be documented providing all necessary explanations.

The Basis for Entering Securities into Accounts

- 1.12 An investment fund must record transactions with securities in its books following the trading day principle, i.e. when a buy/sell transaction of securities is recorded. Due to this fact, financial statements of the investment fund contain accounts for amounts receivable and payable in case of purchase or sale of securities.
- 1.13 When carrying out off-the-exchange transactions, securities transactions shall be recorded when the title to securities is actually acquired, or when payment for the securities is received, or when the obligation to pay for the securities purchased or the obligation to deliver the securities sold comes into effect.

Some Methods of Securities Valuation

- 1.14 Listed securities that are actively traded on an organized stock market shall be valued according to their market value which is established every day. If securities are traded every day, they shall be valued according to their last quoted sales price. If on the day of valuation there was no trading in the security, the value established on the previous trading day may be used. If there was no trading in the security for a longer period of time, its value shall be established on the basis of other acceptable methods that are briefly described in item 1.16.
- 1.15 If bid / ask prices of a security are announced, the value of a security shall be established within the range of the closing bid and ask prices of the security. It is recommended that the announced bid price be shown as the value of the security or the average arithmetic mean of bid and ask prices. Moreover, buy and sell prices of the security at the close of several trading days in a row should be reviewed. One should not be guided by the announced buy price of the security. Where it is

possible, prices announced by several independent organizations or enterprises shall be taken into consideration.

1.16 When it is impossible to establish the value of a security on the basis of the analysis of its market prices due to absence of trading in that security for a prolonged period or due to trading in very small amounts (several or several tens of securities), due to unreliability of the prices of these securities, or due to other reasons, alternative methods of securities valuation shall be employed. The objective of those methods is to help establish how much the holder of these securities can get for the securities he holds in the near time. The acceptable alternative valuation methods are based on the amount of discounted income, on a discount from the market value of a security, on the comparison with similar securities that are actively traded on an organized stock market; in case of debt securities, on income on the coupon before its maturity. A combination of this and other methods of securities valuation may be used. If investment is made into several securities issued by the same issuer, all these securities may be valued as a block.

1.17 When evaluating securities, the value of which cannot be established on the basis of the market price at an organized stock exchange (exchanges), the following factors shall be considered: (a) the financial status of the issuer; (b) the issuer's business or financial plan; (c) acquisition cost of the security; (d) the amount of securities held, their liquidity or demand; (e) restrictions foreseen in the agreement as to the sale of securities; (f) public offering; (g) pending reorganization activity affecting the instrument (e.g. tender offer, restructurization of debt securities, a possible merger of the issuer, etc.); (h) existence of market prices of similar or comparable securities of a similar or comparable issuer; (k) change in economic conditions that might exercise an influence upon the issuer. The number of these factors may be even bigger, yet, adherence to them should be given careful consideration.

In case of a tender offer, the investment fund shall value securities according to the previously employed methods disregarding the tender offer. Only after the conditions of the tender offer are approved is it possible to re-evaluate these securities with regard to the price offered for them or the value of other assets.

1.18 the Board of Directors of the investment fund shall make sure and resolve that the valuation methods are appropriate and that all factors of importance are taken into consideration. the decisions of the Board of Directors shall be recorded in the minutes of their meetings. It is desirable that all materials on the basis of which decisions are taken be attached to the minutes. the Board of Directors may also invite independent experts to advise them on these issues.

Accounting of Investments into Money Market Instruments and T-Bills

1.19 Short-term investments, such as investments into T-bills, commercial papers, bank deposit certificates and others are acquired at their par or discount value. The value of these investments on the secondary market usually is different from their value (interest rate) as established on the primary market and is determined on the basis of their demand and supply or on the yield on security (T-bills) and the market interest

rate. In that way, on the secondary market these instruments (T-bills) are sold at a premium or discount which has to be amortized until the maturity of the instrument. When acquiring them, these investments shall be recorded at the acquisition cost, and later re-valued with regard to the changes in the market price.

- 1.20 The amortized value of short-term money market instruments or the value of T-bills usually is close to their market value and no revaluation is needed. In certain cases, however, for instance, when the credit rating of the issuer of that instrument is decreased, the market value of these instruments drops considerably and it must be re-valued in the accounts of the investment fund.

Accounting of Investments into Foreign Securities

- 1.21 Securities issued by foreign issuers usually are denominated in foreign currencies. Dividends and interest on securities are also paid in a foreign currency.

- 1.22 Upon acquisition, such securities shall be recorded by their value in litas following the official exchange rate of foreign currencies. Later, each time when the net value per redeemable share is calculated, the realized or unrealized gain (loss) from securities issued abroad shall be determined.

- 1.23 Realized and unrealized gain (loss) from securities denominated in a foreign currency and from foreign currencies held is received in the following cases: (a) when securities issued abroad or foreign currencies are bought, sold, or held; (b) when the value of securities issued abroad changes (unrealized gain (loss) occurs due to the change in the value of the securities /currency; (c) when dividends and interest are received from securities issued abroad; (d) when there are expenses in a foreign currency, such as agency commissions and the like; (e) when the investment fund has amounts receivable, payable or accrued in a foreign currency.

- 1.24 Gain (loss) from securities denominated in a foreign currency or from foreign currencies held by the fund may be accounted separately or together with a respective position. For instance, when foreign securities are acquired, the difference that occurs between the exchange rate of the litas and that of a respective foreign currency on the trade day and on the settlement day may be recorded in the unrealized gain (loss) from foreign currency account (i.e. this difference shall be accounted separately) or this difference may be used to adjust the acquisition cost of the securities purchased (except the cases when such a transaction is hedged by a forward currency transaction. Accrued interest and compound dividends (if dividends are accrued???) are recorded in a similar way.

- 1.25 When the market value of securities held changes, the accounts of the investment fund shall reflect unrealized appreciation (depreciation) of value of investments in securities and unrealized appreciation (depreciation) of value of foreign currencies resulting from the change in the value of securities (the amount of unrealized gain (loss) changes accordingly) from the change in the rate of national and foreign currencies. Again, these differences may be recorded and provided in the statements together or separately with regard to the importance of that information to risk management against changes in foreign exchange rates and to financial information

for the investors to make a decision. These principles shall also be applied in the event the investment fund has acquired short-term debt securities that are recorded by amortizing the premium or discount already paid.

Accounting of Income from Dividends

- 1.26. An investment fund shall recognize income from dividends at the time payment of dividends is approved by the general shareholder meeting of the company, the securities of which the investment fund owns.
- 1.27 When the general shareholder meeting of that company decides, instead of dividends, to issue new equity securities of the same class, these securities shall not be recognized as investment income. These securities shall be entered into the investment account. When the investment fund can choose whether to receive dividends in cash or equity securities of the company, these securities may be recognized as investment income to the amount that would be paid as dividends. Other dividends that were allocated to the investment fund in a different than monetary form may be recognized as investment income but should be recorded after their proper evaluation (in their fair value preferably). In the event a company allocates its shareholders (the investment fund) the rights in proportion to the amount of equity securities held by them, the fund, in its turn, shall allocate these rights to the securities it holds. In the event the investment fund holds short positions, dividends approved by the general shareholder meeting of the company shall be recognized as expenses (costs).
- 1.28. An investment fund shall establish proper internal procedures with regard to timely recognition of dividends, their accounting, collecting or formation of dividend provisions when they are not collected in time.

Accounting of Income from Interest

- 1.29. Income on debt securities shall be accrued and recognized every day. In the event debt securities (e.g. T-bills) are acquired at a discount or premium, this discount or premium shall be amortized in the income from interest account every day too.
- 1.30. The investment fund shall establish proper internal procedures for accrual and recognition of income from interest and analysis of accrued interest taking into consideration the collection of income from accrued interest.

Sales of Securities

- 1.31. For the purposes of financial accounting the cost of the investment fund's securities and realized gain (loss) in case of sales of securities may be established only following the specific identification method or the average-cost method. (For tax purposes a different procedure may be established. In the USA accounting for tax purposes only the method of specific identification may be used.) The investment fund may use only one of these methods for all securities it holds. (An alternative: the fund may use the method of average cost when it trades in one class of securities (e.g. T-bills) very actively. In all other case it may use the method of

specific identification). The amortization cost shall include commissions for the sale of securities, etc.

- 1.32 Interest accrued on debt securities between the dates of interest payment shall be recorded in the accounting as receivable interest. As it was mentioned above, premium or discount of debt securities shall be amortized through the income from interest account (or maybe, some other account?). Amortization methods of premium or discount of debt securities shall be disclosed in the Explanatory Note of the investment fund.

2. Accounting of the Investment Fund's Capital Stock (Redeemable Shares)

Distribution of the Investment Fund's Shares

- 2.1 Redeemable shares of the investment fund may be distributed to the public in various ways. The fund may sell its redeemable shares directly to the public, it may engage a principal underwriter or retail distributors. There may be other methods of securities distribution.
- 2.2 Accounting of redeemable shares depends on the selected method of distribution. For instance, when redeemable shares are distributed with the help of an underwriter, the latter buys all securities issue (or the established amount) for its own account and then sells them directly to investors or retail distributors (financial brokerage firms). In that case the fund knows the number of its shares and their price at the moment of the transaction and can report that in its accounts. When distribution is carried out with the help of wholesale and retail distributors, the fund must receive information about the number of shares distributed or redeemed every day. The prices at which the shares are distributed or redeemed shall be announced by the fund itself (when the accounting is carried out by the fund) on the basis of net asset value per share, but distributors take a commission fee (sales commission) which is included into the sales or redemption price of the share. Therefore, this information shall reach the fund fast enough in order to be able to calculate the net asset value per share.
- 2.3 Investment funds may draw a contract of securities distribution (or other), which should provide for the varying commission fee for securities distribution. In that case the fund shall establish proper internal controls to ensure fair calculation of the commissions with regard to the distributed amount of shares, etc.
- 2.4 Information about operations with the fund's shares shall be recorded in sales and redemption registers of equity securities. These registers shall contain all relevant information related to the sales of shares and all other necessary information.

Cancellation of orders

(This section will require corrections based on the rules on distribution of redeemable shares, namely, on the number of days during which the investor will be required to pay for the shares and whether a possibility to withdraw the buy order is foreseen.)

2.5 Orders to buy or redeem shares in certain cases may be withdrawn. That may be done by the investor or the brokerage firm. In that case the fund may carry a gain or a loss due to the change in net asset value per share during the period from the day of sales of securities and until the day of withdrawal of the order.

2.6 In the event the fund's securities are distributed with the help of an underwriter, that gain or loss due to the reasons referred to in item 2.5 may be transferred to the underwriter or financial brokerage firm. This situation should be defined in the distribution agreement. When accounting this gain or loss the following principle shall be employed: the loss must be recognized immediately while the gain may be accrued for the coverage of the possible future losses and must be left undistributed.
(?)

Accounting of Redeemable Shares

(The accounting of redeemable shares shall be based on the assumption that these shares will be accounted only by units and on the net asset value per share. In the USA, investment funds that function as investment management enterprises conduct the accounting of redeemable shares according to their par value and additional paid-in capital for the amount paid over the par value)

2.7 Accounting of the investment fund's redeemable shares is to some extent similar to the accounting of equity shares of other firms. The difference is that these are accounted by units and on the basis of the net asset value per share at a certain moment. When selling shares, the fund's equity account is credited and when they are redeemed, it is debited. In order to keep undistributed income from being affected by changes in the number of shares outstanding (i.e. in order to retain net asset value per share unchanged), the method of equalization may (must?) be used, which is discussed in item 2.8. (This approach depends on the order that the investment fund selects for payment of dividends to its shareholders. If dividends are paid only from net investment income (interest + dividend - expenses of the fund), the equalization method for the undistributed share of investment income shall be applied. If dividends are paid from accrued realized gain, the same method shall be applied for the undistributed share of this gain. However, if dividends are not paid from realized gain on investments into securities or if the fund has the realized loss from investments into securities, the equalization method shall not be applied. This method is not applied for accrued unrealized gain or loss on investments into securities either.)

2.8. The equalization method is used in order to retain the undistributed net investment gain per share unchanged at the regular sale of the new shares of capital stock or redemption of the old. That means that the amount of undistributed income available for distribution per each share of capital stock is relatively decreasing when these shares are sold (issued) and increasing when they are redeemed.

Here is an example of equalization. An investment fund has 1 thousand redeemable shares and net own assets of 7.5 thousand litas, including 500 litas of undistributed income which will be distributed to the fund's shareholders as dividends. Each share is allocated 0.5 litas (500 litas of undistributed income divided by 1000 shares) of

undistributed net income. Let's say the fund sells 100 shares for 7.5 litas. All in all the fund receives 750 litas, 700 of which is transferred into the account of capital stock redeemed, and 50 litas shall be entered into the equalization account. That means that the fund has 1100 outstanding shares. Should they have to distribute the undistributed net investment income, the shareholders would receive 0.45 litas per share. That would be unfair with regard to shareholders who acquired the shares earlier (those who owned 1000 shares) as part of the undistributed income earned by their shares would be allocated to the new shareholders. By using the equalization method 50 litas shall be transferred from the equalization account into undistributed income, in which case all shareholders of all 1100 shares would get 0.5 litas per share. When redeemable shares are redeemed, the fund shall pay for them on the basis of the net asset value per share. In the example above the fund has issued 1100 shares, and its net own assets are $7500 + 750 = 8250$ litas, i.e. the share price is the same 7.5 litas. That way, when selling the fund's shares, shareholders will get part of dividends belonging to them as these will be included into the value of these shares. Accordingly, the undistributed net investment income per share, 0.5 litas, must be debited into the equalization account. Where it is not done, the remaining shareholders would get a relatively higher dividend, i.e. more than 0.5 litas per share.

2.9. The investment fund shall establish proper procedures for the accounting of redeemable shares in units and value, investment income (dividends, interest), realized and unrealized gain (loss), the equalization account, undistributed dividends, distributed but not yet paid dividends. Moreover, on the basis of the share issue prospectus and decisions of the general shareholder meetings the fund may, instead of dividends to be distributed, issue new redeemable shares that could be distributed among the shareholders of the fund. Then the fund shall establish procedures or methods of how these newly issued shares will be evaluated. Usually it is done on the net asset value per share on the first day following the general meeting that approved of the payment of dividends (or re-investment of dividends). As soon as new shares are issued, they have to be recognized in the accounts of the fund.

3. Other Principles of Financial Accounting

Compensation for Investment Management

(This item must be coordinated with the provisions of the rules setting forth the requirements for agreements between the investment fund and investment management and consulting firms)

3.1 Advisory fee paid to the investment management and consulting firm is usually one of the main expense accounts of the investment fund. Based on the contractual agreement between the fund and the investment management and consulting firm, this compensation may be calculated every day when net asset value per share is calculated. The compensation may be calculated on some other basis, e.g. a fixed amount as a percentage of the average net asset value and performance fee may be paid.

Amendments and Supplements to the Law on Investment
Companies of the Republic of Lithuania

1. Supplement and amendment to the definitions of concepts: "Diversified investment portfolio is the investment portfolio which meets the following requirements:
 - 1) No more than 5 per cent of the investment company net (own) capital have been invested in the securities issued by one issuer, **except in cases when securities issued or guaranteed by municipality (the state) are acquired and the by-laws of the investment fund contains data provided for in item 15, Part 7, Article 5 of this Law.**
 - 2) No more than 10 per cent of **voting** shares of one issuer have been purchased;
 - 3) No more than 10 percent of **non-voting** shares of one issuer have been purchased
 - 4) No more than 10 per cent 10 per cent of debt securities of one issuer have been purchased, **except cases when the investment company acquires securities issued (or) guaranteed by the municipality (the State).**
 - 5) No more than 30 per cent of the net (own) assets of the investment company has been invested into securities issued or guaranteed by the government (the State), and the investment portfolio is made up of securities of no less than 6 issues.
2. Supplement the definition of concepts: "**Persons related to the custodians or management enterprise shall be entities controlled by management enterprises or custodians or controlling the management enterprises and custodians, or managers of the management enterprises or the custodians. In cases when the controlled or controlling persons are legal persons, managers of these legal persons are deemed related persons. The related persons shall also include managers of other legal persons, belonging to the same group as the custodian or the management enterprise. The controlling entity shall be a legal or natural person which being a shareholder (member) itself holds more than one third of all votes, or according to an agreement with other shareholders (members) holds a solitary control of more than one third of all votes, or is vested with a right to elect (appoint) majority of members of the Supervisory Board or the Head of the Administration, or exercises actual control over the decisions made by the legal person**". Indirect investment - investment of the controlled entity deemed the indirect investment of the controlling entity. Significant investment - acquisition of securities which grants 10% or more of votes in the general meeting of shareholders, or acquisition of more than 10% of securities not granting the votes or more than 10% of debt securities.
3. Supplement the definitions of concepts: "**Derivative securities - financial instruments confirming the right or an obligation to acquire (sell) financing means confirming the participation in the stock capital or (and) rights, arising from the credit relations, and granting the right to receive interest, dividends and other revenues.**

4. Amend part 1 of Article 3 and lay down as follows: The Investment company is a public company (**with the exceptions provided for in part 4 of this Article**), which accumulates funds of legal and natural persons through offering its own securities and has at least one of the following characteristics:

- 1) Investment or reinvested in securities and/or trading in securities constitutes the principal activity generating over 60 percent of income (**except cases provided for in part 2 of this Article**);
- 2) securities constitute more than 50 percent of the company's property value.

2. **Activities of investment fund generating revenues of the fund may be only investment and reinvestment of funds received from public offering of the redeemable shares of the investment fund and trading in securities. Also, without prejudice to the provisions¹ of this law an investment fund may receive proceeds from the term deposits in commercial banks or other instruments of money market and only to the extent it is necessary to secure against the currency risk or avoid the impact of the inflation upon funds of the investment fund. The investment fund shall be precluded from involving into other activities (or the investment fund shall be precluded from receiving funds from other sources).**

Parts two and three of this Article shall be deemed parts 3 and 4 respectively.

5. Supplement to part 2 of Article 4: **The Investment Fund does not have a authorized capital to be registered. Upon issuing or redeeming the securities of the investment fund the capital gain or loss shall not be registered. Provisions of the Company Law regarding the change of the authorized capital of the company and the resulting registration of changes of the by-laws of the company in the Enterprise Register are not applied to investment funds.**

6. Amendment of part 4, Article 5: **Shares of the first issue of the newly established closed-end investment fund or an investment holding fund may be purchased only by its founders. Founders of the investment fund shall acquire shares of the newly founded investment fund for an amount not less than the minimum authorized capital of the investment fund set forth in part 1, Article 6 of this Law. Shares acquired by founders of the investment fund shall be paid up prior to the issuance of the permit to engage in the activity of the investment company**".

7. Insert part 5 (between the current parts 4 and 5): **Within 7 days from the general meeting of shareholders founders of the investment fund shall transfer the assets constituted of cash funds and securities transfer to the custody in the Central securities Depository and shall transfer the asset management to the investment fund asset management enterprise.**

8. Amend part 5 of Article 5: Seeking to obtain a permit the investment company (when the investment company is founded - the founders) shall file an application

¹ Without prejudice to the provisions of the law means that the investment norms shall be adhered to.

3.2 As this expense account is one of the most important for an investment fund, the latter shall establish proper procedures of internal controls to ensure fair calculation of the advisory fee. Adequacy of investment decisions shall be also checked to a certain extent, e.g. compliance with the restrictions set forth, churning, etc. (maybe that function can be delegated to the Central Depository?). When the performance fee is paid, its amount depends to a large extent on valuation methods used to determine the value of shares. Therefore, valuation methods must be properly evaluated.

Founding Expenses

3.3. Founding expenses may be accounted in several ways depending on the way the fund is founded. In the event an investment fund is founded by a management enterprise as a non-legal entity (without the rights of a legal entity), all founding expenses shall be accepted by the management enterprise and recognized as its expenses. When the fund is established as a legal entity, the management of which is transferred to the investment management and consulting firm, the founding expenses shall be accepted by the fund itself.

3.4 Expenses of an open-end investment fund are incurred only until the moment it is registered with the Securities Commission (or more exactly, until its redeemable shares are registered with the Securities Commission). From the moment the fund (its shares) is registered, all expenses incurred shall be deemed expenses of the fund.

3.5 Founding expenses, such as preparation and publication of the prospectus, registration costs, etc., shall be recognized as deferred expenses of the fund (recorded in the section of "Liabilities") and have to be amortized during a certain period. That means costs deferred should be amortized to income over the period that a benefit is expected to be realized. The order of recognition and amortization of expenses shall be disclosed in the Explanatory Notes attached to the financial statements. The general principle of amortization of expenses is based on the requirement to have them amortized in the period no longer than 5 years with the help of the direct method. The fund may use some other method too if it proves in the Explanatory Notes that it is more appropriate. Moreover, in case of necessity the fund may change the established period for amortization, having revealed causes and effects of this change in the Explanatory Notes attached to the financial statements.

3.6 Where the newly established investment fund itself (after it registers its shares with the Securities Commission) distributes its shares and manages its securities portfolio (unless there is a mandatory requirement transfer management of the fund's portfolio to the management enterprise) what under usual circumstances is done by other firms (broker-dealers, investment management firms), staff training on issues of securities distribution, market making and other related expenses shall be treated as expenses of the fund and by no means can these expenses recognized as deferred expenses (charges?).

Unusual Income Items

3.7 Unusual income items such as amounts recovered from the settlement of litigation for which earlier provisions were made shall be recorded in the account of "Other income" in the Statement of Operations. Where this amount is material, explanations should be provided in the Explanatory Notes attached to the financial statements. When the fund acquires an inforceable right to recover a certain item, it should be valued by the fund's Board of Directors (or a respective body). Later, if appropriate, the item shall be re-evaluated.

Expenses of Distribution of the Fund's Redeemable Shares

(this item must be harmonized with the rules on distribution of the investment fund's shares)

3.8 In its prospectus an investment fund may provide for the distribution expenses of the investment fund's redeemable shares to be covered by the fund itself, i.e. investors will not be paying for acquisition of the fund's redeemable shares. In that case the expenses of distribution of the fund's redeemable shares in the form of commissions to the distributors and the like shall be recorded in the operational expenses of the fund.

with the Securities Commission. **The application shall be filed in accordance with rules approved by the Securities Commission.**

9. Supplement to part 6, Article 5: **or the agreement is concluded whether it is required by the law or not”.**
10. Supplement item 5 of part 7, Article 5: **the number and par value of the closed-end fund or investment holding company shares, by-laws of the investment fund may indicate the largest number of shares the investment fund plans to issue.**
11. Item 11, part 7, Article 5: **regulations of own (net) asset evaluation and establishment of investment fund share sale and redemption price;**
12. Supplement item 6 of part 7, Article 5, and lay down as follows: **rights attaching to the shares, terms and conditions for sale and redemption of shares of investment fund, terms and conditions for settlement for redeemed or sold shares, term for settlement for redeemed shares may not be longer than four days from the day the redemption transaction has been executed; the term for settlement for sold securities may not be longer than 3 days from the order to sell the shares; the procedure to suspend the redemption of shares; the perms and procedures for the suspenssion or termination of the sale of shares”.**
13. Amend item 10, part 7, Article 5: **Increase of investment portfolio value and other income distribution policy”.**
14. Supplement by item 15, part 7, Article 5: **Where the investment of closed-end investment fund intends to invest more than 35% of its own (net) assets in securities issued or guaranteed by one State (municipality), the State (municipality) shall be indicated in the by-laws of the investment fund or closed-end investment fund. (part 2, Article 23 of the Directive).**
15. Supplement to part 8, Article 5: **The Commission may refuse to issue the permit in cases when changes of the by-laws, management enterprise or depository contradicts the interests of the shareholders or there are no guarantees that their rights will be secured and also in cases when such changes contradict laws or other legal acts”.**
16. Amend item 4, part 9 , Article 5: **Not all shares of the first issue of the newly established closed-end investment fund or an investment holding company are fully paid up or founders of closed-end investment company or an investment holding company have purchased only part of the shares of the first issue; or founders of the investment fund have acquired shares for an amount which is less than the minimum own capital of the investment fund established by part 1, Article 6 of this Law, or the initial minimum capital of the investment fund, as referred to in part 1 of Article 6 of this Law has not been fully paid up”.**
17. Repeal part 11 of Article 5.
18. Part 12, Article 5, amend the second sentence: **It shall be prohibited to reorganize the investment fund. It shall be prohibited to modify (change) the activity of the investment fund.**
19. Supplement item 6, part 13, Article 5: **“ except cases when the circumstances appeared by fault of the depository and the management enterprise”.**
20. Supplement item 7, part 13, Article 5: **“except cases when the depository or the management enterprise are to be held responsible for that”.**
21. Supplement part 13 by adding a sentence: **“ In cases when the basis for revocation of the license referred to in items 6 and 7 emerges by fault of the depository or the management enterprise of the investment company, the Securities Commission has a right to instruct the investment company to**

change the depository or (and) the depository in the manner provided by this law.

22. Amend third sentence of part 15, Article 5: Information concerning the investment company's liquidation process and **terms and other information related to the liquidation of the investment company**, may be presented to every shareholder who requests it, to a directly interested third person and the Securities Commission **pursuant to the rules approved by the Securities Commission**. Supplement by last sentence: **The sale and redemption of the shares of the investment fund under liquidation shall be prohibited.**
23. New part 17 of the Article 5: **Investment funds shall be precluded from founding subsidiaries.**
24. New part 18 of the Article 5: **Provisions of part 5 Article 13 of the Law on Investment Companies shall not be applied to investment companies.**
25. Amendment to part 2 of Article 6: Contributions in kind may account for no more than 20% of the authorized (**initial own**) capital of the investment company **at the time of foundation of the company.**
26. Amend part 3 of Article 6 and lay down as follows: When the authorized own capital of the **close-end investment fund or an investment holding company or issuing the shares of the investment fund**, the shareholders shall have no preemptive rights with respect to **the new shares**".
27. Supplement part 1 of Article 7: **The by-laws of the investment fund may provide for a maximum number of shares which will grant votes. All shares acquired by any person in excess of the established maximum number do not grant any voting right at the general meeting of shareholders.**

The shares of investment companies at the time of foundation may be paid up in cash or in kind (by property contributions). **The property contributions may be only securities specified in part 2 of Article 9 and immovable property, necessary to perform the activities of the investment company. Upon founding the investment fund, the property contributions may be only securities specified in this part. The evaluation of the property contributions shall be approved by the founding meeting of the investment company. Contributions in kind may not be in the form of work and services, intellectual and other intangible property. Upon public offering of securities of the investment company, payment for the acquired shares may be only in cash.** The shares of the closed-end and investment holding company must be fully paid up prior to the registration of the authorized capital and the increase thereof. An investment fund shall have no right to sell its shares to be paid up by installments or postpone the date of payment. Payment for the investment fund shares must be effected no later than within 3 days **from the request to sell shares of the investment fund. The transaction related to the purchase of securities is deemed effected after the acquired shares of the investment company are fully paid up. Only after the shares of the investment company are fully paid up they are deemed issued and may be recorded in the personal securities account of the shareholder and accounted for in the securities register². The investment fund shall have no right to issue the shares (to transfer**

² The concept of the share register must be approximated with the concept to be used in the rules on the registration of shares.

them to the shareholders), unless they have been fully paid up by the established price. The transaction related to redemption of the shares of investment company shall be deemed concluded from the moment the request to redeem the securities from their owner is submitted to the person in charge of redemption of the investment company shares. From the moment the redemption transaction is concluded the shareholders of the investment fund are denied of all the rights attaching to the shares of the investment fund, except the rights arising from the conclusion of the redemption transaction. *(At this point it may be indicated that the sale and purchase of securities is executed following the rules of the Securities Commission. The Rules might provide for all the terms and conditions of the transactions, terms of executing the transactions, rights and duties arising from the transactions, consequences of partial fulfillment or a failure to fulfill the transactions. It would be a wise decision to regulate the matters by rules, since Rules may be amended and supplemented with time. Besides, in the laws of foreign laws the issues are not subject to any regulation either, and often are subject to the mutual agreement between the investment funds and the investors).*

29. Part 4, Article 7, delete the second sentence. To lay down the third sentence as follows: The Investment company share sale and redemption price shall be calculated in accordance with the investment company's own (net) asset valuation methods and must amount to the part of the investment company's own (net) assets due to the share. **Upon selling the shares of the investment company, the share selling price may be increased by the amount equal to the total of the asset management and the share sale cost per one share. Upon redeeming the shares the total of the investment company, its asset management and the share redemption cost per one redeemed share shall be subtracted from the redemption price of the share. The costs added to the sale price or subtracted from the redemption price may not exceed 1 per cent of the share redemption or sale price. (Or: The costs are determined following the methods approved by the Securities Commission)³.**

30. To supplement part 6 of Article 7 by an item: **"From the moment the decision to suspend the offering of the shares of investment fund neither the investment fund, nor persons authorized to redeem the shares of the investment fund has a right to redeem them."**⁴ In the event the shareholder requested to redeem his shares prior to the decision and the settlement has not been made with the shareholders after the decision to suspend the redemption of the shares has been passed, the investment fund must pay the shareholder at prices effective on the day of submission the request.

31. To supplement part 8 of Article 7: **Having registered with the Securities Commission the issue of the investment fund shall be offered for an unlimited period of time. There will be no limit established to the size of the issue except**

³ The methods should determine what may be deemed the costs and limitations imposed upon them. This would be necessary to prevent the unnecessary increase or lowering of the price and inclusion of expenses which should not be attributed to costs.

⁴ This provision is necessary to avoid cases when a certain period of time passes from the decision to suspend the redemption of shares till the actual redemption starts, and persons aware of the undisclosed information may request to have their shares redeemed prior to the decision coming into force.

cases when the by-laws of the investment fund provides for the maximum value of shares allowed to be offered. When in the process of offering the shares of the investment fund, the data submitted in the prospectus are changed or a material event take place it has to be notified in the manner established by the legal acts. In this case persons, who have previously acquired shares of the investment fund has a right to request the fund to redeem the shares in the manner laid down by the laws. In this case the persons have a right to request the fund to redeem the shares at the price determined in the manner set forth in the by-laws of the investment fund. The person has no right to request that the investment fund or the underwriter return the contributions in the manner provided for by part 3, Article 7 of the Law on Public Trading in Securities. The offering of the shares of the Investment fund may be suspended or terminated only in the manner provided by this Law, the Law on Public Trading in Securities, or the by-laws of the investment fund. In the event the by-laws of the investment fund provides for the maximum amount of shares which may be distributed, the offering shall be terminated after the target amount of reached. The shares will be further offered when and if the outstanding amount becomes less than the established minimum amount due to redemption of shares, or the by-laws of the investment fund are changed in the manner provided for by this law and other legal acts, and a new issue of the investment company shares is registered with the Securities Commission. The founders of the investment fund have a right to submit for redemption the shares of the investment fund subscribed at the moment of foundation of the investment company only after shares representing more than half of the initial own capital, specified in art 1 of Article 6 of this law have been distributed. The founders of the fund have a right to submit to the fund for redemption the amount of securities the value of which is no less than 4/5 of the securities of the investment fund distributed at the moment of submission of securities for redemption.

32. Supplement part 9, Article 7: Subscription to (or redemption) of shares of the investment fund is conducted in accordance with the rules approved by the Securities Commission. Provisions of the Company Law regulating the subscription and payment for shares of public companies shall not be applied to investment companies.
33. Part 1, Article 8, sentence 3 and further: "In such instances the investment company board and administration may are not be formed. If the management of property is transferred to the management enterprise, the Supervisory Board must be formed in the investment company. In the event when neither management enterprise, nor the depository by the agreement with the investment company assumes an obligation to conduct accounting of the investment company, the investment company must have a position of the chief financier denominated by the Supervisory Board and the employment agreement with him shall be signed by the Chairman of the Supervisory Board. Other persons in charge of the accounting of the investment company are hired and removed form the position by the Chairman of the Supervisory Board.
34. Part 2, Article 8: The right to participate in the general meeting of shareholders of the investment company shall be vested to persons holding the outstanding shares of the investment company where those shares are accounted in the personal securities account of the shareholder opened in the name of the persons concerned and the persons have not requested the investment fund to

redeem the shares. The quorum at the general (shareholder's) meeting shall be determined according to the number of shares which have been issued and not redeemed at the day of the general meeting of shareholders.

35. Supplement part 2, Article 8: **Only the general meeting of shareholders has right to pass decisions on the following issues:**

- 1) amend and supplement the by-laws of the investment fund. The resolution of the general meeting of shareholders to amend or supplement the by-laws of the investment company shall come into force only after it is approved by the Securities Commission.
- 2) elect the auditor to conduct accounting of the investment fund;
- 3) elect members of the Supervisory Board and the auditor of the investment fund. The members of the Supervisory Board shall be deemed elected only after they are approved by the Securities Commission.
- 4) remove the members of the Supervisory Board and the auditor of the investment fund from the office.
- 5) approve the asset management agreement with the management enterprise and approve a possible management enterprise.
- 6) change the management enterprise and approve the new management enterprise. The decision to change the management enterprise shall come into force only after the new management enterprise and the decision to change the management enterprise are approved by the Securities Commission. The general meeting may change the management enterprise only in cases provided for by this law.
- 7) establish terms of payment for the auditor's service;
- 8) approve the annual accounting documents and the report of the management enterprise on the activity of the investment fund;
- 9) issue a new issue of shares where the by-laws of the investment fund provides for the maximum number of issued shares and the decision is taken to issue more shares than the established maximum number;
- 10) liquidate or reorganize the company;
- 11) denominate an expert (group of experts) to examine the foundation of the investment fund and its management.
- 12) approve the evaluation of non-pecuniary contributions (contributions in kind) at the time of foundation of the investment fund.
- 13) pass a decision regarding the transfer of part of the assets of the investment fund to relinquish indebtedness to the state, municipal and social security fund budgets. To participate in the general meeting of shareholders with a right of advisory vote may be the authorized representatives of the management enterprise of the investment fund even though the management enterprise is not the shareholder of the investment fund.

Resolutions of the general meeting of the shareholders shall be adopted by a simple majority vote, with the exception of cases when resolutions regarding issues referred to in items 1, 10 and 12 of this part which will require $\frac{3}{4}$ majority vote and other cases referred to in the Company Law.

36. Part 4 of Article 8: The general meeting of shareholders shall have no right to revoke the resolutions of the management enterprise regarding the asset management or adopt resolutions on asset management which are binding to

to the management enterprise, except cases when the by-laws of the investment company are amended.

37. Part 5, Article 8: The Supervisory Board of the investment fund shall have the following powers:

- 1) select the management enterprise and submits to the general meeting proposals regarding the asset management agreement and the amendments thereof, as well as proposals to change the management enterprise;
- 2) analyse the performance of the management enterprise, the utilization of financial resources, organization of the asset management of the investment fund, settlement for the asset management, accuracy of depreciation deductions, the prospects of the financial status;
- 3) selects the investment fund custodian and concludes the agreement with it;
- 4) examines the financial accounting of the investment fund and other documents of the investment fund;
- 5) submits proposals and comments to the general meeting of shareholders on the annual financial statements of the company, draft profit distribution account and the report of the management enterprise to the general meeting of shareholders.
- 6) represent the investment fund in court proceedings when disputes between the Company and its management enterprise, depository or the representative of the investment fund are examined;
- 7) submits proposals to the management enterprises regarding revocation of its resolution which are not in compliance with the laws or by-laws of the investment fund;
- 8) resolves other issues specified in the by-laws and the resolutions of the general meeting of shareholders;

38. Supplement part 6 of Art. 8: "In case of an investment fund the rights and obligations of the Board provided for in the Law on Public Companies shall be transferred to the management enterprise and (o) Supervisory Board. The transfer of these rights and obligations and their division must be specified in the By-laws of the investment fund and (or) provided in the Asset Management Agreement."

39. item 2 of part 1 of Art. 9 shall be worded as follows: "money and liquid (no longer than 3 month maturity) money market instruments".

40. item 2 part 2 of Art. 9 supplement: "... where the price of securities in these markets can be determined at least as frequently as specified in part 5 of Art.7"

41. Supplement Art. 9 with part 4: "An investment fund shall be prohibited from investing more than 5% of its net (own) assets into shares of other investment funds. An investment fund shall be prohibited from acquiring shares of closed-end investment funds or investment holding companies".

42. Supplement Art 9 with part 5: **“An investment fund may invest into shares of another investment fund that is managed by the same management enterprise or a management enterprise with which the management enterprise of the investing fund is connected by single management or control or by a substantial direct or indirect investment only where the investment fund, into shares of which the investment is made, according to the activities specified in its By-laws, specializes in investing in a certain economic sector or a concrete geographical area under the condition that a permit of the Securities Commission is received for such an investment. A permit of the type is issued only in the event the By-laws of the investment fund clearly state that the investment fund shall be entitled to use the investment option set forth above.”**
43. Supplement Art. 9 with part 6: **“A management enterprise shall be prohibited from charging any fee to the investment fund for transactions when the investment fund invests into shares issued by another investment fund that is managed by the same management enterprise or a management enterprise with which the management enterprise of the investing fund is related by single management or control or by a substantial direct or indirect investment”**.
44. Supplement Art. 9 with part 7: **“An investment fund may hold up to 20% of its net (own) assets as term deposits in commercial banks for the period no longer than 3 months and only up to 4% of net (own) assets as a single deposit and only up to 8% of its net (own) assets in one commercial bank.”**
45. amend item 1 of part 1 of Art. 10 and read it as follows: **“extending loans, giving a guarantee or warranty for another person’s fulfillment of liabilities, mortgaging of securities or real property held by them; an investment fund may pledge the securities or real property in cases set forth in parts 5 and 6 of Article 6 of this Law; an investment fund may lend its funds only upon acquisition of debt securities of other legal entities, without prejudice to the norms set forth in this Law . The requirements set forth in item 6 of part 2 of Art. 13 of the Law on Public Companies shall not be applied.”**
46. supplement part 1 of Art. 10 with item 6: **“acquiring precious metals or precious metal certificates.”**
47. supplement part 1 of Art. 10 with item 7: **“acquiring derivative securities”**.
48. supplement part 1 of Art. 10 with item 8: **“acquiring securities issued by the fund’s management enterprise”**.
49. part 2 of Art. 10: **“If the investment fund or closed-end fund violates the requirements of the diversified investment portfolio due to the preferential right to acquire newly issued securities provided for in the laws and other legal acts of the Republic of Lithuania or for other objective reasons that are beyond its control, the closed-end investment fund or the management enterprise of the investment fund must sell the portion of securities due to which restrictions specified in this part were violated not later than within 3 months.”**

50. Amend part 6 of Art. 10 and read it as follows: **“An investment fund, a management enterprise or a custodian acting on behalf of the investment fund shall be prohibited from transferring and (or) taking the obligation to transfer securities that the investment fund is not the owner of.”**

51. Supplement the Law with Article 10¹ **“Distribution of the Increase of the Value of the Investment Portfolio and Other Revenues”**

1. Increase of the value of the investment portfolio and other revenues shall be distributed following the By-laws of the investment fund. The By-laws of the investment fund shall clearly specify which revenues of the investment fund (the increase in the value of the investment portfolio, dividends allocated), what part of these revenues and for what purpose will be used.

1. An investment fund’s revenues may be used for the following purposes: to pay dividends, to increase the net (own) asset value of the investment fund, to allocate bonus shares to the investment fund’s shareholders in proportion to the value of shares they hold, etc. with all revenues of one type, all revenues of several types, part of the revenues of several types or part of the revenues of one type.

3. The decision as to the distribution of the investment fund’s revenues shall be passed by the management enterprise of the investment fund. The custodian of the investment fund shall carry out the decision of the management enterprise providing it is in conformity with the By-laws of the investment fund, this Law or other legal acts.⁶

52. Supplement part 6 of Article 11 with the last sentence: **“The prospectus, annual and semi-annual reports shall be supplied to the public free of charge.”**

53. supplement part 1 of Art. 12: **“A close stock company registered in the Republic of Lithuania and having its main office in the Republic of Lithuania which holds a license issued by the Securities Commission...”**

54. supplement part 3 of Art. 12: **“The Securities Commission may set forth additional requirements for the authorized capital of the management enterprise, including a larger minimum capital requirement with regard to the size of capital of the investment companies the assets of which are managed by the management enterprise.”**

⁶ This article is necessary in order to enable an investment fund to project the ways of revenue distribution. In the event this article is missing, the revenues of the investment fund should be distributed in the manner prescribed by the Law on Public Companies and would depend upon shareholders. To simplify matters, this article may be worded in a more generalized way. An alternative: *“The By-laws of an investment fund shall clearly provide for the purposes and proportions that the revenues of the fund can be used. The decision as to the distribution of the investment fund’s revenues shall be passed by the management enterprise of the investment fund following the rules set forth in the By-laws of the investment fund.”*

55. amend part 4 of Art. 12: "At least two managers of the management enterprise must have broker's qualification certificate or any other certificate recognised by the Securities Commission. **Only a reputable person may be the head of the management enterprise (there should be no proof of dishonesty or frequent violations of financial discipline, penalties for the abuse of the office position, administrative penalties for violations of legal acts regulating the securities market, punishment for fraudulent bankruptcy, prosecution for deliberate crimes). The decision of the authorized bodies of the management enterprise to replace the managers of the management enterprise shall come into effect only after the new candidates are approved by the Securities Commission. To acquire shares of the management enterprise which grant 10 or more per cent of votes at the general shareholder meeting of the management enterprise the permit of the Securities Commission is needed. A person who has acquired shares granting 10 or more per cent of votes at the general shareholder meeting of the management enterprise without a due permit shall be denied the right to vote at the general shareholder meetings. The right to vote shall be recovered after the shares exceeding the threshold established in this part are transferred. The requirements of this part shall also apply to persons that are deemed connected persons that hold a block of shares as defined in the Law on Public Trading of Securities of the Republic of Lithuania.**

5. The Securities Commission may refuse to issue the permit to acquire shares of the management enterprise which grant 10 or more per cent of votes at the general shareholder meeting of the management enterprise, if the applicant is not a very reputable person (there is proof of dishonesty or frequent violations of financial discipline, penalties have been imposed for abuse of his office position or administrative penalties have been imposed for violations of legal acts regulating the securities market, or he has been punished for fraudulent bankruptcy or tried for deliberate crimes), or he is a person connected with the investment company, the assets of which are managed by the management enterprise (alternative: the head of the investment company, the assets of which are managed by the management enterprise), or a person connected to the custodian which holds the funds and/or securities. Where the applicant for the permit is a legal person, the above requirements shall be applied to the managers or controlling persons of the legal person.

In the event the circumstances specified in part 3 of this Article become known or appear only after the Securities Commission has issued a permit to acquire shares of the management enterprise, the person who owns 10 or more per cent of votes at the general shareholder meeting of the management enterprise shall promptly notify the Securities Commission about the appearance of such circumstances. The person shall be denied the voting right at the general shareholder meeting of the management enterprise from the moment said circumstances occur. The right to vote shall be recovered after the shares exceeding the threshold established in part 4 are transferred or the person rectifies the situation (e.g. resigns from the position of a member of the Supervisory Board or the like)."

56. Part 5 of Article 12 to be regarded as part 7, and Supplement Part 8 of Article 12: **The management enterprise shall have no right to involve into any other activity than the asset management of the investment companies and pension funds and investment management and consulting activity”**

57. Supplement Part 9 of Article 12: **The management enterprise may be reorganized only by merging it with another management enterprise or by splitting it into several management enterprises. The management enterprise may be reorganized in other ways only in cases when it does not manage the assets of a single investment company. To reorganize the management enterprise a permit of the Securities Commission must be obtained. The Securities Commission may refuse to issue a permit to reorganize the management enterprise in cases when the reorganization of the management enterprise may impair the shareholders’ interests, the reorganization contradicts the laws of the Republic of Lithuania or other regulations, or the management enterprise which will function after the reorganization will not comply with the laws and will fail to meet the requirements set forth by other legal acts”.**

58. Supplement the Law with Article 12’: **Rights and obligations of the management enterprise:**

1. **The management enterprise shall have a right to have the own (net) assets at its disposition and exercise the rights granted by the own (own) assets of the investment company pursuant to the terms of the asset management agreement concluded with the investment company, by-laws of the investment company and legal acts of the Republic of Lithuania.**

2. **The management enterprise shall be precluded from investing the net (own) assets of the investment company in securities of the company controlled by the management enterprise, members of the bodies of management of the management enterprise or employees or persons associated with the management enterprise, except cases when the Supervisory Board of the investment company decides that such investments do not contradict the interests of the shareholders of the investment company and such investment is approved by the Securities Commission.**

3. **The management enterprise has a right to manage the assets of several investment companies. In they event the investment portfolio of the investment company must be diversified, and securities of one issuer held by several investment companies the portfolios of which are managed by the same management company constitute no more than 10 per cent of the voting shares of the issuer, in the general meeting of the issuer’s shareholders the management enterprise shall have a right to vote on behalf of the investment companies only by shares not exceeding the 10 percent vote limit. If in this case investment companies vote themselves, or investment companies and the management enterprise on behalf of one or several of them, all companies may vote only by the shares which grant no more than 10 percent of votes at the general meeting of shareholders. Part of shares that grants the votes to the investment company shall be determined in proportion to the**

participation of the investment company in the issuer's equity. The rule shall not be applied to the investment holding companies, but in this case the management enterprise or other person representing investment companies managed by the same management enterprise, the investment portfolio of which must be diversified, are precluded from representing the investment holding company.

59. Part 2, Article 13, - delete the second sentence.

60. Part 2, Article 13, - The last sentence to be laid down as follows: The asset management agreement may be terminated by the decision of the general meeting of shareholders adopted by the simple majority vote may be terminated only **in the event the management enterprise violates the terms of the agreement, by-laws of the investment fund, this law or other laws or other legal acts. All disputes concerning termination of the agreement shall be resolved in court following the procedure provided for by the laws of the Republic of Lithuania.**

61. Supplement the Law with Article 13': **In the event where:**

- 1) **the term of the asset management agreement has expired (where it is a term agreement);**
- 2) **the management agreement has been terminated;**
- 3) **the management enterprise declares insolvency or is announced insolvent or a bankruptcy proceeding has been initiated against the management enterprise;**
- 4) **the license of the management enterprise to engage in the management of the assets of investment companies has been revoked;**
- 5) **the asset management agreement is terminated in other cases provided for by laws and the asset management agreement.**

the investment fund shall no later than within three months from the termination of the asset management agreement transfer the asset management to another investment management enterprise. Until the assets of the investment fund are transferred to another management enterprise the assets of the investment fund shall be managed by the depository of the investment fund. The depository shall manage the assets following the same terms and conditions as provided for in the asset management agreement of the management enterprise. In the period when the assets of the investment fund is managed by the depository, it shall be precluded to offer the shares of the investment fund.

2. **The new management enterprise and the agreement shall be approved by the general meeting of shareholders and the Securities Commission. The new asset management agreement shall be in compliance with the by-laws of the investment fund, unless the general meeting of shareholders approves the relevant amendments to the by-laws.**
3. **The Commission may refuse to approve the selection of the management enterprise and the asset management agreement in the event the selection of the management enterprise or the asset management agreement contradict the laws of the Republic of Lithuania and other legal acts or the interests of the shareholders of investment fund.**

4. The Securities Commission has a right to request management of the investment company be transferred to another management enterprise when the management enterprise no longer meets the requirements of the laws of the Republic of Lithuania and other legal acts, the management enterprise violates the asset management agreement, this law, other laws and other legal acts.
5. In the event the investment fund fails to conclude a new asset management agreement when the circumstances specified under parts 1 or 4 of this Article within the period specified in Part 1. The Securities Commission shall revoke the license of the investment fund.
6. *Procedure set forth in this Article shall also be applied in cases when the by-laws of the IHC or CIC provides that their assets are in obligatory manner transferred for management to the management enterprise, and the general meeting of shareholders fails to introduce appropriate amendments to the by-laws within the established period of time (is this provision necessary?).*
62. Amend Part 1 Article 16 and lay down as follows: A bank as well as brokerage company and a bank subsidiary, **registered in the Republic of Lithuania and holding its main office in the Republic of Lithuania**, and having the license issued by the Securities Commission to engage in the activities of a custodian may be a custodian.
63. Supplement Part 4, Article 17: **“In the event the investment company has separate depositories for cash funds and securities, the both depositories shall hold a joint responsibility for the losses incurred to the investment company. The two depositories shall bear a joint responsibility for fulfillment of obligations set forth in Part 3 of this Article”.**
64. Supplement Part 7, Article 17: **Where the custodian of the investment fund has undertaken an obligation to conduct the financial accounting of the investment fund, the custodian shall, on a daily basis, submit the information on the assets of the investment fund in custody to the person or persons in charge of the financial accounting of the investment fund”.**
65. supplement the Law with Article 17¹: **“Change of the Custodian”:**
 1. **In the case when:**
 - 1) **the agreement with the custodian is terminated;**
 - 2) **the license of the custodian to engage in the activity of a custodian of money and/or securities is revoked;**
 - 3) **the custodian is declared insolvent or a bankruptcy procedure is initiated against it;**
 - 4) **the agreement expires in other cases provided for by law or by the agreement with the custodian;**

within two weeks from the appearance of the above specified events the funds and/or securities of the investment company shall be transferred to another custodian for safekeeping. A new custodian for the investment company shall be selected and the agreement with it made by the Supervisory Board of the

investment fund or the head of the administration of the closed-end investment fund or investment holding company or the Supervisory Board if the administration is not formed.

2. In the event the custodian of the investment company fails to meet the requirements set forth by the laws or other legal acts, or the custodian fails to properly perform its obligations pursuant to the agreement with the investment company or its obligations to the investment company arising from laws and other legal act, seeking to ensure the rights of the shareholders of the investment company the Securities Commission has a right to instruct the investment company to change the custodian.
3. Where under circumstances provided for in parts 1 and 2 of this Article, within the term established in the first part, the funds and/or securities are not transferred to another custodian, the Securities Commission shall revoke the license of the investment company.

66. supplement the Law with Article ***

1. Persons connected to the investment company, managers and employees of the investment company custodian or management enterprise, and persons connected to the custodian or management enterprise shall be prohibited from transferring directly or through its management enterprise, securities or any other assets to the investment company, as well as from receiving from the investment company securities or any other assets, except the funds for the redeemed shares of the investment company or wages, established by the employment agreement.
2. Prohibitions set forth in part 1 of this Article shall not be applied in the cases when the Supervisory Board or the Board, where the Supervisory Board is not formed, of the investment company passes a decision that the acquisition or transferring of securities or any other assets is beneficial to the shareholders of the investment company and does not violate their rights and legitimate interests. Such a decision shall be passed in every individual case and shall be recorded in the minutes of the meeting of the Supervisory Board or the Board of the investment company.
3. Where the member of the Supervisory Board or the Board or members of their families have a personal interest in the decision, they are precluded from voting regarding the issue of the permit referred to in part 1 of this Article.
4. Persons, having violated provisions of this Article, shall compensate for the losses incurred to the investment company and shall be responsible in the manner provided for by the laws of the Republic of Lithuania (the manner is to be established).

67. supplement the Law with Article 18¹ :

- 1. A person employed by the investment company or a member of managing bodies of the investment company shall have no right to work with the custodian or management enterprise of this investment company, or be a member of managing bodies of the custodian or management enterprise of this investment company.**
- 2. A person employed by the custodian of the investment company or a member of managing bodies of the custodian shall have no right to work with the investment company, the assets of which are in custody of this custodian, or with the management enterprise of this investment company, or be a member of managing bodies of this management enterprise.**
- 3. The custodian of the investment company shall be precluded from acquiring securities of the management enterprise of the same investment company.**
- 4. Persons connected with the investment company shall be precluded from acquiring shares of the management enterprise or the custodian of the investment company granting 10 or more per cent of votes at the general shareholder meetings of these enterprises.**
- 5. In the event the requirements set forth in this Article are violated, the Securities Commission shall have a right to instruct the management enterprise of the investment fund or the custodian to rectify the situation within the time set forth by the Securities Commission. In the event the situation is not rectified within the time set forth, the Securities Commission shall be entitled to revoke the license of the management enterprise and (or) the custodian or issue a motion to the investment company that its management enterprise or custodian be changed.**

THE LITHUANIAN SECURITIES COMMISSION

Resolution No.31

Vilnius, October 16, 1998

**On the Rule on Concluding the Agreements
Between Financial Brokerage Firms and Their Clients**

The Lithuanian Securities Commission hereby resolves:

1. To approve the Rule on Concluding the Agreements between the Financial Brokerage Firms and their Clients
2. To obligate the financial brokerage firms, by the time the Rule comes into force to submit a written proposal to their clients with which the Agreements have been concluded concerning adjustment of the terms of the Agreements pursuant to the requirements of this Rule.
3. To determine that the Rules on Concluding the Agreements Between Financial Brokerage Firms and their Clients shall come into force on January 1, 1999.

Chairman of the Securities Commission

Virgilijus Poderys

RULES ON CONCLUDING AGREEMENTS BETWEEN FINANCIAL BROKERAGE FIRMS AND THEIR CLIENTS

1. GENERAL PROVISIONS

1. Scope of regulation and the legal basis

- 1.1. This Rule establishes the general and specific requirements for brokerage service agreement, covering the custody of the client's securities and execution of the clients' orders and discretionary account agreements concluded between financial brokerage firms or commercial banks entitled to perform operations with securities (hereinafter referred to as financial brokerage firms) and the clients.
- 1.2. The legal basis of this Rule is Part 4 of Article 11 and Part 2 of Article 13 of the Law on Public Trading in Securities of the Republic of Lithuania.

II. GENERAL REQUIREMENTS FOR THE AGREEMENTS

2. Form of the Agreements

All agreements concluded between financial brokerage firms and their clients, the subsequent amendments and supplements thereto shall be executed in written form.

3. Retention of Agreements

- 3.1. One copy of the agreement signed by a representative of the financial brokerage firm and the client shall be handed over to the client, another copy shall be placed for safekeeping in the financial brokerage firm.
- 3.2. Upon termination or expiry of the agreement the financial brokerage firm shall retain custody of the agreement, subsequent amendments and supplements thereto and other records relating to the agreement for the period of ten years following the termination or expiry of the agreement.

4. Prohibition imposed upon financial brokerage firms to transfer its obligations pursuant to its agreement with the client

Financial brokerage firm is prohibited from transferring its rights and obligations as per agreement with the client to other persons, also from instructing third persons to carry out the obligations with respect to the client, except cases when otherwise provided by other legal acts or the financial brokerage firm has received in advance a written consent of the client.

5. Protection of the clients' rights

- 5.1. Where the present Rule in specific cases establishes specific rights, duties and responsibilities of the parties and does not provide for a possibility for the parties to achieve the agreement otherwise the financial brokerage firm shall ensure that agreements concluded with the clients provide for the specific rights, duties and responsibilities of the parties. Agreements between the financial brokerage firms and the clients may include additional provisions but the financial brokerage firm is precluded from including into the agreements with the clients provisions

limiting the obligations and responsibility of the brokerage firm with respect to the client set forth by laws of the Republic of Lithuania, other legal acts and this Rule.

5.2. Financial brokerage firms shall be liable in the manner provided for by the law for violation of obligation set forth under part 5.1. of this Rule.

5.3. Brokerage service agreement, covering the custody of the client's securities and execution of the clients' orders and discretionary account agreements shall include an indication that they have been provided following this Rule. Upon the client's request the broker representing the financial brokerage firm shall comment on the rights granted to the clients by this Rule and the terms of the proposed agreement.

5.4. The agreements concluded between financial brokerage firm and the client shall provide for the obligation of the firm to submit the annual financial statements of the firm to the client upon his request. The financial brokerage firm shall also submit the annual financial statements of the firm to every potential client.

6. Liability

Liability for violation of the terms of agreements concluded between financial brokerage firm and the client shall be established on the basis of the laws of the Republic of Lithuania and other legal acts, except cases when otherwise provided by parts of this Rule regulating specific agreements.

7. Parties to the Agreements

7.1. One party to the agreement is the financial brokerage firm holding the appropriate license issued by the Securities Commission, or the commercial bank licensed to carry out operations with securities, represented by a financial broker who has passed the qualification examination arranged by the Securities Commission or holding other type of qualification certificate recognized by the Securities Commission.

7.2. The agreements shall include the following requisites of the firm: full name, company code, office address, license number, name of the representative who signed the agreement, the basis for representation.

7.3. Brokerage service agreement, covering the custody of the client's securities and execution of the clients' orders and discretionary account agreements are concluded with individual natural and legal persons; according to the agreements the natural and legal persons are deemed individual clients, except cases when several natural or legal persons act as co-owners of personal securities accounts and securities portfolio. Prior to concluding agreements with persons who currently are or seek to become co-owners of personal securities accounts or securities portfolio, the financial brokerage firm shall obtain from the persons concerned documents confirming their will (e.g. the marriage certificate, agreement on joint activity), or the agreement with other persons shall explicitly provide for their will to become the co-owners of personal securities accounts or securities portfolio.

7.4. Co-owners of personal securities account or securities portfolio manage, use and has full disposition of personal securities accounts and securities portfolios

pursuant to the requirements set forth by the Civil Code of the Republic of Lithuania and this Rule. Agreements of financial brokerage firms and the concerned co-owners for custody of the clients' securities, execution of the clients' orders and management of the securities portfolios shall provide for the order of manifesting the joint will of co-owners to the financial brokerage firm.

- 7.5. Where the brokerage service agreement and the securities portfolio management agreement are concluded with the co-owners part owned by each party shall be segregated in kind, except where otherwise agreed upon by the parties to the agreement. Agreement concluded between the co-owners of securities and financial brokerage firms shall provide for the procedure of segregation of those securities which are impossible to segregate exactly by parts owned by co-owners.
- 7.6. The agreements shall provide the following information on the client (co-owner of personal securities account and securities portfolio):
 - 7.6.1. For natural person - name, personal code, residence place and address, telephone and telefax numbers;
 - 7.6.2. For legal person - full name, enterprise code, office address, position of the representative, name and the basis for representation, telephone and telefax numbers (foreign legal persons shall also file the legalized registration certificate or other document certifying its existence).
- 7.7. The agreements shall also indicate the client identification codes, assigned pursuant to the Rules on Identification of Clients of Intermediaries of Public Trading in Securities approved by the securities Commission.

8. Notifications

- 8.1. Parties to the agreement shall deliver notices addresses to each other at addresses indicated under part 7 of this Rule, except cases when the agreement or individual notes provide for different addresses delivery of said notices.
- 8.2. Where the Rule or other legal acts set forth the requirement to submit notices in writing, the agreement between the financial brokerage firm and the client shall provide for hand delivery of the notices, delivery via a representative or by recommended mail. In all cases the agreements may provide for a different procedure to deliver notices of the parties to the agreement addressed to each other.

9. Services rendered by financial brokerage firms

Every agreement concluded between the financial brokerage firm and the client shall define in detail the scope of services the financial brokerage firm shall render to particular client.

10. Compensation to the financial brokerage firm

- 10.1. The agreement between the financial brokerage firm and the client shall provide for the kind of services for which the financial brokerage firm shall receive compensation, also the size of compensation and the procedure of calculation the amount of compensation following the restrictions provided for in this Rule. The financial brokerage firm shall have no right to require compensation not provided for in the agreement concluded with the client.

10.2. The financial brokerage is entitled to receive compensation from third persons for transactions executed in its own name or on behalf of the client but for the account of the firm only in cases when upon the written consent of the client. Upon the client's request the financial brokerage firm shall supply him with the information on the basis and the amount of compensation paid to the financial brokerage firm by third persons.

11. Amendments to the agreements

11.1. Seeking to amend the terms of the concluded agreements the financial brokerage firm shall notify the client in writing and shall propose to the client to amend the terms of the agreement and allow the client the term no shorter than fourteen days to respond.

11.2. Where the client fails to inform the financial brokerage firm within the established term that he has assumed an obligation to adhere to the changed conditions, the firm has a right to terminate the agreement.

11.3. Where the client fails to inform the financial brokerage firm within the established term that he had assumed an obligation to adhere to the changed conditions, and within the term for termination of the agreement counted from the end of the term established under 11.1. the client does not receive the agreement termination notice, the agreement shall remain valid under its original terms and conditions.

11.4. Where for certain types of agreements this Rule provides for specific requirements different from those laid down in this part, the specific requirements shall be applied.

12. Termination of Agreements

12.1. The client may terminate the agreement concluded with the financial brokerage firm at any time by filing a written notice. On this basis the agreement shall be deemed terminated from the moment the written notice of the client is filed with the financial brokerage firm. It shall be prohibited to constrain this right of the client by requiring the client to pay a fine upon unilateral termination of the agreement.

12.2. The financial brokerage firm may terminate the agreement with the client by delivering a fourteen day termination notice to the client except the cases when the agreement is terminated because the client fails to fulfill his contractual obligations.

12.3. In the event the financial brokerage firm undertakes an obligation to render the client several services according to one agreement, the agreement shall provide for a possibility to amend the agreement by terminating rendering of specific types of services and provide for the procedure of realization this possibility complying to the requirements set forth under items 11.1, 12.2, 16.2 and 17.1 of this Rule. Upon termination of the agreement with the client with respect to one type of service the financial brokerage firm shall continue fulfilling all of its obligations related to all other services rendered to the client.

12.4. Where this Rule provides for requirements for termination with respect to specific types of agreements different from those established by this part, the specific requirements shall be applied.

13. Agreements with persons of foreign countries

13.1. While concluding agreements with foreign legal and natural persons, the laws of the Republic of Lithuania shall be complied with.

13.2. While concluding agreements with foreign legal and natural persons based outside the Republic of Lithuania, the financial brokerage firm may take on an obligation to exchange the foreign currency into litas where the client shall assume all the currency exchange risk and cover the expenses related to the currency exchange procedure.

III. SPECIFIC REQUIREMENTS TO INDIVIDUAL TYPES OF AGREEMENTS

14. Specific requirements to brokerage service agreements

14.1. Financial brokerage firm has a right to open and manage the personal securities account of the client only upon concluding the agreement with the client pursuant to requirements of the General Accounting Rules of Securities and Their Circulation, regulations adopted on the basis thereof and specific requirements set forth in this Rule, except cases when the issuer transfers the management of its issued securities to the intermediary of public trading in securities in the manner established in part 3 Article 28 of the Public Trading in Securities.

14.2. Financial brokerage firms shall open and manage personal securities accounts on the basis of custody, i.e. these agreements shall comply with all the requirements set forth to the custody services in the appropriate Articles of the Civil Code of the Republic of Lithuania.

14.3. Financial brokerage firm shall have no right to use securities held in the personal securities account of the clients for its own needs or for the needs of other clients, except cases when the client has expressed his consent in the agreement with the financial brokerage firm or a separate notice that securities owned by him be used for the needs of the financial brokerage firm or for the needs of other clients. The client's consent to use securities owned by him for the needs of the financial brokerage firm or for the needs of other clients shall be documented as securities lending.

14.4. Compensation shall be provided for usage of securities held in the personal securities account of the client, except cases when the client has waived the compensation in writing.

14.5. In the event the brokerage service agreement is concluded with the co-owners the agreement shall separately indicate the shares of the co-owners or shall contain a notice that securities are owned under joint common property.

14.6. Seeking to terminate the brokerage service agreement the client shall submit a written notice to the financial brokerage firm. In this written notice the client has a

right to indicate another account operator to whom the accounting (custody) of securities shall be transferred enclosing a copy of the agreement concluded with the latter or the obligation assumed by it to hold (provide custody to) the securities of the client.

14.7. In cases when the brokerage services agreement is unilaterally terminated by the financial brokerage firm, the brokerage firm shall notify the client of its intention and allow the client a period no shorter than 14 days to indicate another account operator to whom the accounting (custody) of securities shall be transferred. In this case the client is entitled to require that the financial brokerage firm recommend or select the account operator following the criteria indicated by the client.

14.8. As soon as the financial brokerage firm is notified of the new account manager the firm shall immediately transfer the accounting (custody) of securities to the account manager, with an exception of the case provided for under part 11 of the Rule of Acceptance and Execution of the Client's Orders and other exceptions provided for in other laws and legal acts of the Republic of Lithuania.

14.9. Where the client fails to exercise his right to indicate another account operator, to whom the accounting (custody) of securities shall be transferred, and does not require that the firm recommend or select the operator in cases provided for by this Rule, the financial brokerage firm has a right to transfer the accounting (custody) of the securities of the client to the issuer of the securities or to the intermediaries of public trading in securities authorized by the issuer pursuant to provisions of part 3 of Article 28 of the Law on Public Trading in Securities of the Republic of Lithuania.

14.10. The financial brokerage firm or the client upon notifying about another account operator shall indicate the following data thereof: full name, company code, residence address, license number, the code assigned by the Central Securities Depository, and the name, position, telephone and fax numbers of the representative authorized to supply information.

15. Special terms and conditions of the agreements relating to the custody of the clients' funds

15.1. Custody of the clients' funds does not constitute an independent type of activity of financial brokerage firm. Terms and conditions relating to the custody of the client's funds and the use thereof shall be established in the agreements on execution of the clients' orders and the securities portfolio agreements.

15.2. The funds held at the financial brokerage firms and intended for investment in securities, also funds received from the sale of the clients' securities, also funds, received in the form of dividends and interests for the client's securities and other investment revenues of this type received in the form of cash shall be held by the financial brokerage firm on the basis of custody.

15.3. Financial brokerage firm without a separate consent of the client has a right to use the funds for payment for securities acquired according to the client's order. A separate consent of the client is also not mandatory when the financial brokerage firm uses the funds to pay for the securities acquired for the client according to the investment decision taken by the financial brokerage firm itself under a

discretionary account agreement. All other expenses from the client's funds account (including payment to the financial brokerage firm) are allowed only upon consent of the client received in advance, manifested in the agreement or in any other note signed by the client.

- 15.4. Upon the client's request, the financial brokerage firm shall immediately return the funds accounted in the client's funds account to the client. The financial brokerage firm has a right to refuse to fulfill the requirement of the client, where:
 - 15.4.1. the client's funds have been pledged, or transferred to the financial brokerage firm as a pledgee, or the financial brokerage firm holds the funds following the instruction of the pledgee.
 - 15.4.2. An order of the client has been placed to the financial brokerage firm pursuant to which the clients funds will have to be used to pay for the acquired securities and which at the moment of the request to return the funds has not been revoked in an established order.
 - 15.4.3. In other cases prescribed by the agreement or some other note signed by the client, when the financial brokerage firm has a right to cover some expenses using the funds from the client's account and the expenses are due to payment.
 - 15.4.4. So prescribed by laws and other legal acts.

16. Special requirements for agreements on execution of clients' orders

- 16.1. Prior to accepting the clients' orders to execute operations with securities, the financial brokerage firm shall conclude an agreement with the client following the requirements of the Rule on Acceptance and Execution of the Clients' Orders and the general requirements of this Rule and the specific requirements of this part of the Rule.
- 16.2. The finance brokerage firm shall be precluded from refusing to conclude or execute the Brokerage Service Agreement for the reason that the clients requests his securities be held (placed under custody) in another financial brokerage firm and the funds be held in a credit institution.
- 16.3. Agreements on execution of the clients' orders shall provide for the following:
 - 16.3.1. Requisites of the client's order and the procedure of handing over the order forms to the clients and standard terms for execution of the order;
 - 16.3.2. Client's order form and methods of placing the order to the financial brokerage firm;
 - 16.3.3. Procedure of registration and confirmation of the client's orders;
 - 16.3.4. Amendment of the conditions of the order and revocation of the orders;
 - 16.3.5. Provisions regarding combining or splitting the execution of the client's order.
 - 16.3.6. Procedure for transferring securities and funds to the financial brokerage firm for execution of the client's orders;
 - 16.3.7. Procedure for confirmation of execution of the client's order.
 - 16.3.8. Other conditions in individual cases required by the Rule on the Acceptance and Execution the Client's Orders.
- 16.4. The Agreement on execution the client's orders may be terminated following the regular procedure; from the moment of the client's filing the notification with the financial brokerage firm on termination of the agreement the firm is denied of

the right to execute the new orders of the clients. The financial brokerage firm, however, shall not be precluded from executing the orders which have been placed with the firm prior to the moment of filing the notification concerned and which cannot be revoked in an established manner.

17. Special requirements for discretionary account agreements

17.1. Prior to commencing to manage the client's (natural or legal persons) securities portfolios, i.e. engage in activity when the financial brokerage firm at its own discretion on behalf of the client accepts and places for execution decisions regarding purchase and sale, exchange, pledging, lending or borrowing of securities, borrowing of funds to acquire securities, realization of rights attaching to securities constituting the portfolio, seeking for the maximum benefit for the client, shall conclude a written agreement pursuant to the specific requirements of this part of the Rule.

Custody of the securities portfolio

17.2. The finance brokerage firm shall be precluded from refusing to conclude or execute the Discretionary account Agreement for the reason that the clients requests his securities be held (placed under custody) in another financial brokerage firm and the funds be held in a credit institution.

17.3. In cases when the client requests his securities constituting the managed securities portfolio be placed under custody in another financial brokerage firm the latter shall be indicated to the financial brokerage firm managing the securities portfolio. Also where the funds intended for management and replenishment of the securities portfolio, upon the client's request are placed under custody in a credit institution rather than the financial brokerage firm managing the securities portfolio, the client shall also indicate the credit institution.

17.4. The notification on the financial brokerage firm and the credit institution referred to in item 17.3 shall be placed in writing and shall contain the full name, the company code, office address, license number of the financial brokerage firm and the credit institution, and the date and number of the agreement concluded with the client.

17.5. The client has a right to transfer his securities and funds constituting the portfolio to another financial brokerage firm or a credit institution without a consent of the financial brokerage firm managing the securities portfolio of the client. The discretionary account agreement in this case shall provide for the duty of the client to immediately file to the financial brokerage firm managing the discretionary account the notification referred to in item 17.4. containing the information on the newly selected financial brokerage firm and the credit institution or instruct the latter to file the said notification. Where the financial brokerage firm managing the securities portfolio of the client at the same time provides custody for his securities and funds constituting his portfolio, the realization of the client's right referred to in this item shall not preclude the execution of investment decisions which were filed for execution prior to the moment of filing the said notification and which cannot be revoked in an established manner.

- 17.6. Where the client fails to perform his duty to immediately inform on the change of the financial brokerage firm or the credit institution referred to in item 17.3., the financial brokerage firm shall not be liable against the client for the losses of the securities portfolio (including unrealized income) caused by the client's failure to perform.
- 17.7. The Discretionary Account agreement shall provide for the authorizations the financial brokerage firm managing the securities portfolio is granted in relation to the financial brokerage firms and credit institutions referred to under items 17.3 and 17.23.6.1., including the following actions:
- 17.7.1. place orders to carry out operations with the client's securities
 - 17.7.2. instruct the financial brokerage firm holding (providing custody) the client's securities portfolio, or the credit institution providing custody to the client's cash funds provide the securities and/or the funds seeking to execute the transaction indicated in the client's order.
 - 17.7.3. compensate the financial brokerage firm for execution of the orders relating to the securities portfolio and the accounting (custody) of the securities portfolio.
 - 17.7.4. receive order execution confirmations and deliver them to the client;
 - 17.7.5. perform other actions necessary to fulfill its obligations pursuant to the Discretionary account agreement.
- 17.8. The Discretionary account agreement shall provide for the duty of the financial brokerage firm managing the securities portfolio to immediately inform the client on the violations committed by the financial brokerage firms or credit institutions referred to in items 17.3 and 17.23.6.1. in the course of carrying out operations relating to the discretionary account. The client also has a right to authorize the financial brokerage firm managing his securities portfolio to undertake other actions seeking to protect his rights in relations to the third persons concerned.
- 17.9. Where at the moment of conclusion of the Discretionary account agreement or the supplementary agreement regarding the replenishment of the securities portfolio the client has not deposited any securities and (or) cash funds, the Discretionary account agreement or the supplementary agreement regarding the replenishment of the securities portfolio shall provide for the obligation of the client to deposit the cash funds and (or) securities at specific terms and where the securities and (or) cash funds are placed under custody in a financial brokerage firm different from that managing the securities portfolio to notify the latter in writing that the obligation has been fulfilled, or instruct the financial brokerage firm holding (providing custody to) the securities forming the securities portfolio or the credit institution providing custody to the cash funds to file said notification.
- 17.10. In the case referred to under item 17.9. the Discretionary account agreement or the supplementary agreement regarding the replenishment of the securities portfolio shall be concluded with a the suspensive clause, i.e. the agreements come into force after the financial brokerage firm managing the securities portfolio receives a notification confirming that the client's funds have been deposited.

The Initial Contents of the securities portfolio, its objectives and restrictions

- 17.11. The Discretionary account agreement shall provide for the initial contents of the securities portfolio transferred for management of the financial brokerage firm (name of the securities, code assigned by the Central Securities Depository and the number of securities of each type), the market value of the securities portfolio, also the amount of cash intended for the replenishment of the securities portfolio or the amount of cash meant exclusively for the formation of the securities portfolio. The financial brokerage firm may establish the minimum value of the discretionary account or the amount of cash meant for the formation of the securities portfolio.
- 17.12. The client has a right at any time to replenish his discretionary account instructing the financial brokerage firm to manage the additional cash funds and (or) securities. The increase of the client's securities portfolio out of additional contributions of the client shall be made formal in a supplementary agreement to the discretionary account agreement. The supplementary agreement shall enumerate the securities additionally transferred to the discretionary account (the names of securities, and codes assigned by the Central Securities Depository, and number of securities of each type), indicating the market value of the securities as well as the amount of cash funds meant for replenishment of the discretionary account, or the amount meant exclusively for replenishment of the securities portfolio.
- 17.13. The client, seeking to reduce the size of the securities portfolio managed by the financial brokerage firm shall notify the financial brokerage firm in writing. From the moment of delivery of the said notice to the financial brokerage firm it shall lose its right to manage the securities and cash funds indicated by the client, but this shall not preclude the firm from executing the orders which were placed for execution prior to the moment of delivery of the notification and which cannot be revoked in an established manner.
- 17.14. Unless otherwise provided by the Discretionary account agreement revenues received from the management of the securities portfolio are deemed part of the discretionary account and shall be managed in a general order.
- 17.15. The Discretionary account agreement shall define the objectives pursued by the client concluding the agreement (e.g. investment in securities seeking for capital gain, investment in debt securities seeking for regular income, acquisition and sale of securities seeking for trade proceeds, etc.). The client is entitled to request other provisions be included in the Discretionary account agreement to reflect objectives pursued by the client and subsequently request the agreement be amended or supplemented with a view to the changed objectives.
- 17.16. While taking specific investment decisions relating to the discretionary account the financial brokerage firm shall take into consideration the objectives pursued by the client while concluding the Discretionary account agreement.
- 17.17. The Discretionary account agreement shall explicitly state whether the financial brokerage firm managing the client's securities portfolio is granted the right to:

17.17.1. realize rights attaching to the securities on behalf of the client(voting, subscription rights, etc.);

17.17.2. pledge, borrow and lend securities and lend cash funds on behalf of the client;

17.18. In cases when the client instructs the financial brokerage firm to realize the rights attaching to the securities forming the securities portfolio, the Discretionary account agreement shall explicitly state which rights the financial brokerage firm is authorized to realize and shall also provide for the obligation of the client to issue the financial brokerage firm the relevant documents of authorization. The Discretionary account agreement shall include a provision that all rights attaching to the securities forming the portfolio are vested to the client.

17.19. In cases when the client authorizes the financial brokerage firm managing his securities portfolio to carry out securities pledging, lending or borrowing or cash funds borrowing operations the firm shall perform the operations only upon receipt of the client's written consent except the cases where the client has explicitly waived the said right in the Discretionary account agreement.

17.20. The Discretionary account agreement shall establish the following restrictions upon investment:

17.20.1. Securities which may form the portfolio or securities which may not form the portfolio (including the restriction to include in the client's portfolio the securities which the financial brokerage firm or a person connected to it are distributing or have been distributing within the recent 12 months).

17.20.2. securities the amount of which is restricted in the portfolio;

17.20.3. markets where securities may be acquired;

17.20.4. operations the financial brokerage firm may not perform while managing the securities portfolio and operations for the performance of which the written consent of the client is required (the Discretionary account agreement may not include provisions restricting the right of the financial brokerage firm to take decisions and place them for execution with relation to the purchase or sell of securities at its own discretion).;

17.20.5. other restrictions established by the client.

17.21. If so requested by the client the investment restrictions referred to in item 17.19. are not established in the Discretionary account agreement. In this event the agreement shall explicitly note which restrictions the client has refused to establish.

17.22. In the event the Discretionary account agreement provides for the investment in securities of foreign issuers the account shall contain the following provisions:

17.22.1. the obligation of the client to assume the currency risk;

17.22.2. the client's authorization to the financial brokerage firm to convert litas into foreign currency necessary to execute the transactions and obligation to cover expenses related to the currency exchange or other procedures for supplying the financial brokerage firm with foreign currency;

17.22.3. the client's right to identify the securities intermediary authorized to provide custody (hold) securities issued by foreign issuers or carry out operations with them or to authorize the financial brokerage firm managing the securities portfolio to recommend or select the intermediary. In the latter case the financial brokerage firm shall recommend or select an intermediary with the

service-fee ratio most beneficiary for the client, taking into consideration price of the service, as well as effectiveness, scope and efficiency of the service and other factors relevant to the client.

Principles of managing the securities portfolio

17.23. Financial brokerage firm, managing the securities portfolios of their clients shall adhere to the following principles, set forth in the Discretionary account agreement:

17.23.1. **Principle of Priority of the Clients' Interests.** Upon taking the investment decisions pursuant to the Discretionary account agreement, or on behalf of the clients realizing the rights attaching to the securities of the client, concluding the transactions on behalf of the client or on their own behalf but for the account of the client the financial brokerage firm shall follow the principle of the superiority of the client's interests over the interests of the financial brokerage firm or the third persons. Reflecting the principle the financial brokerage firm shall be precluded from effecting transactions with third persons or perform legally relevant actions on behalf of the client or on their own behalf but for the account of the client in which the financial brokerage firm or its employees are directly or indirectly self-interested and that severely interferes with the firm's duty to act in the best interests of the client, except cases when the financial brokerage firm has notified the client on its own interest or the interest of its employees, and has obtained the client's written consent to execute the said transaction.

17.23.2. **Principle of Confidentiality.** The financial brokerage firm shall have no right to divulge the client's confidential information to any third persons, except the information which has been already disclosed by the client or persons authorized by the client, or the information which the financial brokerage firm must provide to the government authorities or legal institutions in the cases and following the procedure set forth by laws. The financial brokerage firms shall be precluded from using confidential information to conclude transactions, beneficial to itself or any third persons, unless the client has produced a written consent regarding the said transactions. The client is entitled to specify which information is deemed confidential in the Agreement or in a side letter.

17.23.3. **Principle of Unbiased Approach.** The firm shall exercise all possible efforts to equally satisfy the needs of its clients. Following this principle the financial brokerage firm shall elaborate the procedure of coordinating interests of individual clients. The clients shall be familiarized with the procedure which will be confirmed by the client's signature. The procedure shall be treated as an annex to the Discretionary account agreement.

17.24.3. **Principle of Maximum Profit at the Lowest Risk.** Prior to adopting any investment decision regarding the securities portfolio, the Firm shall evaluate the benefit resulting from the said decision in the view of the risk involved. This evaluation shall make a basis for the decision whether the investment decision is in conformity with the objectives the client pursued by entering into the Agreement.

17.23.5. **Principle of Professional Approach.** The financial brokerage firm shall adopt the investment decisions regarding the securities portfolio of the clients in a professional manner, based on its expertise, knowledge and all information available.

17.23.6. **Principle of Economy.**

17.23.6.1. The Financial brokerage firm, managing the client's securities portfolio shall explore the best methods to execute the operations with securities, i.e. the ratio between the fee for the intermediary service provided by the firm itself and the quality of the service shall be most appropriate to the client, or another financial brokerage firm to carry out operations with the client's securities to better correspond to the client's interests. (In the latter case the financial brokerage firm managing the client's securities portfolio acts as a representative of the client or authorizes another financial brokerage firm to carry out operations with securities forming the securities portfolio).

17.23.6.2. The Firm shall be precluded from effecting by itself or authorizing another financial brokerage firm (in cases referred to under item 17.23.6.1.) to execute excessive trading the scope of which is too large in terms of the objectives of the client pursued by concluding the Discretionary account agreement and the objective of which is to generate proceeds for the financial brokerage firm managing the securities portfolio, or other financial brokerage firms or credit institutions referred to under items 17.3 and 17.23.6.1.

17.24. Where losses are incurred to the clients due to the transactions concluded by the financial brokerage firm or other actions prejudicial to the requirements of items 17.23.1. and 17.23.2., the clients have a right to claim losses from the financial brokerage firm. Financial brokerage firm also assumes an obligation to provide for in the Code of Ethics:

17.24.1. the responsibility of the employees to inform the relevant managers of the firm on the interest in transactions executed on behalf of the client or on behalf of the firm but on the account of the client or other actions performed on behalf of the client and not to disclose the confidential information of the clients;

17.24.2. the liability of the clients for failure to carry out duties referred to in items 17.24.1.

The Client's permissions and instructions

17.25. In the event an extraordinary situation develops in the market or in other cases provided for in the Discretionary account agreement the financial brokerage firm has a right to request a consent of the client to perform specific operations with the securities portfolio having furnished the client with accurate and complete information necessary to take an informed decision, and upon the client's request - the necessary advice.

17.26. In all cases when operations with securities constituting the portfolio is not in accordance with the Discretionary account agreement the client's consent is mandatory. Prior to obtaining the client's consent, the firm shall furnish the client with the accurate and complete information necessary to take an informed decision, and upon the client's request - the necessary advice.

17.27. The Discretionary account agreement shall provide for the client's right to issue the bidding instructions to the client regarding the management of the

securities portfolio, for example change of the purpose of the agreement, establishment of the investment restrictions, instruction to liquidate the securities portfolio (sell securities forming the portfolio). Parties to the Discretionary account agreement may agree that the client has a right to issue binding instructions regarding specific transactions with securities forming his portfolio. Such instructions shall be issued in writing and the financial brokerage firm shall in writing confirm the receipt thereof.

17.28. Where the Discretionary account agreement provides for the right of the client referred to in item 16.26 to give the financial brokerage firm managing is securities portfolio the binding instructions, the Agreement shall also provide for the obligation of the financial brokerage firm to alert the client on the risk related to the instructions given by him.

Reports

17.29. The financial brokerage firm managing the client's securities portfolio shall, in the manner and within the periods set forth by Discretionary account agreement but not less frequently than once in three months, furnish the client with a report which shall include:

17.29.1. all operations executed with the securities portfolio of the client within the accounting period including realization of rights attaching to the securities, also compensation to the financial brokerage firm executing operations with the securities portfolio (in the case provided for in item 17.23.6.1.), and other expenses from the client's cash fund account related to managing of his securities portfolio;

17.29.2. the average value of the securities portfolio at the beginning and the end of the accounting period and the method of calculation;

17.29.3. compensation for the management of the client's securities portfolio.

17.30. The Discretionary account agreement shall provide for the obligation of the financial brokerage firm to accumulate and provide safekeeping of all the investment decisions relating to the client's securities portfolio, and, upon the client's request, supply him with the information on the decisions, basis and realization thereof.

17.31. The Discretionary account agreement shall also provide for the duty of the financial brokerage firm managing the securities portfolio upon the client's request to promptly supply him with the information additional to that referred to in items 17.29.1. and 17.29.2. on the process of executing the agreement.

17.32. It shall be prohibited to provide for in the Discretionary account agreement to charge additional fee for the information and reports referred to in items 17.29-17.31.

17.33. The Discretionary account agreement shall provide for the client's right, having received the report on his securities portfolio, to make remarks to the financial brokerage firm managing his securities portfolio, and the duty of the financial brokerage firm to provide a motivated response to the client's remarks within the terms and in the manner set forth by the Discretionary account agreement.

Compensation for management of the client's securities portfolio

- 17.34. The Discretionary account agreement may provide only for the following compensation to the financial brokerage firm for managing the securities portfolio:
- 17.34.1. a fixed management fee, set by the financial brokerage firm on the day of concluding the Discretionary account agreement;
 - 17.34.2. compensation related to the appreciation of the securities portfolio value determined on the basis of the market prices or following the methods of evaluation of the securities portfolio recognized by the Securities Commission.
- 17.35. The Discretionary account agreement shall set forth the procedure and terms of payment of compensation to the financial brokerage firm while applying the following restrictions:
- 17.35.1. the management fee is payable no more frequently than once a month and shall not be paid in advance;
 - 17.35.2. the management fee shall be paid only for the period the Discretionary account agreement was in effect (the fee shall be reduced proportionally to the duration of the period when the Agreement was terminated or was not effective due to suspension or revocation of the financial brokerage firm's license);
 - 17.35.3. compensation related to the appreciation of the value of the securities portfolio shall be paid for the equivalent periods established upon an agreement with the client. The periods shall be no shorter than three months (in the event of termination of the Discretionary account agreement the periods may be shorter);
 - 17.35.4. the appreciation of the value of the securities portfolio shall be calculated as the aggregate appreciated values of the securities forming the portfolio at the end of the period referred to in item 17.35.3. less the initial value of the securities portfolio at the time the portfolio was transferred to the financial brokerage firm, or less the value recorded at the moment the financial brokerage firm last requested the payment from the appreciation of the value of the securities portfolio, and less the management fee paid for the period since the Discretionary account agreement came into effect or in the period following the most recent payment to the financial brokerage firm for the appreciation of the value of the securities portfolio.
- 17.36. The financial brokerage firm shall be prohibited to deduct the compensation for management of the securities portfolio from the proceeds from sales of securities forming the portfolio, except cases when the client has in advance expressed his consent, or the compensation is exacted from the assets owned by the client in the manner provided by the laws of the Republic of Lithuania.
- 17.37. Where the financial brokerage firm managing the client's securities portfolio also carries out operations with the securities portfolio and (or) holds (provides custody to) the securities portfolio, the firm is entitled to compensation for execution of operations with the client's securities portfolio and accounting (custody) of securities forming the securities portfolio. The payment shall be reflected in the report of the financial brokerage firm submitted to the client.

Termination of the Discretionary account agreement

17.38. From the moment of termination of the Discretionary account agreement the financial brokerage firm managing the securities portfolio shall be denied the right to act on behalf of the client, the termination of the agreement however does not preclude the firm from carrying out the investment decisions (orders) which were placed prior to the termination of the agreement and can not be revoked in an established manner.

17.39. The financial brokerage firm a party to the Discretionary account agreement shall promptly notify the financial brokerage firms and credit institutions referred to in items 17.3 and 17.23.6.1. on the termination of the Discretionary account agreement except the case when this obligation has been assumed by the client himself.

Liability

17.40. The liability for violations of the Discretionary account agreement shall be established on a general basis with an exception that the financial brokerage firm shall bear no responsibility for depreciation of the value of the securities portfolio due to the fluctuations of the value of securities and inflation, provided the firm acted in compliance with the provisions of the Discretionary account agreement.

The Pragma Corporation

Lithuanian Capital Market
Development Project
Stock Exchange Building
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MEMORANDUM

December 9, 1998 2:43PM

To: Aldas Kriauciunas
USAID - Vilnius, Lithuania

From: Nijole Maskaliuniene,
The Pragma Corporation, Vilnius

Re: **STATUS REPORT FOR THE MONTH OF NOVEMBER, 1998**
Lithuania Capital Markets Development Project
CONTRACT EPE-I-95-00040-00, Task Order 05

CC: Ieva Veidemanis: USAID - Washington, D. C.
Kevin O'Hara: Pragma Corporation - Falls Church, Virginia
The Pragma Corporation: Vilnius Office File (Diana Sokolova)
The LSC, the NSEL, the CSDL, the NAFB

PROJECT DESCRIPTION

The Pragma Corporation ("Pragma") is implementing the Lithuanian Capital Markets Development Project ("Project") funded by the United States Agency for International Development ("USAID"). The Project is to provide legal and regulatory development assistance to the Lithuanian Securities Commission ("LSC") and organizational development assistance to the National Stock Exchange of Lithuania ("NSEL"), the Central Securities Depository of Lithuania (CSDL), and the National Association of Finance Brokers of Lithuania ("NAFB"). In addition, the Project is providing assistance in the procurement of software and operations capabilities to support an order-driven, continuous trading stock exchange.

PROFESSIONAL STAFFING

The Project is staffed by four local experts, Skirmantas Rimkus, a financial advisor, Gediminas Rečiūnas and Evaldas Valčiukas, legal advisors, and Dr. Arvydas Paškevičius, advisor in macroeconomics, working full time. Expat consultants work with the Project on a short-term contract basis. In November 1998, there was only one expat advisor, Mr. Donald Buddenbohn. He left the Project on November 13, 1998.

PRIMARY AREAS OF FOCUS

The activities of the team were focused on the long-standing issues of accounting, market regulation, and investment funds. Procurement of the trading system for the NSEL has also been the primary focus of the Project for quite a long time as it requires careful planning and much preparatory work. In October, Mr. Kevin O'Hara provided

technical assistance on critical tasks involving NSEL hardware acquisition. Following his Memorandum of October 21, the NSEL prepared the Hardware Specifications which were approved by the meeting of the Selection Committee on 10 November 1998. During November 1998, Mr. Kevin O'Hara was reviewing this document to prepare for further necessary steps. (See Attachment "A").

Mr. Donald Buddenbohn, at the request of the Securities Commission, continued to provide assistance in preparing inspection programs for financial brokerage firms and requirements for their internal controls, rules on required reporting of financial brokerage firms, wrote comments and recommendations for audit programs. Recommendations of accounting principles for investment funds were in the focus of the expert's concern. Mr. Buddenbohn reviewed and recommended changes to Description of Principles (Methods) of Financial Accounting Applied for Investment Funds prepared by local Pragma staff member, Skirmantas Rimkus. (See Attachment "B". Trip Report. 1-6)

In November, Skirmantas Rimkus continued working on financial accounting (financial statements) and principles of accounting for open-end investment funds. The prepared drafts were revised taking into account Mr. Buddenbohn's comments and recommendations. As mentioned in the previous report, the task is of high importance for further development of the accounting system in Lithuania as today all financial institutions, except banks, complete the same forms of financial statements as manufacturing companies. These forms do not reflect any investment activity of a firm. Nor do they show its financial status because the main activities are not reflected. Moreover, the statements are the same for regulatory purposes and for tax authorities. Therefore, the Project was challenged to prepare accounting requirements for financial brokerage firms and all types of other companies providing investment services.

A set of documents for financial brokerage firms (balance sheet, profit (loss) account, off-balance statement, the explanatory notes) prepared by Skirmantas Rimkus was discussed at the meeting at the Ministry of Finance in October. As a result of the discussion, the advisor was asked to prepare an additional document, namely, Rules on Recognition of Income and Expenses in a Financial Brokerage Firm. These Rules aim at addressing the specific character of income and expenses in the activities of a financial brokerage firm. When adopted, the Rules will allow the brokers to recognize unrealized gain (loss) which does not exist in their accounting today. A few other important issues will be also addressed. They will facilitate to get a true and fair view of the soundness of a financial brokerage firm as a financial institution. The principles of financial accounting will meet internationally accepted standards.

In November draft amendments and supplements to the Law on Investment Companies were finalized by the legal advisor Evaldas Valčiukas. They are distributed for comment to all market participants. Several meetings were held with the NAFB and other market participants to discuss different issues being proposed. The draft amendments aim at improving the legal and regulatory basis for investment companies and mutual funds. When adopted, these amendments will eliminate contradictions between the Law on Investment Companies and the Law on Public Companies that showed up after the latest amendments to the latter. The amendments are to bring the

Law in harmony with the requirements of the European Union Directive 611/85/EEC, too. As a result, conditions for appearance of local investment funds (as of today, there are none) will be created on the basis of the European standard. Many provisions of the effective Law that caused controversy will be amended (e.g. governance of the fund will be simplified, etc.). Mr. Stanley Judd, a legal advisor of Pragma, will be reviewing the latest draft of the amendments in December. (See Attachment "C")

Besides, Mr. Valčiukas is working on offering and redemption of the investment fund's shares which is to be a constituent part of the new Rules on Registration and Public Offering of the Investment Fund's Shares. It is the first time that such rules are being prepared. When adopted, they will provide for the procedure of registration, public offering and redemption of the investment fund's shares, which will create the conditions for registration of the investment fund's shares and all procedures afterwards. They will also equip the Securities Commission with a reliable tool for the investment fund's regulation.

Mr. Rečiūnas continued working on the final draft of the Rule on Securities Registration and Public Offering prepared by the Department of Corporate Finance of the Securities Commission. This Rule is to be finished in December. The expert was also working on the proposals to amend the Rule on Discretionary Accounts for Investment Management and Consulting Firms. Although the Rule was passed not long ago (in March 1998), new developments in the legal framework necessitate certain changes to be made in the latter. For instance, the Rule on the Clients' Order Placement and Execution which was passed in July provides for segregation of securities custody and trading services and sets forth the option of keeping cash for operations with securities in the bank account, which was prohibited before. (Until July, all operations with securities were allowed only to that financial brokerage firm which operated the personal securities account of the particular client.) There are other alterations that should be made in order to update the Rule pursuant to the latest developments in the market regulation. All proposals were submitted to the Securities Commission.

In November, Dr. Paškevičius prepared a preliminary report on the Lithuanian stock market capitalization and the secondary market turnover. It is a continuous project to analyze the tendencies in the Lithuanian capital market in the context of the world market development. The trading dynamics in the period of 1993 - 1998 was reviewed with respect to trading dynamics each year. Trading volumes of the 20 most actively traded securities as well as the most substantial deals were singled out for each year. In the report the analysis of the central market transactions and block trades was presented separately. This work is being performed at the request of the Securities Commission which has to get feedback as to the effect of the regulatory decisions it takes. (See Attachment "D")

MAJOR ACHIEVEMENTS

In November hardly any project can be singled out as a major achievement. The Pragma team concentrated on the tasks they had been involved with for some time. All of them will be continued in December.

WORKSHOPS/SEMINARS

On November 5, Dr. Paškevičius participated at the Financial/ Fiscal Strategic Objective Team meeting working on the study of fiscal reforms in Lithuania. It was organized by the USAID. On November 13, Diana Sokolova and Nijole Maskaliuniene attended the USAID/ Lithuania Close-Out Workshop to discuss the transition/close-out process between now and September 2000.

UPDATE ON PREVIOUS REPORT

COMPLETED:

- ☆ Draft Amendments to the Law on Investment Companies (a new draft)
- ☆ Rules on Recognition of Income and Expenses in Financial Brokerage Firms
- ☆ Memo on the Compliance Function, Internal Audit and Independent audit and the Impact of Internal Controls upon them as they relate to Financial Brokerage Firms
- ☆ Audit (Inspection) Programs
- ☆ Proposals Concerning Amendments to the Rule on Discretionary Accounts for Investment Management and Consulting Firms
- ☆ The Main Capital Market Indicators in 1998

All documents were passed to the Securities Commission.

IN PROGRESS:

- Rule on Securities Registration and Public Offering
- Rule on Registration, Offering, and Redemption of Investment Fund's Shares
- Requirements for Financial Statements of Mutual Funds

PLANS FOR NEXT MONTH AND ANTICIPATED ISSUES

In December, Mr. Rimkus will complete the set of financial statements and principles of financial accounting for mutual funds. Then he will proceed with financial statements for closed-end investment funds and management enterprises of investment companies. Mr. Rečiūnas will be working on the Rule on Registration and Public Offering of Securities he is currently working on. Mr. Valčiukas will finalize the Rules on Issuance and Redemption of the Investment Fund's Shares. Later, he will be working on the content of the prospectus of the investment fund's share issue, which is also a constituent part of the rules on registration and public offering of the investment fund's shares. Dr. Paškevičius will continue with the capital market analysis according to the schedule approved by the Securities Commission. Minor tasks will be addressed when they come due.

ATTACHMENTS:

ATTACHMENT A: HARDWARE SPECIFICATIONS

ATTACHMENT B: DONALD BUDDENBOHN'S TRIP REPORT

**ATTACHMENT C: AMENDMENTS TO THE INVESTMENT COMPANY LAW
(INCORPORATED)**

ATTACHMENT D: THE MAIN CAPITAL MARKET INDICATORS IN 1998



**NACIONALINĖ
VERTYBINIŲ POPIERIŲ BIRŽA**

Ukmergės g. 41, 2600 Vilnius, Lietuva
Tel. 723871 Faks 724894

FAX COVER SHEET

TO: Mr. Kevin O'HARA, Project Director / The Pragma Corporation
FAX #: +1 703 237 9326

CC: Mr. Aldas KRIAUCIUNAS, Director, US AID/ Vilnius
FAX #: 22 29 54

FROM: The National Stock Exchange of Lithuania
FAX #: +370 2 72 48 94

DATE: 10 November 1998

Dear Sirs,

Following our previous agreement and the Memorandum distributed by Mr. O'Hara, we are pleased to attach the Hardware Specifications prepared by the NSEL and approved at the meeting of the Selection Committee on 10 November 1998.

We would very welcome your comments and recommendations regarding both the structure and contents of the document. Given that time is of importance, your urgent attention to this matter will be greatly appreciated.

In addition, please advise us how the decision of the Selection Committee must be officially recorded.

Yours sincerely,

Rimantas Busila
President, NSEL

NATIONAL STOCK EXCHANGE OF LITHUANIA

Ukmergės st. 41
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National Stock Exchange of Lithuania (NSEL)

Hardware Specifications for an Automated Trading System

1. INTRODUCTION AND SUMMARY

A. Project Overview

International investors have considerable scope in deciding where to invest. They favor markets that provide a superior level of service and efficiency of execution and settlement. To meet these requirements, the National Stock Exchange of Lithuania (NSEL), with assistance from USAID, is continuously enhancing the current automated trading system and is seeking to acquire a new trading system. This document defines the Specifications of hardware configuration for automated trading to be acquired for the NSEL under USAID auspices and competitive bidding procedures.

B. System Synopsis

The NSEL trading system provides the following features:

- *Screen-Based Trading:* Trading is Automated Order-Driven and manual. The system supports multiple instrument types (e.g. Equities, Debt, etc.).
- *Market Data Dissemination:* The system disseminates market data to data vendors (e.g. Reuters, Telerate, Bloomberg, etc.), news services, NSEL members and other interested parties.
- *Electronic Surveillance:* The system provides alerts of unusual activity to the NSEL surveillance personnel and has the ability to reconstruct the market as it existed at any point in time.
- *Member Services:* The system captures and makes available at member workstations best bids and offers, limit order book summaries and other market data. It provides statistics including open, close, high and low prices.
- *Exchange Support:* The system provides the Management Information and other tools the Exchange needs to function and to support the system (for Listings, Membership, Archiving, etc.)

C. Business Objectives

NSEL's goal is to establish itself as a "World-Class" market. The NSEL seeks to:

- Establish a reputation domestically and internationally as fair, liquid and efficient.
- Instill public and investor confidence in the Exchange and its procedures.

- Strengthen international competitiveness.
- Accommodate high trading volumes.

D. Technology Objectives

The NSEL recognizes implementation of modern technologies to be essential to meeting its goals. Its Information Technology goals are to:

- Accommodate the growing volume (and anticipated additional growth) of trading in an affordable manner without straining staff or market operations.
- Reduce the labor-intensive nature of trading.
- Provide NSEL members an efficient, inexpensive means of trading and settlement.
- Enable the Exchange to be self-supporting and cost-effective irrespective of transaction volumes.
- Integrate trading, settlement and member operations into a smooth seamless chain with minimal manual steps between processes.
- Develop a skilled staff able to maintain and enhance NSEL's automated systems.

E. Capacity Plans and Projections

The analysis of the Lithuanian securities market historical performance (during the recent years trading on the NSEL has grown more than 300%) and growth trends of other emerging markets enable to estimate the minimum activity levels that the system will encounter in its first years of operation:

- | | |
|-----------------------------------------------|--------|
| ➤ Listed main board companies | 50 |
| ➤ Second-tier market companies | 200 |
| ➤ Free market companies | 1500 |
| ➤ Corporate debt issues | 100 |
| ➤ Government debt issues (national and local) | 50 |
| ➤ Financial Brokerage Firms (FBF) | 60 |
| ➤ Daily trades | 2,500 |
| ➤ Daily orders | 10,000 |
| ➤ Daily Settlement transactions | 5,000 |
| ➤ Daily trades on the corporate debt market | 500 |
| ➤ Daily trades on the government debt market | 500 |
| ➤ Blocks, crosses and negotiated trades | 500 |
| ➤ Workstations | 200 |
| ➤ System response time in seconds, less than | 2 |

2. SYSTEM ARCHITECTURE

A. Overall System Architecture

The hardware of the trading system is based on a fast and flexible three-tier client-server system which runs on reliable, stable and scaleable UNIX platform machines. Each tier is connected to the neighbor through the LAN network: the first and the second tiers are connected through Fast Ethernet network while the second and the third tiers are linked either through Fast Ethernet or Ethernet network. All communications are carried out in TCP/IP protocol.

B. First Tier Description

The first tier of system architecture consists of the main and redundant Trading Engines. These machines must be compatible with Oracle, Informix, and Sybase databases. If due to any reason the first machine stops, its functions are automatically transferred to the redundant machine possibly off-site.

C. Second Tier Description

The second tier is based on fast and stable UNIX platform machines functioning as Gateways between the Trading Engine and workstations of the NSEL members and several PCs for system administration and technical support. The number of Gateway machines depends on the number of workstations: as many as 50 member workstations can be linked to one Gateway. System maintenance PCs are connected to Fast Ethernet network linking the Trading Engine with Gateways.

D. Third Tier Description

The third tier comprises the NSEL system administration and support and the NSEL member workstations. They can be connected to Gateway machines both through LAN (Fast Ethernet or Ethernet) and leased lines controlled by routers. The market data distribution server belongs to this tier. It is linked to a Gateway machine on one side and to the open NSEL LAN connected to Internet on the other side.

E. Additional Hardware

1. Hardware Needs in Transitional Period

The current trading system of the NSEL runs on IBM AS/400, the capacity of which no longer meets market needs. In transition to a new trading system, an upgraded IBM AS/400 machine will be needed to run and develop the existing system.

2. UPS

In order to protect the trading system from a failure in power supply, all UNIX machines and active LAN equipment must have UPS which would ensure uninterrupted work of the system for 1/2 hour. An autonomous power generator located on the NSEL premises should be used in case the UPS can not provide power for 1/2 hour.

3. Data Back-up Capabilities

In order to protect data from failures in the computer system, both Trading Engine machines must be supported by a streamer, one cartridge of which would be capable of holding the whole hard disk data.

4. Local Area Network Hardware

A large number of NSEL member workstations linked through a Gateway machine will overload the LAN connection between the second and the third tiers. Having in mind that the NSEL member workstations will be connected through leased lines to the same overloaded LAN, a fast device for commutation and routing of Ethernet packets with a Firewall option is required as well as software allowing the network administrator to timely and reliably control and monitor this network device.

The technical staff of the NSEL should be provided with a device for automated identification of damages in the physical lines in order to quicken this process.

5. Telecommunications

The system platform supports both leased and dial-up lines. In general, the quality of telephone services for data communication is satisfactory although this varies from region to region. Service levels and quality are improving quite rapidly.

The NSEL intends to own telecommunication devices for leased lines to its remote members, therefore telecommunication equipment is required.

6. Workstations

The majority of computers and software package for data processing currently in use do not meet the requirements for the new trading system. The NSEL intends to install PCs at working places of the NSEL personnel.

7. Training

The NSEL staff has no experience with administration and technical support of UNIX platform machines, thus relevant training will be required.

3. HARDWARE SPECIFICATIONS

All UNIX platform machines can be either HP or IBM or Sun. All numbers given below represent the minimum levels of hardware configuration.

A. Primary Trading Engine

It is a UNIX platform machine. The minimum requirements for its constituent parts are the following:

- Double CPU (SPECint95>25, SPECfp95>60)
- 768 MB RAM
- 4 x 4 GB SCSI-2 HDD
- 2 x SCSI-2 controllers
- 4 mm tape (>16 GB)
- Fast Ethernet LAN attach (2 units)
- Simple console
- UPS (support > 0.5 hour)
 - OS UNIX

B. Redundant Trading Engine

It is a UNIX platform machine. The minimum requirements for its constituent parts are the following:

- CPU (SPECint95>12.5, SPECfp95>30)
- 768 MB RAM
- 4 x 4 GB SCSI-2 HDD
- 2 x SCSI-2 controllers
- 4 mm tape (>16 GB)
- Fast Ethernet LAN attach (2 units)
- Simple console
- UPS (support > 0.5 hour)
 - OS UNIX

C. Database

The database will be selected from the following list (the number of licenses is indicated in brackets):

- Oracle 8 (100)
- Informix (10)
- Sybase (10)

D. Gateways (4 pcs)

These are UNIX platform machines. The minimum requirements for its constituent parts are the following:

- CPU (SPECint95>12.5, SPECfp95>30)
- 512 MB RAM
- 1 x 4 GB SCSI-2 HDD
- Fast Ethernet LAN attach (4 units)
- Simple console
- UPS (support > 0.5 hour)
 - OS UNIX

E. Upgrade of IBM AS/400

IBM AS/400E model 600:

- CPU #2129
- 256MB RAM
- 20GB HDD
- an IBM 7208012, 8mm, 5GB cartridge, streaming tape drive
- 2 Ethernet interfaces
 - OS/400 V4R1

The machine of given configuration is currently in use at the NSEL. In transition to a new trading system, the NSEL will need to upgrade it to:

- CPU #2135
- 256MB RAM
- 24GB HDD
- 4mm streaming tape drive
- 2 Fast Ethernet interfaces
 - OS/400 V4R2
 - DB2 Query Manager and SQL Developer Kit
 - IBM MQSeries (20 user licenses)
 - ILEC

F. Market Data Distribution Server

The minimum requirements for its constituent parts are the following:

- Double PII 350 MHz
- 2 x 1 MB L2 Cache
- 256 MB RAM

- 3 x 9 GB SCSI HDD
- 4 mm tape (>18 GB)
- Fast Ethernet LAN attach (2 pcs)
- Video adapter 2 MB RAM
- 17" monitor
- UPS (support > 0.5 hour)
 - Windows NT 4.0 server (TSE)
 - MS SQL server (or identical) (20 licenses)
 - Visual C++ (one user)

G. LAN Hardware

- 12 ports Fast Ethernet Hubs (10 pcs)
- 24 ports Fast Ethernet switch

supporting SNMP, routing of protocols and firewall functions. The set should include firewall software and network administrator's software with graphic interface (GUI) for monitoring and configuration of all application functions. Compatibility with other network technical equipment using SNMP protocol is desirable.

- UPS capable of supporting all Fast Ethernet hubs (10 pcs) and Fast Ethernet switch for 0.5 hour.
- A device for fast and accurate identification and registration of defects in data transfer channels.

H. Telecommunication Devices

- Synchronous modem to maintain 64 kbps speed on noisy lines (8 pcs)
- Set of 8 synchronous modems, 64 kbps speed on noisy lines per each (1 pc)
- Set of 8 asynchronous modems, 33 kbps speed on noisy lines per each (1 pc)
- Router (1 Ethernet with 1 serial port) (12 pcs)
- Router (1 Ethernet with 16 serial ports or combined) (1 pc)
- Technical devices allowing to connect remote LANs within 5 km distance at 128 kbps speed (4 sets).

I. Personal computers (up to 30 pcs)

- PII 350 MHz
- 1 Mb L2 Cache
- 64 MB RAM
- 4 GB HDD
- Fast Ethernet LAN adapter
- Video adapter with 4 MB RAM

- 17" monitor
 - Windows NT 4.0 workstation

J. Additional Devices and Products

- Autonomous power generator (5 kW)
- MS Office 97 professional (20 licenses)

4. ADDITIONAL REQUIREMENTS

- The producer of listed goods must have an office based in Lithuania for warranty and post-warranty maintenance.
- The warranty of listed goods should cover at least 3 years.
- The supplier must provide training on administration and maintenance of UNIX operational system for 3 NSEL IT professionals. It is desirable that training be carried out in Lithuania.
- All listed goods must be Y2K compliant.

5. USEFUL REFERENCES

IBM Lietuva

Sv. Jono 3

Vilnius 2600, Lithuania

Phone: +370 2 22 11 03

Fax: +370 2 22 21 73

Contact: Rimantas Tautvydas

HP rep office in Lithuania

Seimyniskiu 21B-306

Vilnius 2600, Lithuania

Phone: +370 2 790978

Fax: +370 2 790986

Contact: Justas Darguzas, Sales manager

Sun distributor in Lithuania

UAB Compservis

Raitininku g. 2

2051 Vilnius

Phone: +370 2 723496

Fax: +370 2 721197

Contact: Mr. Richardas Pivoriunas

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TRIP REPORT

LITHUANIAN CAPITAL MARKET DEVELOPMENT PROJECT

DATE: November 13, 1998

LENGTH OF CONTRACT: September 29 to November 13, 1998

NAME OF CONSULTANT: Donald Buddenbohn

PURPOSE OF TRIP: Conduct a seminar for the brokerage community on Internal Controls and Risk. Prepare a Rule for the Securities Commission on requiring financial brokerage firms to report selected financial and other related data on a periodic basis. Observe an inspection of a financial brokerage firm and comment on the Securities Commission's draft Rule on inspection. Advise and report on the differences between a Compliance and Internal Audit Function and an Independent Audit and their relationship with Internal Controls. Comment on the Securities Commission's draft Procedure on Internal Control. Review and comment on the Description of Principles (Methods) of Financial Accounting Applied for Investment Funds.

WORK PERFORMED

SEMINAR ON INTERNAL CONTROL AND RISK

Along with advisor, James Ryan, conducted a three day seminar on Internal Controls and Risks for brokerage community. Presentations were aided by use of films and slides. Seminar was well received and attended (in excess of 30 people each day) by staffs of the Securities Commission, Stock Exchange and Depository, and officers and members of Brokers Association.

RULE ON REQUIRED REPORTING OF FINANCIAL BROKERAGE FIRMS

Prepared Draft Rule on Required Reporting of Financial Brokerage Firms (deliverable). Rule provides 11 pre-formatted schedules to provide information on trading, customers, revenues and other statistics for 27 different categories. Reviewed with Department Head of Market Regulation.

INSPECTIONS

Observed actual on site inspection at a financial brokerage firm conducted by Securities Commission Inspector. Critiqued inspection procedures with Inspector and Department Head of Market Regulation. Reviewed the Securities Commission Draft Rule on Inspection of Financial Brokerage Firms. Co-ordinated comments and recommendations on observation of inspection and review of Draft Rule into one document, Comments on the Rule on Inspection of Financial Brokerage Firms and Related Matters (deliverable). Suggested use of Audit (Inspection) Programs, through Memorandum on Audit (Inspection) Programs (deliverable) and provided three sample audit (inspection) programs, one each for cash, employee accounts and executed order tickets (deliverables).

INTERNAL CONTROLS

Reviewed and criticized Draft of The Procedure of Internal Control in a Financial Brokerage Firm. Edited portion of Procedure and presented edits with memorandum, Comments on Draft of the Procedure of Internal Control in a Financial Brokerage Firm (deliverable). Reviewed memorandum and edits with Commissioner and Department Head of Market Regulation. To clarify concept of Internal Controls and suggest a practical approach to overseeing their use, prepared memorandum, Background Memo on the Compliance Function, Internal Audit and Independent Audit and the Impact of Internal Controls upon Them as They Relate to Financial Brokerage Firms (deliverable). Reviewed memorandum with Commissioner and Department Head of Market Regulation.

RECOMMENDATIONS OF ACCOUNTING PRINCIPLES FOR INVESTMENT FUNDS

Reviewed and recommended changes to Description of Principles (Methods) of Financial Accounting Applied for Investment Funds prepared by local Pragma staff member, Skirmantas Rimkus.

ATTACHMENTS

RULE ON REQUIRED REPORTING OF FINANCIAL BROKERAGE FIRMS

COMMENTS ON THE RULE ON INSPECTION OF FINANCIAL BROKERAGE FIRMS AND RELATED MATTERS

MEMORANDUM ON AUDIT (INSPECTION) PROGRAMS:

Sample Audit (Inspection) Program for Cash

Sample Audit (Inspection) Program for Employee Accounts

Sample Audit (Inspection) Program for Executed Order Tickets

COMMENTS ON DRAFT OF THE PROCEDURE OF INTERNAL CONTROL IN A FINANCIAL BROKERAGE FIRM

Edited Portion of Procedure of Internal Control in a Financial Brokerage Firm

BACKGROUND MEMO ON THE COMPLIANCE FUNCTION, INTERNAL AUDIT AND INDEPENDENT AUDIT AND THE IMPACT OF INTERNAL CONTROLS UPON THEM AS THEY RELATE TO FINANCIAL BROKERAGE FIRMS

Draft

Prepared By: Donald Buddenbohn

Date : October 18, 1998

**RULE ON REQUIRED REPORTING OF
FINANCIAL BROKERAGE FIRMS**

I. GENERAL PART

- A. Pursuant to Article 32 Of the Law On Public Trading Of Securities, this Rule provides that all Financial Brokerage Firms (FBF) report certain financial and other statistical information to the Lithuanian Securities Commission (LSC) on a periodic basis as specified herein.

II. DEFINITIONS

III. REPORTING REQUIRED

- A. On a quarterly basis, information on the trading of securities, as follows:

1. The number of and amounts paid and received for purchases and sales of securities categorized by trades of residents for the FBF's own account and groups of clients' accounts, as designated in the February 14, 1997 Resolution No. 4 of the LSC (the Resolution), except that portfolio management accounts shall be reported separately. The number of and amounts paid and received for purchases and sales of securities shall be further categorized by the following types of securities:
 - a. On Exchange Equity
 - b. Off Exchange Equity
 - c. Underwriting
 - d. Corporate Bonds
 - e. Municipals
 - f. Government
 - g. Foreign Securities
 - h. Derivatives
 - i. Other

Rule on Required Reporting...

2. The number of and amounts paid and received for purchases and sales of securities by non-residents categorized by country of origin for groups of clients' accounts, as designated in the Resolution, except that portfolio management accounts shall be reported separately. The number of and amounts paid and received for purchases and sales of securities shall be further categorized by the types of securities designated in paragraph 1., a. through i. of this section of this Rule.
3. A copy of the report submitted to the Central Securities Depository of Lithuania (CSDL) on the valuation of securities as required by the CSDL April 17, 1997 Rules On The Provisions Of Information Concerning The Securities Owners, Balances And Value Of Securities In Securities Accounts, approved by the Securities Commission on June 6, 1997 by Resolution No. 14.
4. The following information on the ten largest trades:
 - a. Security
 - b. Shares or Par Value of Bonds
 - c. Buy or Sell
 - d. Client
 - e. Group of Client Account
 - f. Amount
5. The following information on the five most actively traded securities:
 - a. Security
 - b. Purchases:
 - i. Shares or Par Value of Bonds
 - ii. Amount
 - c. Sales:
 - i. Shares or Par Value of Bonds
 - ii. Amount
 - d. Totals
 - i. Shares or Par Value of Bonds
 - ii. Amount

- B. On a quarterly basis, information on clients' accounts, as follows:
1. The number of clients' accounts, as of the beginning of the quarter, accounts opened and closed during the quarter and accounts as of the end of the quarter, categorized by groups of clients' accounts as designated by the Resolution, except that portfolio management accounts shall be reported separately.
 2. As of the end of the quarter, the number of clients' accounts with cash balances , the cash balances in those accounts, the number of clients' accounts with securities and the market value of securities in those accounts, categorized by groups of clients' accounts, as designated in the Resolution, except that portfolio management accounts shall be reported separately..
 3. As of the end of the quarter, the following information on unsecured debits:
 - a. Number of Accounts
 - b. Total Unsecured Debits
 - c. Largest Unsecured Debit
 4. The following information on customer complaints received:
 - a. Customer
 - b. Group of Client Account
 - c. Nature of Compliant
 - d. Written/Verbal Compliant
 - e. Date Received
 - f. Response
 - g. , Date of Response
 5. As of the end of the quarter, the following information on securities concentrations:
 - a. Security
 - b. Shares or Par Value of Bonds
 - c. Market Value
 - d. Number of Customers
- C. On a quarterly basis, revenue derived from FBF's permitted activities according to Paragraph 8 of the LSC August 1, 1997 Resolution 18 On Issuance And Revocation Of Licenses For Finance Brokerage Firms, categorized by groups of clients' accounts, as designated in the Resolution, except that portfolio management accounts shall be reported separately.

Rule on Required Reporting...

D. On a quarterly basis, other statistical information, as follows:

1. The number of items and total principal amounts of confirmations mailed after settlement date.
2. As of the end of the quarter, the number of items and amounts of bank reconciliation items over 30 days old.
3. As of the end of the quarter, the number of items and amounts of accounts receivable over 30 days old.
4. As of the end of the quarter, the number of items, securities value and money amounts of differences with the CSDL.
5. As of the end of the quarter, the number of items, securities value and money amounts of differences with the Lithuanian Stock Exchange.
6. As of the end of the quarter, the number of items, securities value and money amounts of differences in the books and records.
7. As of the end of the quarter, the number of items, securities value and money amounts in suspense accounts.
8. As of the end of the quarter, the number and amounts of fails to receive.
9. As of the end of the quarter, the number and amounts of fails to deliver.
10. The amount of capital borrowing due within six months.
11. The amount of planned capital expenditures within six months.
12. The number of employees at the beginning and end of the quarter, categorized as follows:
 - a. Licensed Brokers
 - b. Brokers' Assistants
 - c. Operations
 - d. Administration
 - e. Total

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TRADE INFORMATION

Resident Purchases for the Quarter (Part 1 of 8):

	<u>Total</u>		<u>On Exchange Equity</u>		<u>Off Exchange Equity</u>		<u>Underwriting</u>		<u>Corporate Bonds</u>	
	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>
Portfolio Management (not Included in Resolution No.4 Categories, below)										
Resolution No 4 Categories										
1 Financial Brokerage Firms										
2 Central Bank										
3 Commercial Bank										
4 Savings Bank										
5 Other Credit Institutions										
6 Insurance Institutions (except Mandatory Social Insurance)										
7 Pension Funds (including Mandatory Social Insurance)										
8 Investment Companies (Funds)										
9 Natural Persons										
10 Other Financial Intermediaries										
11 Public and Municipality Institutions										
12 State Government Institutions										
13 Companies in which the State (Municipality) Owns More than 50% of the Authorized Capital										
14 Companies in which the Privately Owned Capital Makes More than 50% of the Authorized Capital										
15 Companies which Have No Rights of a Legal Person (Partnership, Limited Partnership, Personal Companies and Others)										
16 Non-profit - Seeking Organizations (Public Institutions, Associations, Charities and Support Funds)										
17 Others										
Total Clients										
Trading for Own Account										
Totals										

LITHUANIA SECURITIES COMMISSION
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TRADE INFORMATION

Resident Purchases for the Quarter (Part 2 of 8):

	<u>Municipals</u>		<u>Government</u>		<u>Foreign Securities</u>		<u>Derivatives</u>		<u>Other</u>	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount
Portfolio Management (not included in Resolution No 4 Categories, below)										
Resolution No 4 Categories										
1 Financial Brokerage Firms										
2 Central Bank										
3 Commercial Bank										
4 Savings Bank										
5 Other Credit Institutions										
6 Insurance Institutions (except Mandatory Social Insurance)										
7 Pension Funds (including Mandatory Social Insurance)										
8 Investment Companies (Funds)										
9 Natural Persons										
10 Other Financial Intermediaries										
11 Public and Municipality Institutions										
12 State Government Institutions										
13 Companies in which the State (Municipality) Owns More than 50% of the Authorized Capital										
14 Companies in which the Privately Owned Capital Makes More than 50% of the Authorized Capital										
15 Companies which Have No Rights of a Legal Person (Partnership, Limited Partnership, Personal Companies and Others)										
16 Non-profit - Seeking Organizations (Public Institutions, Associations, Charities and Support Funds)										
17 Others										
Total Clients										
Trading for Own Account										
Totals										

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TRADE INFORMATION

Non-resident Purchases for the Quarter (Part 3 of 8):

<u>Country</u>	<u>Investor Group</u>	<u>Total</u>		<u>On Exchange Equity</u>		<u>Off Exchange Equity</u>		<u>Underwriting</u>		<u>Corporate Bonds</u>		<u>Municipals</u>		<u>Government</u>		<u>Foreign Securities</u>		<u>Derivatives</u>		<u>Other</u>	
		<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>

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TRADE INFORMATION

Resident Sales for the Quarter (Part 4 of 8):

	<u>Total</u>		<u>On Exchange Equity</u>		<u>Off Exchange Equity</u>		<u>Underwriting</u>		<u>Corporate Bonds</u>	
	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>
Portfolio Management (not included in Resolution No.4 Categories, below)										
Resolution No 4 Categories:										
1 Financial Brokerage Firms										
2 Central Bank										
3 Commercial Bank										
4 Savings Bank										
5 Other Credit Institutions										
6 Insurance Institutions (except Mandatory Social Insurance)										
7 Pension Funds (including Mandatory Social Insurance)										
8 Investment Companies (Funds)										
9 Natural Persons										
10 Other Financial Intermediaries										
11 Public and Municipality Institutions										
12 State Government Institutions										
13 Companies in which the State (Municipality) Owns More than 50% of the Authorized Capital										
14 Companies in which the Privately Owned Capital Makes More than 50% of the Authorized Capital										
15 Companies which Have No Rights of a Legal Person (Partnership, Limited Partnership, Personal Companies and Others)										
16 Non-profit - Seeking Organizations (Public Institutions, Associations, Charities and Support Funds)										
17 Others										
Total Clients										
Trading for Own Account										
Totals										

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TRADE INFORMATION

Resident Sales for the Quarter (Part 5 of 8):

	<u>Municipals</u>		<u>Government</u>		<u>Foreign Securities</u>		<u>Derivatives</u>		<u>Other</u>	
	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>
Portfolio Management (not included in Resolution No 4 Categories, below)										
Resolution No 4 Categories:										
1 Financial Brokerage Firms										
2 Central Bank										
3 Commercial Bank										
4 Savings Bank										
5 Other Credit Institutions										
6 Insurance Institutions (except Mandatory Social Insurance)										
7 Pension Funds (including Mandatory Social Insurance)										
8 Investment Companies (Funds)										
9 Natural Persons										
10 Other Financial Intermediaries										
11 Public and Municipality Institutions										
12 State Government Institutions										
13 Companies in which the State (Municipality) Owns More than 50% of the Authorized Capital										
14 Companies in which the Privately Owned Capital Makes More than 50% of the Authorized Capital										
15 Companies which Have No Rights of a Legal Person (Partnership, Limited Partnership, Personal Companies and Others)										
16 Non-profit - Seeking Organizations (Public Institutions, Associations, Charities and Support Funds)										
17 Others										
Total Clients										
Trading for Own Account										
Totals										

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TRADE INFORMATION

Non-resident Sales for the Quarter (Part 6 of 8):

<u>Country</u>	<u>Investor Group</u>	<u>Total</u>		<u>On Exchange Equity</u>		<u>Off Exchange Equity</u>		<u>Underwriting</u>		<u>Corporate Bonds</u>		<u>Municipals</u>		<u>Government</u>		<u>Foreign Securities</u>		<u>Derivatives</u>		<u>Other</u>	
		<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>

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TRADE INFORMATION

Ten Largest Trades (Part 7 of 8):

	<u>Security</u>	<u>Shares or Par</u>	<u>Buy/ Sell</u>	<u>Client Code</u>	<u>Investor Group</u>	<u>Amount</u>
1.						
2.						
3.						
4.						
5.						
6.						
7.						
8.						
9.						
10.						
Total						

Five Most Actively Traded Securities (Part 8 of 8):

	<u>Security</u>	<u>Buys</u>		<u>Sells</u>		<u>Totals</u>	
		<u>Shares or Par</u>	<u>Amount</u>	<u>Shares or Par</u>	<u>Amount</u>	<u>Shares or Par</u>	<u>Amount</u>
1.							
2.							
3.							
4.							
5.							
Totals							

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CUSTOMER ACCOUNT INFORMATION

Number of Accounts (Part 1 of 6):

	<u>Beginning</u> of the <u>Quarter</u>	<u>Opened</u> during <u>Quarter</u>	<u>Closed</u> during <u>Quarter</u>	<u>End</u> of the <u>Quarter</u>
Portfolio Management (not included in Resolution No.4 Categories, (below)				
Resolution No.4 Categories:				
1 Financial Brokerage Firms				
2 Central Bank				
3 Commercial Bank				
4 Savings Bank				
5 Other Credit Institutions				
6 Insurance Institutions (except Mandatory Social Insurance)				
7 Pension Funds (including Mandatory Social Insurance)				
8 Investment Companies (Funds)				
9 Natural Persons				
10 Other Financial Intermediaries				
11 Public and Municipality Institutions				
12 State Government Institutions				
13 Companies in which the State (Municipality) Owns More than 50% of the Authorized Capital				
14 Companies in which the Privately Owned Capital Makes More than 50% of the Authorized Capital				
15 Companies which Have No Rights of a Legal Person (Partnership, Limited Partnership, Personal Companies and Others)				
16 Non-profit-Seeking Organizations (Public Institutions, Associations, Charities and Support Funds)				
17 Others				

Total Clients

LITHUANIA SECURITIES COMMISSION
 FORM NO. _____ DATE _____

CUSTOMER ACCOUNT INFORMATION

Cash Balances and Securities Market Value End of Quarter (Part 2 of 6):

Cash Balances
 Number of
Accounts Balances

Securities
Market Value
 Number of Market
Accounts Value

Portfolio Management (not included in Resolution
 No.4 Categories, (below)

Resolution No.4 Categories:

- 1 Financial Brokerage Firms
- 2 Central Bank
- 3 Commercial Bank
- 4 Savings Bank
- 5 Other Credit Institutions
- 6 Insurance Institutions (except Mandatory Social Insurance)
- 7 Pension Funds (including Mandatory Social Insurance)
- 8 Investment Companies (Funds)
- 9 Natural Persons
- 10 Other Financial Intermediaries
- 11 Public and Municipality Institutions
- 12 State Government Institutions
- 13 Companies in which the State (Municipality) Owns More than 50% of the Authorized Capital
- 14 Companies in which the Privately Owned Capital Makes More than 50% of the Authorized Capital
- 15 Companies which Have No Rights of a Legal Person (Partnership, Limited Partnership, Personal Companies and Others)
- 16 Non-profit - Seeking Organizations (Public Institutions, Associations, Charities and Support Funds)
- 17 Others

Total Clients

LITHUANIA SECURITIES COMMISSION
FORM NO. _____ DATE _____

CUSTOMER ACCOUNT INFORMATION

Ten Most Active Customer Accounts for the Quarter, Based on Number of Trades (Part 3 of 6):

	<u>Client Code</u>	<u>Investor Group</u>	<u>Buys</u>		<u>Sells</u>		<u>Total</u>	
			<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>
1.								
2.								
3.								
4.								
5.								
6.								
7.								
8.								
9.								
10.								

Customer Complaints (Part 4 of 6):

	<u>Customer</u>	<u>Investor Group</u>	<u>Nature of Complaint</u>	<u>Written/ Verbal</u>	<u>Date Received</u>	<u>Response</u>	<u>Date of Response</u>
1.							
2.							
3.							
4.							
5.							

CUSTOMER ACCOUNT INFORMATION

Client Unsecured Debits (Part 5 of 6):

<u>Number of Accounts</u>	<u>Total Unsecured Debits</u>	<u>Largest Unsecured Debit</u>
-------------------------------	---------------------------------------	----------------------------------------

Concentrations (Part 6 of 6) (1):

<u>Security</u>	<u>Shares or Par</u>	<u>Market Value</u>	<u>Number of Customers</u>
1.			
2.			
3.			
4.			

(1) A concentration exists in any one security issue, when one or more customer's securities exceed 10 percent of the outstanding shares in that issue, or 100 percent of the average weekly volume (during the preceding three month period).

LITHUANIA SECURITIES COMMISSION
FORM NO. _____ DATE _____

Revenues in Activities as Permitted by RULES ON ISSUANCE AND REVOCATION
OF LICENSES FOR FINANCIAL BROKERAGE FIRMS:

This Year
Quarter to Date

Paragraph 8.1 Acting as intermediaries in public trading of securities

Paragraph 8.2 Buying or selling securities in own name or on behalf of their clients, for their own
own account or for the account of their clients:

Portfolio Management (not included in Resolution No.4 Categories, below)

Resolution No.4 Categories:

- 1 Financial Brokerage Firms
- 2 Central Bank
- 3 Commercial Bank
- 4 Savings Bank
- 5 Other Credit Institutions
- 6 Insurance Institutions (except Mandatory Social Insurance)
- 7 Pension Funds (including Mandatory Social Insurance)
- 8 Investment Companies (Funds)
- 9 Natural Persons
- 10 Other Financial Intermediaries
- 11 Public and Municipality Institutions
- 12 State Government Institutions
- 13 Companies in which the State (Municipality) Owns More than 50% of the
Authorized Capital
- 14 Companies in which the Privately Owned Capital Makes More than 50% of the
Authorized Capital
- 15 Companies which Have No Rights of a Legal Person (Partnership, Limited
Partnership, Personal Companies and Others)
- 16 Non-profit - Seeking Organizations (Public Institutions, Associations, Charities
and Support Funds)
- 17 Others

Total Clients' Commission

Paragraph 8.3 Providing investment advice to investors on issues concerning prices of securities,
investment in securities as well as their purchase and sale

Paragraph 8.4 Managing their clients' investment portfolio and funds allocated for operations with
securities

Paragraph 8.5 Providing safe custody services

Paragraph 8.6 Consulting the issuers on matters concerning the issue of securities and on
attracting investments

Paragraph 8.7 Pursuant to the agreement with the issuer, underwrite the securities issue

Paragraph 8.8 Conducting the securities accounting for issuers

Paragraph 8.9 Pursuant to the rules approved by the commission, lend securities and cash to their
clients for acquisition of securities

Totals

OTHER STATISTICAL INFORMATION

Corrected Confirmations Within Quarter Mailed After Settlement Date (Part 1 of 12):

Items _____

Amounts _____

As of the End of the Quarter, Bank Account Reconciliation Items Over 30 Days Old (Part 2 of 12):

Items _____

Amounts _____

As of the End of the Quarter, Accounts Receivable Over 30 Days Old (Part 3 of 12):

Items _____

Amounts _____

<u>As of the End of the Quarter</u>	<u>Items</u>	<u>Securities Value</u>	<u>Money</u>
-------------------------------------	--------------	-----------------------------	--------------

Differences with Central Depository (Part 4 of 12)

Differences with Clearing Bank (Part 5 of 12)

Daily Books and Records Differences (Part 6 of 12)

Suspenses Accounts (Part 7 of 12)

Fails to Receive (Part 8 of 12)

Fails to Deliver (Part 9 of 12)

Capital Borrowings Due within Six Months (Part 10 of 12) _____

Planned Capital Expenditures within Six Months (Part 11 of 12) _____

Employees (Part 12 of 12):

<u>Beginning of Quarter</u>	<u>End of Quarter</u>
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Licensed Brokers

Brokers' Assistants

Operations

Administration

Total

Prepared By: Donald Buddenbohn

Date: November 10, 1998

**BACKGROUND MEMO ON THE
COMPLIANCE FUNCTION, INTERNAL AUDIT AND INDEPENDENT AUDIT
AND THE IMPACT OF INTERNAL CONTROLS UPON THEM
AS THEY RELATE TO FINANCIAL BROKERAGE FIRMS**

Summary

Establishment and maintenance of sophisticated internal controls can be a costly, time consuming task. Given the present state of the development of the securities market in Lithuania, in so far as the requirement to establish adequate internal controls is concerned, I think a realistic, cost effective approach is the most practical at this time.

This could begin by requiring financial brokerage firms to comply with existing requirements of paragraph 6 in the Code of Ethics of the Intermediaries of Trading of Public Securities of the National Association of Finance Brokers to prepare written procedures and provide supervisory oversight (compliance) particularly in regard to laws, rules and regulations.

At a later date, when the financial market is more developed and financial brokerage firms are more firmly established and larger, more sophisticated techniques should be required.

The following is a review of the functions of Compliance and Internal Audit and the examination of an Independent Auditor, how they relate to the process of internal control for Lithuanian financial brokerage firms and conclusions I have drawn on how they should relate to the current environment in the Lithuania financial market.

Compliance

The role of the Compliance Function in a financial brokerage firm is to:

1. design supervisory controls and procedures to assist in achieving compliance with applicable securities laws, rules, regulations and policies established by the financial brokerage firm,
2. oversee adherence to those laws, rules, regulations and policies, and
3. enforce compliance with those laws, rules, regulations and policies.

The responsibility of every financial brokerage firm to maintain and enforce adequate standards of supervision extends to every aspect of its activities. Customers dealing with financial brokerage firms have a right to expect to be treated fairly and should be able to rely on them having systems of supervision, internal control and safeguards against employees who may be tempted to engage in improper conduct.

An effective compliance program assists financial brokerage firms in maintaining standards to which they should adhere if investor confidence in the fairness of the market place is to be warranted and sustained. It cannot be overemphasized that to be effective, a compliance program must place the compliance interests of the financial brokerage firm above the interests of the firm or any individual in the firm.

The Compliance Officer of a financial brokerage firm, who often has a legal background, is the person in whom management vests the ultimate authority and responsibility to carry out the role of the Compliance Function. It is essential that the Compliance Officer be vested with sufficient authority and full support of senior management so that he/she is fully empowered to carry out his/her responsibilities successfully.

Written supervisory procedures are essential to ensure compliance of all financial brokerage firm personnel with applicable securities laws, rules, regulations and policies established by the firm.

Background Memo...

The requirement for a supervisory system, in other words a Compliance Function, for financial brokerage firms is founded in paragraph 16, on supervision, in The Code of Ethics of the Intermediaries of Trading of Public Securities of the National Association of Financial Brokers. The Code of Ethics has the approval of the Lithuanian Securities Commission, which gives it the force of law. The Code was modeled after Section 17, Supervisory System, of the Rules of Fair Practice of the National Association of Securities Dealers (United States) which also establishes a foundation for a Compliance Function in the United States.

Application to Small Firm

A small organization may have a special problem with respect to its compliance program because it may not be economically feasible to employ a full time Compliance Officer or staff. In this case, the person designated as Compliance Officer will have other duties, often including sales. Where the Compliance Officer does not devote full time to supervision of the financial brokerage firm, care should be taken that such individual is oriented to and spends an appropriate amount of time in the compliance effort and supervision of the financial brokerage firm and that he has the knowledge required for such a position.

Internal Audit

Internal Audit in a financial brokerage firm is a function, usually established by and ideally reporting directly to the Board of Directors of the firm, to undertake "audits" or examinations often of individual units or functions of the firm. Examinations that an Internal Audit Department undertakes are usually at the discretion of the Internal Auditor when he observes a unit or function that appears to warrant an examination for various reasons, such as when violations of rules, regulations, policies or other deficiencies may be suspected. They may also perform specific examinations at the request of the Board of Directors or other management person or group.

The use of the word "audit" here should not be confused with the term as used in connection with the audit of the financial statements that will be explained in the Independent Audit section of this Memo.

The work of Internal Audit normally results in providing analyses, evaluations, assurances, recommendations, and other information to the firm's management and Board of Directors or others with equivalent authority and responsibility. To fulfill this responsibility, Internal Auditors should maintain objectivity with respect to the activity being examined.

Often, an important responsibility of Internal Audit is to monitor the performance of a firm's internal controls.

Depending on the Independent Auditor's evaluation of the competence and objectivity of the Internal Audit work, he/she may use the Internal Audit work to justify contraction of audit procedures. In addition, it is possible for the Independent Auditor to request assistance from the Internal Audit staff to perform some audit procedures, again depending on his/her evaluation of the competence and objectivity of the staff.

The Internal Auditor and some of the Internal Audit staff may be licensed by a licensing authority, such as the Lithuanian Institute of Audit and Accounting, but it is not required.

Application to Small Firm

Internal Audit is not only a valuable internal control in and of itself, it is often an important monitor of internal controls. While an effective Internal Audit function is an extremely good management tool, it can be a very expensive tool. Because of the expense, their functions will probably have to be accomplished through some alternative means in most small firms. Specifically, small entities may have to use a less formal means to ensure that their internal audit and internal control objectives are achieved. In small firms this is typically accomplished as a part of the overall management of the entity's operation. I know of no laws or regulations in the securities industry or any other industry that require a firm to have an Internal Audit function.

Independent Audit

The European Communities Council Directives require audits of financial brokerage firms. An Independent Audit, as provided for by the Draft Rule on Reports to be Made by Financial Brokerage Firms (Draft Rule), is an examination that an independent auditor performs in order to express an opinion on the fairness with which the financial statements of a financial brokerage firm present, in all material respects, the financial position, results of operations, changes in financial position and cash flows in conformity with generally accepted accounting principles.

Background Memo...

An independent auditor, as provided for by the Draft Rule, is an auditor who is duly licensed, in good standing, by the Lithuanian Institute of Audit and Accounting, who is without bias with respect to his/her financial brokerage firm client since otherwise he/she would lack that impartiality necessary for the dependability of his/her findings, however excellent his/her technical proficiency may be.

As provided for by the Draft Rule, the independent audit shall be made in accordance with generally accepted auditing standards and shall include a review of accounting systems and internal accounting controls. The scope of the audit and review of the accounting systems and internal controls shall be sufficient to provide reasonable assurance that any material inadequacies existing at the date of the examination in (a) the accounting system; (b) the internal accounting controls; and (c) the practices and procedures would be disclosed.

As provided for by the Draft Rule, if material inadequacies exist in the accounting system, internal accounting controls, or otherwise then the independent auditor must prepare a report concurrently with the annual report describing the material inadequacies. This report shall indicate any corrective action taken or proposed in regard thereto.

It is not certain whether this Draft Rule will be issued or not. But, whether it is or not, it seems clear that either a law or a rule sponsored by the Lithuania Government, the Ministry of Finance or the Securities Commission will at some point require audits of financial brokerage firms and as part thereof the Independent Auditors will be required to satisfy themselves that the financial brokerage firm has adequate internal controls.

Application to Small Firm

When it becomes a requirement of the law for financial brokerage firms to have audits and for Independent Auditors to satisfy themselves that the financial brokerage firms have adequate internal controls, then large and small firms alike will have to comply with the requirement.

Internal Control

Internal control is a process designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (a) reliability of financial reporting, (b) effectiveness and efficiency of operations, and (c) compliance with applicable laws and regulations.

What is needed to effectively achieve the objectives of internal control are the following components of internal control:

1. *Control Environment.* The entity's overall attitude toward internal control.
2. *Risk Assessment.* Identification of areas that require internal controls to reduce risk.
3. *Control Activities.* Policies and procedures, preferably written, that are designed to avoid risk.
4. *Information and Communications.* Information is the accounting and other reporting systems. Communications are such things as policy and accounting manuals and sometimes oral communications from management.
5. *Monitoring.* The assessment of the quality of internal control over time.

Internal control is relevant to the entire entity, or to any of its operating units or business functions. It is the responsibility of top management to establish the control environment. After a risk assessment has taken place and appropriate control activities and information and communications to avoid risks are in place, the monitoring component attempts to ensure compliance with the internal controls included in the control activities, and information and communications.

Monitoring is accomplished through ongoing activities, separate evaluations, or by various combinations of the two. In many entities, internal auditors or personnel performing similar functions contribute to the monitoring of an entity's activities.

Background Memo...

Application to Small Firm

The way internal control components apply will vary based on an entity's size and complexity, among other considerations. But, even companies that have only a few employees may be able to delegate responsibilities to achieve some degree of segregation of duties. Nevertheless, small entities may have to use less formal means to ensure that internal control objectives are achieved, such as using management oversight of incompatible activities.

The cost of an entity's internal control should not exceed the benefits expected. For example it may not be practical or cost effective for a small firm to have extensive accounting or sophisticated information systems. Instead, they may have to rely on a firm culture that emphasizes the importance of integrity and ethical behavior through oral communication and by management example.

However, when small entities are involved in complex transactions or are subject to legal or regulatory requirements also found in larger entities, more formal means of ensuring that internal control objectives are achieved may be necessary.

Conclusion

European Communities Council Directive 93/22 on Investment Services in the Securities Field provides that investment firms draw up rules that require them to have "adequate internal control mechanisms".

While good internal control procedures are very important, sophisticated procedures will probably not be very practical or cost effective for most, if not all, financial brokerage firms in Lithuania. It is, however, necessary to not lose sight of the most critical areas in need of adequate controls. Financial brokerage firms deal with complex transactions and must comply with a multitude of laws and regulations and it is in this area where it is essential to establish comprehensive internal controls.

The most basic, and most important, need at present in the Lithuanian securities market in regard to internal control, is ensuring that financial brokerage firms are in compliance with the appropriate laws, rules and regulations. This is generally accomplished by the Compliance Officer and his/her staff. The foundation for the Compliance is already established through paragraph 16, on supervision, in the Code of Ethics of the Intermediaries of Trading of public Securities of the National Association of Finance Brokers.

The major focus of the Compliance Function is to ensure adherence to the laws, rules and regulations. Part of their role is to design controls and procedures to accomplish this. Paragraph 16 of the Code of Ethics requires that financial brokerage firms establish written procedures "to supervise activities" and "to achieve compliance with applicable securities laws, other legal acts and the Code". This is exactly what we are trying to accomplish with both the Compliance Function and internal controls in so far as laws, rules and regulations are concerned. Written procedures should embody the appropriate internal controls necessary for them to be effective.

While this does not address all of three objectives of internal control, in my opinion, it addresses the most important and most basic one (compliance with applicable laws and regulations). It is also noteworthy that it deals directly with two of the components of internal control (control activities, and information and communications) as well, through requiring written procedures.

An Internal Audit Function, in addition to a Compliance Function, can be a very effective monitor of internal controls, but should not be considered as a substitute for Compliance. Internal Audit does not normally have the primary focus of compliance with laws, rules and regulations and also, there is no legal requirement that firms have such a function. Besides, the cost of an Internal Audit Function, would be prohibitive for most, if not all, financial brokerage firms. As the financial market in Lithuania expands and financial brokerage firms become more firmly established, Internal Audit Functions will become much more important, practical and cost effective to establish.

A separate Internal Control group that would solely deal with monitoring internal controls, is an excellent approach, but one that could only be afforded by the most sophisticated of firms with a budget sufficiently large to sustain such an effort.

Background Memo...

In my opinion, the best and most practical approach for establishing internal controls for financial brokerage firms in Lithuania at this time is, first, to require each firm to establish the internal controls that they deem appropriate, given the size and complexity of their organization. Second, require that all financial brokerage firms comply with the paragraph 6 of the Code of Ethics, at least in so far as written procedures are concerned, particularly as they relate to compliance with laws, rules and regulations. Third, again in compliance with paragraph 6 of the Code of Ethics, require all financial brokerage firms to appoint a Compliance Officer to fulfill the role of the of the Compliance Function, as previously outlined, at least as thoroughly as possible, particularly as it relates to overseeing and enforcing compliance with laws, rules and regulations. It should be recognized, that given the size and limited resources of many Lithuanian financial brokerage firms, a Compliance Officer may be only able to devote part of his/her time in this capacity and in some cases it may be a principal of the firm fulfilling this responsibility.

Of course, when the law requires Independent Auditors to satisfy themselves as to the adequacy of internal controls, all financial brokerage firms will have to comply.

Prepared By: Donald Buddenbohn

Date: November 2, 1998

**COMMENTS ON THE
RULE ON INSPECTION OF FINANCIAL BROKERAGE FIRMS
AND RELATED MATTERS**

I have reviewed the RULE ON INSPECTION OF FINANCIAL BROKERAGE FIRMS and offer the following suggests:

MAIN PARTS OF RULE

Paragraph 1.3. - I think that the purpose of the Inspection should also include a determination that "generally good business practices are being followed". Such a reference may allow the Commission to perform an inspection when there is not a clear indication that legal requirements were not followed or something outside the legal requirements, that was not contemplated when the requirements were written, requires investigation.

Paragraph 2. - I believe this paragraph would be clearer, if it were broken down into two sub-paragraphs; one for cause inspections and one for regular inspections.

Paragraph 2.3. - I would make this paragraph the "purpose" of the cause inspection. In addition, I recommend that a cause inspection could be carried out at the discretion of the Commission for good cause. This would allow the Commission to perform a cause inspection when they have strong suspicions that something may be wrong.

Paragraph 2.6. - Perhaps the inspector's responsibility, in so far as material-technical requirements, should be limited to the requirements of the Rule on Instruction on Safety Requirements for Securities and their Trading Accounting. Beyond that, even though you always want an inspector to be aware of any situation that may be detrimental including material-technical considerations, he/she is probably not qualified to make judgments regarding the adequacy of material-technical facilities and arrangements. Also, instead of just "other", it may be more meaningful to say "all other matters deemed appropriate by the Commission."

Paragraph 2.7. - Instead of "only one specific field", why not "only specific fields of activity of the financial brokerage firm shall be examined, as appropriate." This will provide for situations where complaints or violations may cover more than one specific field of activity.

Paragraph 2.8.2. - This calls for submitting the protocol and conclusions of the cause inspection, but submitting them to whom? The Commission, I presume, but what about the financial brokerage firm?

Comments on...

Paragraph 3.2. - See comments on paragraph 2.6. regarding material-technical status.

Paragraph 3.4. - I suggest that "etc." be eliminated and additional specific items be added, as appropriate, if necessary. Also, reference to "rules of ethical behavior" be specifically to "the Code of Ethics of the Intermediaries of Public Trading in Securities."

Paragraph 3.6. - I suggest that the end of the next to last sentence, "regarding elimination of the deficiencies detected during the inspection" be eliminated. It may be appropriate to include conclusions and recommendations that are not regard to elimination of the deficiencies detected during the inspection. Also, it says the completed reported is submitted to the Commission; when does it get submitted to the financial brokerage firm?

Paragraph 3.7. - This paragraph says that the management of the inspected firm shall not be informed of the findings of the inspection. I think it is important that the management of the inspected firm be told of the findings of the inspection, both when there are no violations and when there are violations.

ANNEX 3
QUESTIONNAIRE OF THE ROUTINE INSPECTION OF A
FINANCIAL BROKERAGE FIRM

General - I think the questionnaire would be much easier to work with and review if it would be arranged so that all "no" answers to yes/no questions would indicate a problem or potential problem. Most of the questions already accomplish this. Those that do not, could be dealt with rather easily as follows:

1. Instead of yes/no questions, some questions can be even more effective by asking for lists. These are as follows: I.2.2, 3.5, 4, 4.2, 5.1, 6.1, 6.2, II.1.1, III.1.2, 1.3, V.1.6 and VI.2.4. So, for example, question I.3.5 instead of asking: "Does the FBF provide additional services to its clients?", could ask for a list of additional services the FBF provides to clients.
2. Some questions that are not yes/no questions can be changed to yes/no questions and be even more effective. These are as follows: VI.1.1, 1.3 VII.2.2 and 2.3. So, for example, question VI.1.3 instead of asking: "How are the accounting records and financial statements completed (Chapter VI of the Law on Accounting Principles)?", could ask: "Are the accounting records and financial statements completed in accordance with Chapter VI of the Law on Accounting Principles?".
3. Change question IV.2.1.5 to "Have these accounts been examined for illegal activities (churning, unauthorized trades)?" so that a no answer will indicate a problem or potential problem.
4. Question VI.2.3 is a yes/no question, but needs the yes/no boxes.

Comments on...

It should be a requirement that the inspector comment on all questions getting a "no" response.

"No " answers to some questions and some answers to non yes/no questions are going to require that the inspector examine, at least a sampling, of some documentation. In addition, the inspector will often want to examine documentation to support the accuracy of "yes" answers. An Audit Program is a very useful guide for the inspector to complete the inspection in an organized and thorough way.

Question I.3.1. - I suggest that the list of FBF activities be conformed to the Rule on Issuance and Revocation of Licenses for Finance Brokerage Firms.

Question III.1.3. - A whole separate section (paragraph) should be considered for FBFs acting in the capacity of a Registrar for public companies, handling the recordkeeping and related activities for their issued securities.

Question III.1.4. - It may be expecting too much for an inspector to know requirements for agreements beyond the rules of the Securities Commission, i.e., "the Civil Code, etc."

Question IV.2.1. - This question regarding discretionary accounts is basically the same question as Question III.1.2. One should be eliminated, probably III.1.2.

Question IV.3. - There are two sections on confirmations. This one and Paragraph V. 3. They should be combined, probably at Paragraph V.3.

Questions V.1.3, 1.4, 2.5, 3.2 and VI.1.2.2 - All these questions require multiple yes or no answers. The questions should be re-written to provide one yes or no answer for each question.

Question V.3.1. - I suggest that the parenthetical remark be eliminated so the yes/no question can be answered without complication.

Paragraphs VII. and VIII - Both paragraphs deal with issues normally under the oversight of a Compliance Section in the FBF. I suggest they be combined into one paragraph called "Compliance". Question I.5.2. should be moved to this Section.

AREAS NOT COVERED IN QUESTIONNAIRE

There were a number of areas not covered in the questionnaire that are important. These are as follows:

1. Consulting Issuers
2. Underwriting
3. Custody
4. Trading for One's Own Account

Comments on...

5. Researching Securities
6. Capital
7. Balance Sheet Accounts
8. Securities Concentrations
9. Balancing Differences and Suspense Accounts
10. Training programs, continuing education

ADDITIONAL OBSERVATIONS AND SUGGESTIONS
FOR INSPECTIONS

As a result of observing a portion of the inspection of Hansabank Markets and through inquiries and other observations, I have the following additional suggestions:

The Big Picture – In performing an inspection it is very important for the inspector to ask about and understand the philosophy, volume and kinds of business, objectives and directions of the inspected enterprise. The inspector should keep this big picture in focus throughout the inspection and be aware and make observations of situations and circumstances that do not support it. This may lead the inspector to ask questions about things like the number of employees, the size and quality of the office space, profit motive and other things that seem to be inconsistent with the purported overall picture.

Insight into the big picture can be gained through examination of the inspected firm's organization chart, business plan, budgets, forecasts and the Commission's file on the firm. Previous financial statements should be examined for trends, large changes in amounts and ratios, aberrations and anomalies.

Audit Testing and Procedures - I realize that there are limited resources for performing inspections, so some hard decisions may have to be made as to just how much can be done and to what extent. In any case, the questionnaire is a very helpful and useful tool, but in a sense it is only the beginning of the inspector's examination. The responses to the questionnaire should lead the inspector to the areas that he/she should be examining and the extent of his/her procedures. The procedures that an inspector takes are often outlined in an audit program, which might be called the inspector's work plan. In a separate document I will provide a sample of an audit program for a small portion of an inspection.

Balance Sheet Approach - An important part of routine inspections should be establishing the accuracy and validity of Balance Sheet amounts.

Comments on...

Capital - Routine inspections should include a review of the practices and procedures followed in making the capital adequacy calculation. The inspector should verify the calculation of the inspected firm's capital adequacy requirements, and their compliance with initial capital and capital adequacy requirements throughout the period the inspection encompasses.

Written Procedures - The inspector should ask if there are written procedures relating to financial matters or anything else subject to inspection. The inspector should review any written procedures. Good written procedures could be evidence of good internal controls.

Compliance Officer - The inspector should inquire if there is a Compliance Officer and ask what procedures he/she follows. Even in a very small firm, a Compliance Officer is an important position. It may not be economically feasible to employ a full time Compliance Officer. In this case, the person designated as the Compliance Officer will have other duties. Existence of a functioning Compliance Officer provides an element of good internal control.

Internal Controls - As an inspector performs the inspection and testing procedures he/she should be alert to the presents or absence of good internal controls. Absence of good internal controls, should prompt the inspector to consider expansion of his/her procedures. Presents of good internal controls may allow the inspector to consider a contraction in his/her procedures.

Customer Statement Review - In addition to statements of portfolio management accounts, a test review of all other customer account statements should be considered by the inspector to detect churning, unauthorized trading, suitability and other inappropriate activity. This is also a procedure normally performed by a Compliance Officer. When a Compliance Officer performs this procedure in a conscientious way, it may be deemed as a good internal control by the inspector that may allow the inspector to consider a contraction of his/her procedures in this area.

Review of Customer Correspondence - It is a good procedure for an inspector to examine correspondence of a financial broker firm and its employees to clients and potential clients for misleading, unreasonable or exaggerated statements or the spreading of rumors. This is also a procedure frequently employed by a Compliance Officer. When a Compliance Officer performs this procedure in a conscientious way, it may be deemed as a good internal control by the inspector that may allow the inspector to consider a contraction of his/her procedures in this area.

Prepared by: Donald Buddenbohn

Date: November 10, 1998

**COMMENTS ON DRAFT OF
THE PROCEDURE OF INTERNAL CONTROL IN
A FINANCIAL BROKERAGE FIRM**

I have reviewed the Draft of The Procedure of Internal Control in a Financial Brokerage Firm. Part I. General Part provides some good background information on Internal Control. Part II. Internal Control System provides a good explanation of what Internal Control is, along with some samples of internal controls.

Part III. Organization of Internal Control purports to describe the organization of an Internal Control Department and also describes some of the procedures to be used by an Internal Control Department. To me, however, Part III. is more descriptive of the organization of a Compliance or Internal Audit Function including some procedures such a Function may employ.

I have taken the liberty of changing Part III. to convert it to a description of a Compliance Function and procedures a Compliance Function might use. I was able to do this with relatively few changes and I think it represents a good description of a Compliance Function and procedures it may employ. Attached is Part III. with the changes I have made. I have crossed out wording I would delete and added wording using italicized letters. There are two comments added in brackets where there were things I did not understand.

Part IV. Final Provisions I have also changed to conform to the changes I have made to Part III. and that is also part of the attachment.

III. Organization of Internal Control

8. The financial brokerage firm shall prepare the internal control ~~rules~~ *procedures* which cover the entire scope of activity of the firm putting special emphasis upon supervision of transactions executed on the account of the firm or on the account of employees of the firm, strict separation of duties, prevention of usage of inside information and adherence to legal acts pertaining to the sphere.
9. The financial brokerage firm shall open a separate department or appoint an ~~official~~ *a Compliance Officer* responsible for ~~internal control~~ *compliance*, depending on the size (type) of the firm, scope of business, variety and complexity of business, the degree of risk related to each type of activities. Internal control may also be performed by ~~an out-sourced auditor or~~ an internal auditor.
10. ~~Officials of the internal control department shall hold a general financial broker's license. Officials of the department are~~ *The Compliance Officer* is permitted to engage in the activities of the firm to the extent that it does not interfere with the principle function, - ensuring of ~~internal control~~ *compliance* of the firm. ~~Officials of the department~~ *Compliance Officers* shall be precluded from engaging in activities related to activities controlled by them.
The requirement to establish ~~an internal control department~~ *Compliance Function* or appoint an employee in charge of ~~internal control~~ *compliance* ~~which would engage exclusively in activity related to ensuring the internal of the firm,~~ shall come into force:
For A category firms - starting on January 1, 1999
For B category firms - starting on January 1, 2000
For C category firms - starting on January 1, 2001.
11. ~~The internal control department~~ *Compliance Function* shall be subject to direct authority of the managerial bodies of the company, and shall be segregated from other departments of the firm.
12. ~~The internal control~~ *compliance* of the firm shall be carried out on a continuous basis taking into consideration the changing conditions and the nature of operations performed by the company, following the procedures approved by the firm.
13. The following types of ~~internal controls~~ *compliance inspections* are distinguished:
 - 13.1 by time:
 - 13.1.1. routine - according to the plan drawn for the entire year
 - 13.1.2. surprise inspection - following the decision of the bodies of management
 - 13.2 by scope:
 - 13.2.1. regular - the overall inspection of the activity of the department
 - 13.2.2. partial (cause) - inspection of specific functions or spheres of activities
 - 13.2.3. specialized inspection - inspection of individual areas of activities in several departments.

14. The activity related to ~~internal control~~ *a compliance inspection* shall be recorded and kept separately. Records of individual stages of ~~internal control~~ *a compliance inspection* are as follows:
 - 14.1. plan, program and objectives of ~~internal control~~ *a compliance inspection*;
 - 14.2. criteria of assessment;
 - 14.3. type and procedure of ~~internal control~~ *compliance inspection*, dates of beginning and completion of ~~internal control~~ *compliance inspection*;
 - 14.4. names of employees of ~~internal control~~ *department compliance function* and their executives;
 - 14.5. description of events, discrepancies and deficiencies discovered during the ~~internal control~~ *compliance inspection*;
 - 14.6. report on the results.
15. Report on the ~~internal control~~ *procedures* executed, including the shortcomings, deficiencies and violations discovered during the *compliance* inspection shall be filed with the management of the firm;
16. ~~When the procedure of internal control concludes that the firm is defaulting its obligations, and fails to meet the requirements set forth for the financial brokerage firm. [I do not understand what this paragraph means.]~~
17. ~~The Rule on Internal Control and report on inspection shall be submitted to the person authorized by the Commission, upon his request. [I do not understand what this paragraph means.]~~
18. The Securities Commission may apply measures to the firm, which fails to properly exercise ~~internal control of the firm~~ *a compliance program*.

IV. Final Provisions

19. The managers of the firm shall regularly perform the evaluation of the ~~internal control~~ *compliance function* of the firm.
20. ~~Evaluation of internal control~~ *Compliance inspection* is a procedure ~~an examination~~ to evaluate the *effectiveness of and compliance with procedures mechanism of internal control*, as well as, ~~provisions are made to enhance the efficiency of the internal control.~~

Prepared by : Donald Buddenbohn

Date: November 3, 1998

MEMORANDUM ON AUDIT (INSPECTION) PROGRAMS

Audit (inspection) programs can be very useful tools in carrying out audits (inspections). Attached are samples of three sections of a typical program as it might be written for carrying out inspections of financial broker firms for the Inspection Staff of the Securities Commission. The sections are Cash, Employee Accounts and Executed Order Tickets.

It would be a good technic to create a model audit (inspection) program that would generally apply to all financial brokerage firms in Lithuania. In the planning stages of a specific inspection, the program could be customized for that individual financial brokerage firm. The customized program could take into consideration the individual characteristics of each financial brokerage firm. The extent of testing could be determined based on the inspector's knowledge of the firm and its internal controls.

With this approach, in time, each financial brokerage firm would have their own individual audit (inspection) program, that would only need to be changed as circumstances changed.

The attached sample programs are intended to be illustrative only. Some steps may be unnecessary or inappropriate and additional steps may be warranted in these particular areas.

A sample audit (inspection) program for Cash:

<u>Inspection Procedure</u>	<u>Inspector's Initials</u>	<u>Date Completed</u>
I. Obtain the following documents as of the end of the previous month end, from the firm being inspected:		
A. Copies of all bank account statements provided by the banks of the inspected firm.		
B. Copies of bank reconciliations.		
II. Trace the book balance on the reconciliation to the books.		
III. Verify arithmetic of reconciliation.		
IV. Obtain explanations for all reconciling items from the inspected firm and note age.		
V. If reconciling items required adjustment on inspected firm's books, review the adjustment and note how long it went uncorrected.		
VI. If reconciling items required adjustments on bank's records, review subsequent bank statement to observe correction.		
VII. Examine and obtain copies of all documentation supporting adjustments.		
VIII. Determine whether the adjustments have a material impact on the previous month end financial statements or capital adequacy calculation.		

A sample audit (inspection) program for Employee Accounts:

	<u>Inspection Procedure</u>	<u>Inspector's Initials</u>	<u>Date Completed</u>
I.	Obtain employee account statements for one recent month. Randomly examine the activity on the statements for anything unusual, particularly looking for the following: A. Late Payment of Purchases B. Prepayment for Sales C. Free Riding D. Excessive Trading E. Trading Against Firm Recommendations F. Large Quantity or Big- Money Transactions G. Suitability		
II.	From the employee account statements, randomly select a representative number of specific trades and trace them to order tickets. Determine that order tickets are completed in all respects, particularly with regard to required approvals.		
III.	From the employee account statements, randomly select a representative number of accounts and review the customer account agreements. Determine that they are completed in all respects, particularly with regard to required approvals.		

A sample audit (inspection) program for Executed Order Tickets:

	<u>Inspection Procedure</u>	<u>Inspector's Initials</u>	<u>Date Completed</u>
I.	For a recent two week period* examine all executed order tickets to determine that they are complete in all respects as follows: A. Neatly and Accurately Completed. B. Indication of Time Received. C. Indication of Time Executed. D. Indication of Quantity (Shares) E. Indication of Security. F. Buy/Sell G. Price H. Type of Order (Market, Day, etc.) I. Salesman J. Ticket Number K. Customer Name and Number L. Method of Payment/Location of Security M. Special Instructions N. Approval(s)		
II.	Trace the details of all orders to the Register of Orders.		
III.	Determine that the calculations of the summary of orders in the Register of Orders is accurate and posted to the general books accurately.		

Inspection Procedure

Inspector's
Initials

Date
Completed

IV. Examine copies of all confirmations and agree compare them in detail to the order tickets to determine they are in agreement.

* Test period could be for two days, a month or whatever period the inspector deems appropriate given the unique circumstances of each financial brokerage firm, especially the effectiveness of their internal controls.

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REPUBLIC OF LITHUANIA
LAW
ON
INVESTMENT COMPANIES

Chapter 1

General Provisions

Article 1. Objectives of the Law

1. This Law regulates the specific aspects of investment company establishment, reorganisation and liquidation, management and operation, state supervision of investment company activities, the rights and duties of shareholders and measures for the protection of rights. This Law shall also determine the procedure for reorganising into investment companies the investment stock companies established prior to the date of coming into the effect of this Law and operating for the purpose of state property privatisation under the Law of the Republic of Lithuania on the Initial Privatisation of State Property.

2. Provisions of the Company Law of the Republic of Lithuania shall apply to investment companies unless this Law provides otherwise.

Article 2. (9I-1356, May 30, 1996)

Definitions

As used in the Law:

depository means a bank, ~~subsidiary of a bank or a brokerage company or other credit institution~~ which stores the monetary funds and securities of an investment company and services operations in securities and in cash in accordance with the procedure established by Chapter 4 of this Law;

controlled enterprise means an enterprise in which the investment company holds shares representing more than 30% of the total number of votes;

investment company means a company the type of activities or property composition whereof meets the criteria set by Article 3 of this Law. Investment companies may operate as investment funds, closed-end funds or investment holding companies;

investment stock company means a company established for the purpose of state property privatisation under the Law of the Republic of Lithuania on Initial Privatisation of State Property in compliance with the procedure established by the Government of the Republic of Lithuania;

issuer means a natural or legal person who issues securities on its own behalf;

investment portfolio means a collection of investment certificates held by an investment company;

diversified investment portfolio means investment portfolio which meets all the following requirements:

1) not more than 5% of the investment company's own (net) assets have been invested in the securities issued by one issuer, except cases when:

- a) *no more than 10% of net (own) assets of the investment company are invested in securities of one issuer, and the aggregate investment where more than 5% but no more than 10% of the net (own) assets of the investment company are invested in securities of one issuer constitutes no more than 40% of the net (own) assets of the investment company.*
- b) *when securities issued by the State (Municipality) or issued by one issuer with the guarantee of the State (Municipality) are acquired, and no more than 35% of the net (own) assets of the investment company have been invested into securities of one State or the securities of one issuer with the guarantee of the State (Municipality).*
- c) *when more than 35% of the net (own) assets of the investment company are invested in the securities issued by one State (Municipality) or securities issued by one issuer with the guarantee of the State (Municipality) where the by-laws of the investment fund contains the data specified under item 15 part 7 of Article 5 of this Law, or no more than 30% of the net (own) assets of the investment company are invested in the securities of the State (municipality) of one issue or securities issued by one issuer with the guarantee of the State, and the securities portfolio is comprised of securities of at least six issues.*

2) no more than 10% of one issuer's *voting* shares have been purchased; and

3) ~~no more than 10% of one issuer's debt securities except those issued by the government or local government have been purchased;~~ ***no more than 10 percent of non-voting shares of one issuer have been purchased.***

4) ~~No more than 30 per cent of the net (own) assets of the investment company has been invested into securities issued or guaranteed by the government (the State), and the investment portfolio is made up of securities of no less than 6 issues. No more than 10 per cent of debt securities of one issuer have been purchased, except cases when the investment company acquires securities issued (or) guaranteed by the State; an investment company may acquire debt securities without the consent of the general meeting of shareholders and requirements set forth in item 6 part 2, Article 13 of the Company Law shall not be applied.~~

investor means a person who has purchased or is purchasing securities in his name and with his capital;

authorised capital means the company's capital registered in accordance with the procedure established by law which amounts to the product of the number of issued shares and their nominal value;

own capital means the investment fund shareholders' equity which is not registered and the amount whereof changes due to share redemption or cancellation as well as issue of new shares;

own (net) assets means the investment company's property value minus short-term and long-term liabilities;

persons connected with the investment company:

- 1) persons holding more than 5% of the investment company's shares;
- 2) enterprises or other organisations more than 10% of shares (or other fractional parts of the capital) whereof are held by the investment company; and
- 3) managers of the investment company and enterprises or organisations connected with it;

Persons related to the custodian of the investment companies are as follows:

- 1) entities controlling the custodian or controlled by it;
- 2) managers of the custodian;
- 3) in the event the entity controlling the custodian or controlled by the custodian are legal persons, managers of the entities are deemed related persons;
- 4) managers of other legal persons belonging to the same group as the custodian;

Persons related to the management enterprise of the investment company:

- 1) entities controlling the management enterprise or controlled by them;
- 2) managers of the management enterprise;
- 3) in the event the entity controlling the custodian or controlled by the custodian are legal persons, managers of the entities are deemed related persons;
- 4) managers of other legal persons belonging to the same group as the management enterprise;

Controlling entity means a natural or legal person which being a shareholder (member) itself holds more than one third of all votes or pursuant to the agreement with other shareholders (member) controls alone more than one third of all votes, or is vested with the right to appoint (or elect) the majority members of the Supervisory Board (the Board) or the Head of the Administration, or actually holds control over decisions passed by the legal person.

Indirect investment means investment of the controlled entity deemed the indirect investment of the controlling entity.

Significant investment - acquisition of securities which grants 10 per cent or more of votes.

Initial capital - authorized (own) capital of the investment company held by the company at the time of issuance of permit to engage in the investment company activity and which is by 100 per cent paid up by the shareholders.

managers means members of the Supervisory Board and the Board of the enterprise, manager of the administration and his deputies, chief financier (accountant) and other persons authorised to conclude transactions in its name;

management enterprise means enterprise to which the management of the property and current operation of an investment company is transferred under the property management agreement.

Article 3. The Concept of Investment Company

1. Investment company is a stock company (excluding the exceptions provided for by Par.4 hereof) which accumulates the funds of natural and legal persons by way of public offering of its own shares and has at least one of the following attributes:

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1) investment and reinvestment in securities ~~and/or trading in securities~~ constitutes the principal activity generating more than 60% of income (**except cases set forth in par. 2 of this Article**);

2) securities constitute more than 50% of the company's property value.

2. Activities of the investment fund generating revenues of the fund may be only investment or reinvestment of funds received from public offering of the redeemable shares of the investment fund.

3. Every enterprise which corresponds to the criteria specified in items 1 and 2 of Par. 1 hereof must be reorganised into an investment company in accordance with the procedure established by this Law, with the exception of cases provided for in Par. 3 hereof.

4. The following shall not be considered as an investment company and this Law shall not apply to:

1) banks, insurance companies, brokerage companies, as well as other financial institutions performing operations in securities whose activities are regulated by other laws and legal acts;

2) stock companies having no more than 100 shareholders (owners) who have not offered for sale their securities;

3) stock companies which temporarily exceed the limit provided for by item 2 of Par. 1 hereof, provided that the companies sell the securities exceeding the limit no later than within 3 months;

4) enterprises with the authorised capital less than 250,000 litas.

Article 4. Classification of Investment Companies

1. Investment companies may belong to one of the following types:

1) investment funds;

2) closed-end funds; or

3) investment holding companies.

2. An investment company shall be considered an investment fund provided that it holds a diversified investment portfolio whereas the shares that have been issued or are being issued are redeemable shares whose holders have a right to sell them back to the company and receive therefor a proportionate share of the company's own (net) assets. **An investment fund does not have an authorized capital to be registered with the Enterprise Register. Upon issuing or redeeming the securities of the investment fund the capital gain or loss shall not be registered. Provisions of the Company Law regarding the change of the authorized capital of the**

company and the resulting registration of changes of the by-laws of the Company in the Enterprise Register are not applied to investment funds.

3. An investment company shall be considered a closed-end fund if its investment portfolio is diversified and if it has not issued redeemable shares.

4. An investment company shall be considered an investment holding company if the investment securities portfolio held by it is not diversified and it has not issued redeemable shares.

5. The investment holding company may be established only by reorganising, in accordance with the provisions of Par. 2 of Article 3, an investment stock company as well as an enterprise of another type (except an investment fund or a closed-end fund).

Chapter 2

General Requirements for Investment Companies

Article 5. Establishment, Reorganisation and Liquidation of Investment Companies

1. ~~The investment company~~ The **company** may engage in its activities of an **investment company** only upon being issued a permit by the Securities Commission. The Securities Commission must examine the matter concerning the issue of permit within 30 days from the filing of application for the issue of permit for the investment company activities. If the permit is not issued the ~~founders~~ of the investment company or other representatives must be given a justified reply.

2. The name of the investment company must contain the following words or their acronyms in Lithuanian: "investicinis fondas" or "IF" ("investment fund" or "IF"), "uždarysis investicinis fondas" or "UIF" ("closed-end fund" or "CEF), "kontroliuojančioji investicinė bendrovė" or "KIB" ("investment holding company" or "IHC"). The words "akcinė bendrovė" or the acronym "AB" ("stock company" or "SC") is not mandatory in the name of the investment company. The name of the investment company must correspond to the requirements set in the regulations of enterprise, institution and organisation names approved by the Government of the Republic of Lithuania.

3. The permit for the activities of the investment company may be issued to a newly established investment fund or closed-end fund or to a going concern which is being reorganised into an investment company.

4. ~~The shares of the first issue of a newly established investment company~~ **investment fund or investment holding company** may be purchased only by its founders. **Founders of the investment fund shall acquire shares of the newly founded investment fund for an amount not less than a minimum authorized capital of the investment fund set forth in part 1 Article 6 of this Law.** ~~These shares must be fully paid up prior to the investment company registration in the enterprise register.~~

5. Within 7 days from the general meetings of shareholders founders of the investment fund shall transfer the assets constituted of cash funds and securities to the custody in the Central Securities Depository and shall transfer the asset management to the investment fund asset management enterprise.

6. For the issuance of permit the investment company (when the company is being established - the founders) shall file with the Securities Commission. **The application shall be filed in accordance with rules approved by the Securities Commission.** an application which must state:

- ~~— 1) the name and registered office of the investment company;~~
- ~~— 2) the amount of the registered (in case of company establishment accumulated) authorised (own) capital;~~
- ~~— 3) information concerning material suitability and qualifications required for engaging in the investment company activities (full names, addresses, phone numbers of persons possessing qualifications certificates); and~~
- ~~— 4) information concerning the chosen management enterprise and depository.~~

7. The founding agreement, bylaws, certificate concerning the payment up of investment company's shares as well as agreement concluded with the management enterprise and the depository, if the conclusion of such agreements is required under this Law, **or if the conclusion of such agreements is not required by the law, but the agreements have been concluded,** must be appended to the application for the permit issuance;

8. The investment company bylaws must contain the following information:

- 1) the name;
- 2) the registered office of the company;
- 3) purposes, objects and ways of investment activities;
- 4) the amount of authorised capital of the closed-end fund or investment holding company, initial own capital of the investment fund;
- 5) the number and par value of the closed-end fund or investment holding company shares, the largest number of shares the investment fund plans to issue;
- 6) rights carried by shares; **terms and conditions for the sale or redemption of shares of investment fund, terms and conditions of settlement for sold or redeemed shares; term for settlement for redeemed shares may not be longer than set forth in the law, the procedure for suspension of redemption of shares; procedure of suspension and termination of sale of shares;**
- 7) management bodies forming procedure;
- 8) the competence of the general meeting, the procedure for calling the general meeting and the voting procedure;
- 9) the competence of the supervisory board and the board, if it is formed;
- 10) **appreciation of the investment portfolio value and income on investment distribution policy and procedure;**
- 11) regulations of own (net) asset evaluation and establishment of investment fund share **sale and** redemption price;
- 12) cost structure and the principles of cost covering;
- 13) procedure for making announcements to the shareholders, procedure for presenting annual and semi-annual reports and announcing same to the shareholders; and liquidation procedure.

15) **where an investment fund or closed-end investment fund intends to invest more than 35 per cent of its own (net) assets in securities issued**

and/or guaranteed by one state (municipality), the state (municipality) must be indicated in the bylaws of the investment fund.

The bylaws may also contain other provisions which are in compliance with the laws and other legal acts of the Republic of Lithuania.

9. The investment company bylaws may be amended or supplemented and the depository or the management enterprise may be changed only subject to the approval of the Securities Commission. The approval shall be deemed to have been given if within 15 days of the receipt of appropriate application the Securities Commission does not make a valid objection as regards the reason precluding the amendment of the bylaws or the changing of the depository or the management enterprise. **The Commission may refuse to issue the permit in cases when changes of bylaws, management enterprise or depository contradicts the interests of the shareholders or there are no guarantees that their rights will be secured and also in cases when such changes contradict laws or other legal acts".** Disputes concerning the approval of the amendment and supplementing of the bylaws, changing of the management enterprise or the depository shall be settled by court.

10. The Securities Commission may refuse to issue the permit for the investment company activities if:

- 1) not all documents specified in Paras. 5 and 6 hereof have been presented;
- 2) the documents presented for the issue of a permit do not meet the requirements of this Law;
- 3) documents presented in order to receive a permit contain erroneous or fraudulent information;

- 4) **Not all shares of the first issue of the investment company newly established closed-end investment fund or an investment holding company are fully paid up or founders of investment company closed-end investment company or an investment holding company have purchased only part of the shares of the first issue; or founders of the investment fund have acquired shares for an amount which is less than the minimum own capital of the investment fund established by part 1, Article 6 of this Law, or the initial minimum capital of the investment fund, as referred to in part 1 of Article 6 of this Law has not been fully paid up.**

- 5) investment company managers or founders are not reputable persons (there are proofs of dishonesty or frequent financial discipline violations, penalties have been imposed on them for the violations connected with the abuse of official position or administrative penalties have been imposed for the violations of legal acts regulating the securities market, or they have been punished for fraudulent bankruptcy or tried for deliberate crimes.

11. If the management of the investment portfolio of a newly founded closed-end fund or investment holding company has not been transferred to the management enterprise, at least two investment company managers or other administration officers must possess a broker's qualifications certificate or any other certificate recognised by the Securities Commission. The Securities Commission must be within 10 days informed of the changes of persons possessing qualifications certificates.

12. Investment companies shall be registered in accordance with the procedure established by the Law of the Republic of Lithuania on the Register of Enterprises provided that they have the permit of the Securities Commission for investment company activities.

13. A closed-end fund may be reorganised only into an investment fund. **It shall be prohibited to reorganise an investment fund in any manner, into a closed-end fund or an investment holding company. It shall be prohibited to change the activity of the investment fund.** The consent of the Securities Commission must be obtained for the reorganisation of an investment company. When an investment company is being reorganised by way of division each investment company shareholder must receive the same part of shares of the newly established investment company which he had in the company under reorganisation. Grounds for the reorganisation or liquidation of an investment company may not be the decrease below the limit established in item 2 of Par. 1 of Article 3 of its part of property composed of securities.

14. The Securities Commission may revoke the permit for activities issued to an investment company if the investment company:

- 1) is under liquidation;
- 2) has obtained the permit by presenting erroneous or false information, forged documents as well as by concealing the facts by reason whereof the permit should not have been issued;
- 3) is no longer fulfilling the terms and conditions of the permit issuance or complying with the laws and other legal acts of the Republic of Lithuania;
- 4) fails to comply with the capital requirements established in Par. 1 of Article 6;
- 5) has not used the issued permit for 12 months or has not engaged in its activities during the above period;
- 6) does not guarantee the security of the funds entrusted to it or is no longer in the position to fulfil its obligations to the creditors; **except the cases when the situation has developed through a fault of the depository or the management enterprise of the investment company;**
- 7) maintains the accounting negligently or fraudulently, prepares financial accounts not properly, **except cases when this has happened through a fault of the depository or the management enterprise of the investment company.**

The permit of an investment company may also be revoked in the event of emergence of any of the conditions specified in item 5 of Par. 9 hereof. **In cases when the basis for revocation of the license referred to in items 6 and 7 emerges by fault of the depository or the management enterprise of the investment company, the Securities Commission has a right to instruct the investment company to change the depository or (and) the depository in the manner provided by this law.**

15. An investment company shall have the right to employ an independent auditor to audit its business if the Securities Commission establishes grounds for the revocation of permit for the investment company activities as specified in items 6 and 7 of Par. 13 hereof. The report of the independent auditor must be presented to the Securities Commission within 2 months from the request to perform the audit unless the Commission fixes another date. The issue concerning the revocation of the permit for the investment company activities may be considered without the results of the independent audit if the investment company failed to present said results to the Securities Commission within the established period or refused to perform the independent audit or did not present any information as to the date of the independent audit.

16. In the event of revocation of the permit issued to the investment company the company must be liquidated. The investment company under liquidation must be re-registered and the words "under liquidation" must be added to its name: Information concerning the investment company's liquidation process, liquidation dates **and other information related to the liquidation of the investment company** must be presented to every shareholder who requests it, to a directly interested third person and the Securities Commission **pursuant to the rules of the Securities Commission**. ~~The property of the investment company under liquidation (securities and other movable property, immovable property) must be sold by competitive bidding (by auction) or on the stock exchange.~~ **The assets of the investment company under liquidation, comprised of securities listed in the stock exchanges, shall be sold at the stock exchanges, and securities traded at other recognised, permanently functioning and regulated markets shall be sold at those markets, other securities and other tangible and intangible assets of the investment company shall be sold by way of tender (by auction). Securities of private companies belonging to the private companies following the negotiations shall be sold to persons who have offered the highest price.** The money received for it together with other funds of the company under liquidation shall be distributed, upon satisfying all the company's liabilities, to the shareholders in proportion to the number of the company's shares held by them. The investment company under liquidation may conclude only those transactions which are connected with its liquidation. **Sale and redemption of the investment fund under liquidation shall be terminated.**

17. Disputes concerning the issue or revocation of permits for the investment company activities shall be settled by court.

18. **Investment companies has a right to invest its assets into other company (acquire securities of this company) without the written consent of the creditors.**

Article 6. Capital

1. The own capital of an investment fund must be no less than 1 million litas. The authorised capital of a closed-end fund or investment holding company must be no less than 250,000 litas, whereas their own (net) assets may not be less than the authorised capital. The Securities Commission must be no later than within 5 days notified if:

1) own capital of an investment fund becomes less than 1 million litas; or
2) own (net) assets of a closed-end fund or investment holding company become less than the authorised capital.

2. Contributions in kind may account for no more than 20% of the authorised (initial own) capital of an investment company **at the time of establishment of the company.**

3. When the authorised (own) capital of an ~~investment company~~ **closed-end investment fund or an investment holding company** is increased **or at the issue**

of shares of an investment fund, shareholders shall have no right of priority in subscribing for the shares of the new issue.

4. A closed-end fund or an investment holding company shall have no right to reduce the authorised capital, except reduction by reason of the incurred losses.

5. The borrowed capital of a closed-end fund may not account for more than 10% of its own (net) asset value. If this requirement is not complied with due to the decrease in the value of its own (net) assets, the investment fund or the closed-end fund must rectify the situation no later than within 3 months from the date the violation is committed.

The borrowed capital of an investment fund may not constitute more than 15 % of its own (net) assets. The long-term loans to acquire for tangible and intangible assets necessary for the activity of the fund shall not account for more than 10% of the net (own) assets of the fund. The fund may obtain a short-term (no longer than 60 days) loan for redemption of its own shares which shall not exceed the limit of 10% of the net (own) assets of the fund and the together with the long-term loans may not exceed the limit as specified in this paragraph.

Article 7. Shares

1. An investment company may have only ordinary shares entitling their holders to equal rights. Every share carries a right to one vote at all shareholders' meetings and is entitled, on equal grounds with other shares, to receive payment of dividend and an appropriate share of the investment company's property during its liquidation. **The by-laws of the investment fund may provide for a maximum number of voting shares which may be acquired by one person. All shares acquired in excess of the limit set forth by the investment fund shall not grant any voting rights.**

2. The shares of investment companies **at the time of foundation** may be paid up in cash or in property contributions. **The property contributions may be only securities specified in part 2 of Article 9 and immovable property, necessary to perform the activities of the investment company. Upon founding the investment fund, the property contributions may be only securities specified in this part. The evaluation of the property contributions shall be approved by the founding meeting of the investment company.** ~~Contributions in kind may not be in the form of work and services, intellectual and other intangible property.~~ **Upon public offering of securities of the investment company, payment for the acquired shares may be only in cash. Upon offering of securities of an investment holding fund payment for them may be in assets specified in this Article, the property contributions however, may not account for more than 20 per cent of the offered shares.** The shares of the closed-end and investment holding company must be fully paid up prior to the registration of the authorized capital and the increase thereof. An investment fund shall have no right to sell its shares to be paid up by instalments or postpone the date of payment. Payment for the investment fund shares must be effected no later than within 3 days **from the execution of the sale transaction of shares of the investment fund.** ~~Where the person fails to effect payment for the shares of the investment fund the purchase~~

~~transaction is deemed void.~~ The transaction related to the purchase of securities is deemed effected after the acquired shares of the investment company are fully paid up. Only after the shares of the investment company are fully paid up they are deemed issued and may be recorded in the personal securities account of the shareholder and accounted for in the securities register². The investment fund shall have no right to issue the shares (to transfer them to the shareholders), unless they have been fully paid up by the established price. The transaction related to redemption of the shares of investment company shall be deemed concluded from the moment the request to redeem the securities from their owner is submitted to the person in charge of redemption of the investment company shares. From the moment the redemption transaction is concluded the shareholders of the investment fund are denied of all the rights attaching to the shares of the investment fund, except the rights arising from the conclusion of the redemption transaction. The person in charge of redemption of the investment fund shares shall effect payment to the person who has requested shares of the investment fund to be redeemed no later than within four business days from the redemption of shares.

3. The shares of a closed-end fund and investment holding company may be listed on the Stock Exchange in accordance with the regulations approved by the Securities Commission and the Exchange. Investment fund shares may not be purchased or sold on the stock exchange.

4. At the shareholder's request the investment fund must redeem from him the shares of the fund paying for them in cash. ~~Payment may also be effected in other property if this is provided for by the investment fund bylaws.~~ Share sale and redemption price shall be calculated in accordance with the investment company's own (net) asset valuation methods and must amount to the part of the investment company's own (net) assets due to the share. **Upon selling the shares of the investment company the share selling price may be increased by amount equal to the total of the asset management and the share sale cost per one share. Cost added to sale price may not exceed 1% of the share redemption price. Upon redemption of the investment fund shares it shall be prohibited to deduct any taxes from the redemption price.**

5. The investment fund must publicly announce the selling and redemption prices of its shares each time they are issued or redeemed, but no less frequently than twice a month. The Securities Commission may reduce the frequency of announcements up to one time per month provided that such reduction causes no harm to the investment fund shareholders and other investors.

6. An investment fund may, on the basis of the procedures provided for by its bylaws or other regulations, temporarily (for no longer than 3 months in a business year) suspend the redemption of its shares if:

1) the suspension is performed in order to protect the shareholder's interests from possible insolvency as well as from the fall in the share redemption price due

² The concept of the share register must be approximated with the concept to be used in the rules on the registration of shares.

to the unfavourable securities market condition and the related reduction of value of the investment portfolio held by the investment fund;

2) own capital becomes less than the amount established in Par. 1 of Article 6; or

3) this is requested by the Securities Commission.

From the moment the decision to suspend the offering of the shares of investment fund neither the investment fund, nor persons authorized to redeem the shares of the investment fund has a right to redeem them. ⁴ In the event the shareholder requested to redeem his shares prior to the decision and the settlement has not been made with the shareholders after the decision to suspend the redemption of the shares has been passed, the investment fund must pay the shareholder at prices effective on the day of submission the request.

7. In the event of suspension of share redemption the investment fund must within 5 days notify the Securities Commission of its decisions and make a public announcement thereof through mass media (national newspapers, radio and television) in such a manner and at such time as to provide a real possibility for the investment fund shareholders and potential investors to find out about the event.

8. **Having registered with the Securities Commission the issue of the investment fund shall be offered for an unlimited period of time. There will be no limit established to the size of the issue except cases when the by-laws of the investment fund provides for the maximum value of shares allowed to be offered. When in the process of offering the shares of the investment fund, the data submitted in the prospectus are changed or a material event take place it has to be notified in the manner established by the legal acts. In this case persons, who have previously acquired shares of the investment fund has a right to request the fund to redeem the shares at the share redemption price. The person has no right to request that the investment fund or the underwriter return the contributions in the manner provided for by part 3, Article 7 of the Law on Public Trading in Securities. The offering of the shares of the Investment fund may be suspended or terminated only in the manner provided by this Law, the Law on Public Trading in Securities, or the by-laws of the investment fund. The founders of the investment fund have a right to submit for redemption the shares of the investment fund subscribed at the moment of foundation of the investment company only after shares representing more than half of the initial own capital, specified in art 1 of Article 6 of this law have been distributed. The founders of the fund have a right to submit to the fund for redemption the amount of securities the value of which is not less than 4/5 of the securities of the investment fund distributed at the moment of submission of securities for redemption.**

9. **Subscription to (or redemption) of shares of the investment fund is conducted in accordance with the rules approved by the Securities Commission. Provisions of the Company Law regulating the subscription and payment for shares of public companies shall not be applied to investment companies.**

Article 8. Management

1. The management of an investment fund property must be transferred to the management enterprise which is operating in accordance with Chapter 3 of this Law. Management of a closed-end fund or investment holding company property or part thereof (investment portfolio) may be transferred to the management enterprise. In such instances the investment company board and administration ~~may be~~ is not formed. **Administration and/or the Board may be formed in the closed-end investment fund or the investment holding company the management of the part of the property of which has been transferred to the asset management enterprise.** If the management of property is transferred to the management enterprise the supervisory board must be formed in the investment company. **In the event there is no administration in the investment company, the financial accounting of the company shall be conducted by the management enterprise. This obligation of the management enterprise shall be provided in the asset management agreement.**

2. ~~The persons with whom subscription contracts have been concluded not later than 10 working days prior to the meeting shall have the right to participate in a general (shareholders') meeting of investment fund.~~ The right to participate in the general meetings of shareholders shall be vested to persons who have acquired **shares of the investment fund no later than three days prior to the meeting and who were shareholders of the investment fund at the close of the day preceding the meeting, i.e they have not transferred the shares to the property of third persons and have not requested the investment fund to redeem the shares.** The quorum at the general (shareholders's) meeting shall be determined according to the number of shares which have been issued and not subscribed for ~~10 working days prior to the meeting~~ **at the close of the business day preceding the meeting. All votes granted by the shares acquired no later than three business days preceding the meeting and have not been placed for redemption are included in the quorum of the meeting.**

1. 3. **Only the general meeting of shareholders has a right to pass decisions on the following issues:**

- 1) **amend and supplement the by-laws of the investment fund. The resolution of the general meeting of shareholders to amend or supplement the by-laws of the investment company shall come into force only after it is approved by the Securities Commission.**
- 2) **elect the auditor to conduct accounting of the investment fund;**
- 3) **elect members of the Supervisory Board and the auditor of the investment fund. The members of the Supervisory Board shall be deemed elected only after they are approved by the Securities Commission.**
- 4) **remove the members of the Supervisory Board and the auditor of the investment fund from the office.**
- 5) **approve the asset management agreement with the management enterprise and approve a possible management enterprise.**
- 6) **change the management enterprise and approve the new management enterprise. The decision to change the management enterprise shall come into force only after the new management enterprise and the decision to change the management enterprise are approved by the Securities**

Commission. The general meeting may change the management enterprise only in cases provided for by this law.

- 7) establish and approve the terms of payment for the auditor's service;
- 8) approve the annual accounting documents and the report of the management enterprise on the activity of the investment fund, and the audit report;
- 9) issue a new issue of shares where the by-laws of the investment fund provides for the maximum number of issued shares ~~and the decision is taken to issue more shares than the established maximum number;~~
- 10) liquidate or reorganize the company;
- 11) denominate an expert (group of experts) to examine the foundation of the investment fund and its management.
- 12) approve the evaluation of non-pecuniary contributions (contributions in kind) at the time of foundation of the investment fund.
- 13) ~~pass a decision regarding the transfer of part of the assets of the investment fund to relinquish indebtedness to the state, municipal and social security fund budgets.~~

The authorized representatives of the management enterprise of the investment fund have a right to participate in the general meetings of shareholders with an advisory vote even though the management enterprise is not the shareholder of the investment fund.

The investment fund has a right to provide for the quorum requirements of the general meeting of shareholders. The quorum of the general meeting however, may not be less than 25 per cent of the votes granted by the shares of the investment fund at that meeting of shareholders. The quorum of the general meeting of the shareholders shall be set forth in the bylaws of the investment fund.

Resolutions of the general meeting of the shareholders shall be adopted by a simple majority vote, with the exception of cases of resolutions regarding issues referred to in items 1, 10 and 12 of this par. which will require $\frac{3}{4}$ majority vote, and resolution on issues referred to in item 6 of this par. which will require $\frac{4}{5}$ majority vote, and other cases referred to in the Company Law.

4. The general meeting of shareholders shall have no right to revoke the resolutions of the management enterprise regarding the asset management or adopt resolutions on asset management which are binding to the management enterprise.
5. The Supervisory Board of the investment fund shall have the following powers:
 - 1) select the management enterprise and submits to the general meeting proposals regarding the asset management agreement and the amendments thereof, as well as proposals to change the management enterprise;
 - 2) analyse the performance of the management enterprise, the utilization of financial resources, organization of the asset management of the

- investment fund, settlement for the asset management, accuracy of depreciation deductions, the prospects of the financial status;
- 3) selects the investment fund custodian and concludes the agreement with it;
 - 4) examines the financial accounting of the investment fund and other documents of the investment fund;
 - 5) submits proposals and comments to the general meeting of shareholders on the annual financial statements of the company, draft profit distribution account and the report of the management enterprise to the general meeting of shareholders.
 - 6) represent the investment fund in court proceedings when disputes between the Company and its management enterprise, depository or the representative of the investment fund are examined;
 - 7) submits proposals to the management enterprises regarding revocation of its resolution which are not in compliance with the laws or by-laws of the investment fund;
 - 8) resolves other issues specified in the by-laws and the resolutions of the general meeting of shareholders;
6. In case of an investment fund the rights and obligations of the Board provided for in the Law on Public Companies shall be transferred to the management enterprise and (or) Supervisory Board. The transfer of these rights and obligations and their distribution must be specified in the bylaws of the investment fund and (or) provided in the Asset Management Agreement.

Article 9. The Assets

1. The assets of the investment company may consist of :

- 1) **money and liquid (no longer than three months maturity) money market instruments;**
- 2) securities;
- 3) other immovable and movable property necessary for the ordinary operations of the investment company and which accounts for not more than 20 percent of the value of the total assets of the **investment fund or closed-end investment fund and no more than 25 per cent of the value of the total value of the investment holding company.**

2. Investment company may acquire the following securities:

- 1) securities quoted on the stock exchanges operating in the Republic of Lithuania, **included in the Official List, investment holding companies may acquire securities listed on the Stock Exchanges operating in the Republic of Lithuania.**
- 2) securities traded on other recognised, regulated, permanently operating and public stock markets in Lithuania, **provided the price of the securities may be determined not less frequently than specified in par.5 of Article 7;**
- 3) **the newly issued securities of the issuers the previously issued securities of which have been included into the trading lists of the Stock Exchanges operating in the Republic of Lithuania, if the conditions of their issue provides for the issuer's obligation to to have its shares quoted in the Official list of the stock exchange in Lithuania and there are guarantees that issued securities will be**

registered in the said list within one year of their issue; investment holding companies have a right to acquire the newly issued securities where the conditions of the issue provides for the obligation of the issuer to file an application to have its securities admitted in the trading list of the National Stock Exchange or trading lists of other recognised, regulated and permanently operating stock market in Lithuania and there are guarantees that the issued securities will be registered in the said lists within one year from the issue.

- 4) ~~deposit certificates issued by banks;~~
- 5) **securities issued or guaranteed by the government (municipality);**
- 6) other securities recognised by the Securities Commission as liquid.

3. Investment company may also acquire other securities that are not indicated in Par. 2 of this Article the total value of which may not account for more than 10 percent of the company's own (net) assets. If said requirement is not complied with due to the reduction in value of own (net) assets or due to the exercise of the preemptive right set forth in the laws and legal acts of the Republic of Lithuania, the investment company must rectify the situation not later than within 3 months from the date the violation was committed.

4. **An investment fund shall be prohibited from investing more than 5% of its net (own) assets into shares of other investment funds. An investment fund shall be prohibited from acquiring shares of closed-end investment funds or investment holding companies”.**

5. **An investment fund may invest into shares of another investment fund that is managed by the same management enterprise or a management enterprise with which the management enterprise of the investing fund is connected by single management or control or by a substantial direct or indirect investment only where the investment fund, into shares of which the investment is made, according to the activities specified in its By-laws, specializes in investing in a certain economic sector or a concrete geographical area under the condition that a permit of the Securities Commission is received for such an investment. A permit of the type is issued only in the event the By-laws of the investment fund clearly state that the investment fund shall be entitled to use the investment option set forth above.**

6. **A management enterprise shall be prohibited from charging any fee to the investment fund for transactions when the investment fund invests into shares issued by another investment fund that is managed by the same management enterprise or a management enterprise with which the management enterprise of the investing fund is related by single management or control or by a substantial direct or indirect investment. The management enterprise shall be also prohibited from deducting such expenses from the assets of the investment fund.**

Article 10. Peculiarities of the Activities of Investment Companies

1. Investment fund and closed-end fund shall be prohibited from:

1) extending loans, giving a guarantee or warranty for another person's fulfilment of liabilities, mortgaging of securities or real property held by them; **securities and intangible assets may be pledged only in cases provided for in pars. 5 and 6 of Article 6 of this Law.**

2) taking loans, ~~with the exception of cases when the loan is taken for the acquisition of movable or immovable property necessary for its operations; in derogation from requirements of pars 5 and 6 of Article 6.~~

3) acquiring and holding securities due to which the requirements set forth in the diversified investment portfolio would be violated, except in the case of a newly funded investment fund or a closed-end investment fund which may not abide to the diversified securities portfolio requirements in the course of six months from the issuance of the permit to engage in investment activities;

4) issuing bonds;

5) establishing affiliates or other independent structural subdivisions.

6) **acquiring precious metals or precious metal certificates;**

7) **acquiring derivative securities;**

8) **acquiring securities issued by its management enterprise.**

2. If the investment fund or closed-end fund violates the requirements of the diversified investment portfolio due to the preemptive right to acquire newly issued securities provided for in the laws and other legal acts of the Republic of Lithuania or for other objective reasons that are beyond its control, **the close-end investment fund or the asset management enterprise** must sell the portion of securities due to which restrictions specified in this part were violated not later than within 3 months.

3. The investment holding company shall be prohibited from:

1) investing more than 25 percent of its own (net) assets into the securities issued by one issuer; in the event the requirement is violated due to reduction of the net (own) assets or due to the preemptive right to acquire the newly issued securities provided for in the laws and other legal acts of the Republic of Lithuania, or for other reasons beyond the control of the company, the investment company shall rectify the situation no later than within 6 months from the date the violation was committed.

2) taking loans from the controlled enterprises or obtaining their guarantees;

3) without the decision of the general (shareholder's) meeting, mortgaging, selling, or in any other way transferring total issuer's shareholding or a part thereof, the total value of which accounts for at least 5 percent of the holding company's own (net) assets if due to such transaction the holding company would lose or might lose :

in the general (shareholder's) meeting of the issuer, qualified (2/3 or **bigger part of votes of so is provided for in the bylaws of the investment company**) or simple majority (1/2 of votes) vote, as well as the right of veto (1/3 of votes), calculating from the total number of votes;

the right of initiative to convene general (shareholders') meeting as well as other rights for the implementation of which 1/10 of the authorised capital of the issuer is required;

the right to supplement the agenda or nominate candidates to the members of the Supervisory Board or the Board for the implementation of which 1/20 of the authorised capital of the issuer is required;

4) without the prior decision of the general (shareholders') meeting, mortgaging real property, extending loans, giving guarantee or warranty for the fulfilment of obligations by another person if the total amount of such liabilities of the

holding company and the total amount of extended loans would account for more than 10 percent of the value of its own (net) assets.

4. The closed-end fund and the holding company shall be prohibited from repurchasing, in any way, its shares or accepting them as a collateral.

5. Provided the securities of the issuer are trade on the stock exchange, the investment company shall be prohibited from:

- 1) when buying securities of the issuer _ exceeding the maximum price which is fixed on the day the transaction is made on the stock exchange;
- 2) selling the issuer's securities at a price which is lower than the minimum price of these securities fixed on the day the transaction is made on the stock exchange.

~~6. The investment company shall be prohibited from acting as intermediary in stock market if the investment company is not the owner of these securities. An investment fund, a management enterprise or a custodian acting on behalf of the investment fund shall be prohibited from transferring and (or) talking an obligation to transfer securities that the investment fund is not the owner of.~~

Article 10¹. Distribution of the Increase of the Value of the Investment Portfolio and Other Revenues⁶

1. **Distribution of the increase of the value of the investment portfolio and other revenues shall be carried out following the bylaws of the investmet fund. Investment fund shall pay divideds only provided it is set forth in the by-laws of the investment fund. The investment fund shall clearly specify the revenues of the investment fund to be distributed and what part of the revenues will be allocated to dividends. Persons which were shareholders of the investment fund at the end of the day when the management enterprise, pursuant to the bylaws of the investment fund approved the amount of the dividends and the procedure of payment of the dividends. It shall be prohibited to distribute the unrealised gain of the investment fund. Where the bylaws of the investment fund provides that the investment fund does not pay dividends, the fund shall be under no obligation to pay dividends.**
2. **An investment fund's revenues may be used for the following purposes: to pay dividends, to increase the net (own) asset value of the investment fund, to allocate bonus shares to the investment fund's shareholders in proportion to the value of shares they hold, etc. with all revenues of one type, all revenues of several types, part of the revenues of several types or part of the revenues of one type.**
3. **The decision as to the distribution of the investment fund's revenues shall be passed by the management enterprise of the investment fund. The custodian of the investment fund shall carry out the decision of the management enterprise provided it is in conformity with the By-laws of the investment fund, this Law or other legal acts. ⁶**

⁶ This article is necessary in order to enable an investment fund to project the ways of revenue distribution. In the event this article is missing, the revenues of the

Article 11. **Information that must be Furnished by the
Investment Companies to its Shareholders,
General Public and Supervision Institutions**

1. The investment company must provide:

- 1) the prospectus;
- 2) reports of each business year;
- 3) reports for the first 6 months of a business year.

2. Annual and semi-annual reports must be published with the following regularity:

- 1) annual - not later than within 4 months of the end of the accounting business year;
- 2) semi-annual - not later than within 2 months of the end of the accounting six months.

3. The bylaws of the investment companies must constitute an inseparable part of the prospectus and must be provided together with the annexes attached thereto.

4. The investment company must submit its prospectus and amendments thereto, as well as annual and six-month reports to the Securities Commission in compliance with the requirements set forth with regard to its contents, procedure and time limits for its filing.

5. Financial accounts provided in the annual report must be audited by an independent auditor entitled to perform audit in accordance with the procedure established by laws. Audit results must be provided in the annual report. Auditor's report must also contain information on all the violations of this Law and other laws and legal acts regulating financial activities of investment companies.

6. The prospectus, the last published annual and semi-annual reports must be available to persons who subscribe to the shares in the investment company prior to the entering into subscription contract. In addition, annual and semi-annual reports must be available to the general public at certain places specified in the prospectus. **The prospectus, the annual and semi-annual reports shall be provided to the public free of charge.**

7. The investment company, the management enterprise with whom property management agreement has been concluded, and the depository must keep records of transactions and other operations of the company in accordance with the standards established by the laws of the Republic of Lithuania and other legal acts.

investment fund should be distributed in the manner prescribed by the Law on Public Companies and would depend upon shareholders. To simplify matters, this article may be worded in a more generalized way. An alternative: *"The By-laws of an investment fund shall clearly provide for the purposes and proportions that the revenues of the fund can be used. The decision as to the distribution of the investment fund's revenues shall be passed by the management enterprise of the investment fund following the rules set forth in the By-laws of the investment fund."*

All the documents relative to the activities of the investment company must be available for inspection by the Securities Commission.

8. At the request of the Securities Commission, but not more frequently than once a year, the investment company must, within three months, submit to it the report of an independent auditor, stating whether the investment company complies with the requirements set forth in Articles 9 and 10. Such audit of the investment company may be performed more often at the expense of the Securities Commission.

9. The investment holding companies must, together with annual report, each business year make and publish additional report about the activities of the group of enterprises consisting of the investment holding company and the enterprises controlled by it.

10. In describing the financial position of the group of enterprises specified in Par. 9 of this Article, the investment holding company must present in the report a consolidated balance sheet, consolidated profit and loss account, and explanatory notes, prepared according to the standards established by the Ministry of Finance. The data of the consolidated balance sheet may not be used for judging whether the enterprise meets the requirements set forth in item 2 of Par. 1 of Article 3.

11. The enterprises which under the provisions of Par. 9 of this Article form a group of enterprises, must furnish to investment companies all the information necessary for making consolidated accounts.

12. The data in the consolidated accounts concerning the assets and liabilities, profit and loss of the consolidated group of enterprises, as the separate entity, must be disclosed truthfully and honestly. The report on the management of the group of enterprises must disclose information on the management structure of this group as a separate entity, transformations that have been made or are planned to be made and the material events that have occurred during the accounting period.

Article 11¹.

1. Persons connected to the investment company, managers and employees of the investment company custodian or management enterprise, and persons connected to the custodian or management enterprise shall be prohibited from transferring directly or through its management enterprise, securities or any other assets to the investment company, as well as from receiving from the investment company securities or any other assets, except the funds for the redeemed shares of the investment company or wages, established by the employment agreement.

2. Prohibitions set forth in part 1 of this Article shall not be applied in the cases when the Supervisory Board or the Board, where the Supervisory Board is not formed, of the investment company passes a decision that the acquisition or transferring of securities or any other assets is beneficial to the shareholders of the investment company and does not violate their rights and legitimate interests. Such a decision shall be passed in every individual case and shall be recorded in the minutes of the meeting of the Supervisory Board or the Board of the investment company.

3. Where the member of the Supervisory Board or the Board or members of their families have a personal interest in the decision, they are precluded from voting regarding the issue of the permit referred to in part 1 of this Article.

4. Persons, having violated provisions of this Article, shall compensate for the losses incurred to the investment company and shall be responsible in the manner provided for by the laws of the Republic of Lithuania (the manner is to be established).

Chapter 3

MANAGEMENT ENTERPRISES

Article 12. The Concept of Management Enterprise

1. A stock company or a close stock company registered in the Republic of Lithuania and having its main office in the Republic of Lithuania which possess a licence issued by the Securities Commission to manage the investment portfolio of investment companies may be a management enterprise. The procedure and conditions for the issue of such licences shall be established by the Securities Commission.

2. Disputes concerning the issuing or cancellation of licences shall be settled by the court.

3. The authorised capital of the management enterprise must be not less than **LTL 1 million**. If the authorised capital becomes less than the minimum capital, the management company must inform the Securities Commission of this fact not later than within 5 days. **The Securities Commission may set forth additional requirements for the authorized capital of the management enterprise, including a larger minimum capital requirement with regard to the size of capital of the investment companies the assets of which are managed by the management enterprise.**"

4. At least two managers of the management enterprise must have broker's qualification certificate or any other certificate recognised by the Securities Commission. The management enterprise must submit to the Securities Commission data about all managers (their names, surnames, addresses, telephone numbers). **Only a reputable person may be the head of the management enterprise (there should be no proof of dishonesty or frequent violations of financial discipline, penalties for the abuse of the office position, administrative penalties for violations of legal acts regulating the securities market, punishment for fraudulent bankruptcy, prosecution for deliberate crimes).** The decision of the authorized bodies of the management enterprise to replace the managers of the management enterprise shall come into effect only after the new candidates

are approved by the Securities Commission. To acquire shares of the management enterprise which grant 10 or more per cent of votes at the general shareholder meeting of the management enterprise the permit of the Securities Commission is needed. A person who has acquired shares granting 10 or more per cent of votes at the general shareholder meeting of the management enterprise without a due permit shall be denied the right to vote at the general shareholder meetings. The right to vote shall be recovered after the shares exceeding the threshold established in this part are transferred. The requirements of this part shall also apply to persons that are deemed connected persons that hold a block of shares as defined in the Law on Public Trading of Securities of the Republic of Lithuania.

5. The Securities Commission may refuse to issue the permit to acquire shares of the management enterprise which grant 10 or more per cent of votes at the general shareholder meeting of the management enterprise, if the applicant is not a very reputable person (there is proof of dishonesty or frequent violations of financial discipline, penalties have been imposed for abuse of his office position or administrative penalties have been imposed for violations of legal acts regulating the securities market, or he has been punished for fraudulent bankruptcy or tried for deliberate crimes), or he is a person connected with the investment company, the assets of which are managed by the management enterprise (alternative: the head of the investment company, the assets of which are managed by the management enterprise), or a person connected to the custodian which holds the funds and/or securities. Where the applicant for the permit is a legal person, the above requirements shall be applied to the managers or controlling persons of the legal person.
6. In the event the circumstances specified in part 3 of this Article become known or appear only after the Securities Commission has issued a permit to acquire shares of the management enterprise, the person who owns 10 or more per cent of votes at the general shareholder meeting of the management enterprise shall promptly notify the Securities Commission about the appearance of such circumstances. The person shall be denied the voting right at the general shareholder meeting of the management enterprise from the moment said circumstances occur. The right to vote shall be recovered after the shares exceeding the threshold established in part 4 are transferred or the person rectifies the situation (e.g. resigns from the position of a member of the Supervisory Board or the like)."
7. The management enterprise shall have the right to carry out no other transactions with the investment company than enter into property management agreement.
8. The management enterprise shall have no right to involve into any other activity than the asset management of the investment companies and pension funds and investment management and consulting activity.
9. The management enterprise may be reorganized only by merging it with another management enterprise or by splitting it into several management enterprises. The management enterprise may be reorganized in other ways only in cases when it does not manage the assets of a single investment

company. To reorganize the management enterprise a permit of the Securities Commission must be obtained. The Securities Commission may refuse to issue a permit to reorganize the management enterprise in cases when the reorganization of the management enterprise may impair the shareholders' interests, the reorganization contradicts the laws of the Republic of Lithuania or other regulations, or the management enterprise which will function after the reorganization will not comply with the laws and will fail to meet the requirements set forth by other legal acts.

10. The management enterprise shall submit periodical reports to the Securities Commission on the capital adequacy and other activities pursuant to the Regulations of the Securities Commission.

Article 12'. Duties and Obligations of the Management Enterprise

1. The management enterprise shall have a right to have the own (net) assets at its disposition and exercise the rights granted by the own (own) assets of the investment company pursuant to the terms of the asset management agreement concluded with the investment company, by-laws of the investment company and legal acts of the Republic of Lithuania.
2. The management enterprise shall be precluded from investing the net (own) assets of the investment company in securities of the company controlled by the management enterprise, members of the bodies of management of the management enterprise or employees or persons associated with the management enterprise, except cases when the Supervisory Board of the investment company decides that such investments do not contradict the interests of the shareholders of the investment company and such investment is approved by the Securities Commission.
3. The management enterprise has a right to manage the assets of several investment companies. In they event the investment portfolio of the investment company must be diversified, and securities of one issuer held by several investment companies the portfolios of which are managed by the same management company constitute no more than 10 per cent of the voting shares of the issuer, in the general meeting of the issuer's shareholders the management enterprise shall have a right to vote on behalf of the investment companies only by shares not exceeding the 10 percent vote limit. If in this case investment companies vote themselves, or investment companies and the management enterprise on behalf of one or several of them, all companies may vote only by the shares which grant no more than 10 percent of votes at the general meeting of shareholders. Part of shares that grants the votes to the investment company shall be determined in proportion to the participation of the investment company in the issuer's equity. The rule shall not be applied to the investment holding companies, but in this case the management enterprise or other person representing investment companies managed by the same management enterprise, the investment portfolio of which must be diversified, are precluded from representing the investment holding company.

Article 13. Property Management Agreement

1. The property management agreement between the investment company and management enterprise must provide for:

- 1) the object of the agreement;
- 2) rights and duties of the parties to the agreement;
- 3) purpose, objects and methods of investment activities;
- 4) the amount of the commission paid to the management enterprise, the manner and procedure for the payment thereof;
- 5) structure of expenditures of investment company and procedure for their coverage;
- 6) liability for non- fulfilment of its obligations;
- 7) conditions and procedure for the termination of the agreement;
- 8) duration of the agreement.

The property management agreement may contain other provisions provided they do not contradict the laws and other legal acts of the Republic of Lithuania.

2. The property management agreement must be approved by the general (shareholder's) meeting of the investment company. ~~It may be concluded for the period not exceeding 4 years.~~ The property management agreement may be terminated by the decision of the general (shareholders') meeting **only in case the management enterprise violates the agreement, the bylaws of the investment fund, this or other laws and other legal acts. Disputes concerning the termination of the property management agreement shall be resolved in court.**

3. The commission payable to the management enterprise for the management of the property of the investment company may not be in excess of the higher of the following:

- 1) 2 percent of the annual value of the investment company's own (net) assets;
- 2) 20 percent of the average annual net profit of the investment company.

A part of this commission may be paid by the shares of the investment company if it is provided for in the property management agreement.

Article 13'. The Change of the Management Enterprise

1. In the event where:

- 1) the term of the asset management agreement has expired (where it is a term agreement);
- 2) the management agreement has been terminated;
- 3) the management enterprise declares insolvency or is announced insolvent or a bankruptcy proceeding has been initiated against the management enterprise;
- 4) the license of the management enterprise to engage in the management of the assets of investment companies has been revoked;
- 5) the asset management agreement is terminated in other cases provided for by laws and the asset management agreement.

the investment fund shall no later than within three months from the termination of the asset management agreement transfer the asset management to another investment management enterprise. Until the assets of the investment fund are transferred to another management enterprise the assets of the investment fund shall be managed by the depository of the investment fund. The depository shall manage the assets following the same terms and conditions as provided for in the asset management agreement of the management enterprise. In the period when the assets of the investment fund is managed by the depository, it shall be precluded to offer the shares of the investment fund.

2. The new management enterprise and the agreement shall be approved by the general meeting of shareholders and the Securities Commission. The new asset management agreement shall be in compliance with the by-laws of the investment fund, unless the general meeting of shareholders approves the relevant amendments to the by-laws.
3. The Commission may refuse to approve the selection of the management enterprise and the asset management agreement in the event the selection of the management enterprise or the asset management agreement contradict the laws of the Republic of Lithuania and other legal acts or the interests of the shareholders of investment fund.
4. The Securities Commission has a right to request management of the investment company be transferred to another management enterprise when the management enterprise no longer meets the requirements of the laws of the Republic of Lithuania and other legal acts, the management enterprise violates the asset management agreement, this law, other laws and other legal acts.
5. In the event the investment fund fails to conclude a new asset management agreement when the circumstances specified under parts 1 or 4 of this Article within the period specified in Part 1. The Securities Commission shall revoke the license of the investment fund.

**Article 14. Liability for the Compensation of Losses
(Damages)**

The management enterprise shall be liable for the compensation of losses (damages) inflicted through its fault to the investment company or its shareholders under the laws of the Republic of Lithuania.

Chapter 4

DEPOSITORIES

**Article 15. The Obligation of the Investment Company to
Transfer its Property to the Depository for
Safe Keeping**

The property of the investment company, consisting of monetary resources and securities must be transferred to one depository for safe keeping. ~~If the depository selected by the investment company has no right to accept cash deposits, the investment company may transfer its cash deposits to another institution possessing such right.~~ The investment company may not have more than one depository of securities or cash deposits.

Article 16. Eligibility for Carrying out Depository Operations

1. ~~A bank as well as brokerage company and a bank subsidiary, having the licence issued by the Securities Commission to engage in the activities of a depository may be a Depository~~ may be a bank or other credit institution registered in the Republic of Lithuania and its head office and is licensed to provide custody to the assets (funds and securities) of investment companies.

The licences are of two types:

- ~~1) the licence for carrying out operations with securities;~~
- ~~2) the licence for carrying out operations with securities and cash.~~

~~2. The conditions and procedure for granting licences to brokerage companies and bank subsidiaries to engage in depository activities and cancellation thereof shall be established by the Securities Commission.~~

2. The authorised capital of the depository may not be less than 5 million litas if it operates as the depository dealing in cash and securities and may not be less than 1 million litas if it operates as securities depository. If the authorised capital of the depository becomes less than the minimum capital or its own assets become less than its authorised capital, it must inform the Securities Commission of this fact not later than within 5 days.

Article 17. Activities of the Depository and their Supervision

1. The depository must separate the property entrusted to it by the investment company from its own property and identify it separately. The creditors of the depository shall have no right to settle their claims from the property entrusted to it by the investment company.

2. The Securities Commission shall have the right to establish the rules governing the control of the depository's activities, as well as the requirements for annual and other audit.

3. While fulfilling the instructions of the investment company or management enterprise (if there is such), the depository must ensure that:

1) the selling price and repurchase price of the shares of the investment fund is determined in accordance with the requirements prescribed by this Law and the bylaws of the depository;

2) the investment company or persons acting on its behalf comply with the requirements prescribed by this Law and the bylaws of the company when selling, issuing, repurchasing or cancelling the shares of the company;

3) income received from the transactions with the property of the investment company is transferred to its account in due time;

4) income of the investment company is used in compliance with the laws of the Republic of Lithuania, other legal acts and its bylaws.

4. The depository shall be liable under the laws of the Republic of Lithuania for the indemnification of losses (damage) caused through its fault to the investment company or its shareholders. The depository may not be relieved from the fulfilment of its obligations on grounds that the whole or part of the property entrusted to it has been transferred to a third party.

5. The depository must enter into agreement with the investment company, which must provide for the procedure for the payment for services rendered by it and the rate of charges. The Depository shall carry out the instructions of the investment company (or the management enterprise) provided it does not contradict the Company Law, Law on Public Trading in Securities, and the related regulations and the bylaws of the investment company. **The investment company depository is prohibited from acting as an intermediary when the company acquires securities or transfers securities owned by it.**

Article 17'. Change of the Depository

1. In the case when:

- 1) the agreement with the custodian is terminated;**
- 2) the license of the custodian to engage in the activity of a custodian of money and/or securities is revoked;**
- 3) the custodian is declared insolvent or a bankruptcy procedure is initiated against it;**
- 4) the agreement expires in other cases provided for by law or by the agreement with the custodian;**

within two weeks from the appearance of the above specified events the funds and/or securities of the investment company shall be transferred to another custodian for safekeeping. A new custodian for the investment company shall be selected and the agreement with it made by the Supervisory Board of the investment fund or the head of the administration of the closed-end investment fund or investment holding company or the Supervisory Board if the administration is not formed.

- 2. In the event the custodian of the investment company fails to meet the requirements set forth by the laws or other legal acts, or the custodian fails to properly perform its obligations pursuant to the agreement with the investment company or its obligations to the investment company arising from laws and other legal act, seeking to ensure the rights of the shareholders of the investment company the Securities Commission has a right to instruct the investment company to change the custodian.**
- 3. Where under circumstances provided for in parts 1 and 2 of this Article, within the term established in the first part, the funds and/or securities are**

not transferred to another custodian, the Securities Commission shall revoke the license of the investment company.

Article 18. Independence of Depositories from Investment Companies

1. No enterprise may operate as an investment company (or management enterprise) and a depository concurrently.
2. The investment company or management enterprise and the depository must perform their functions independently.
3. Persons connected with the investment company may not be shareholders or managers of the depository with whom this investment company has deposited its securities or cash.

Article 18'. Prerequisites for independence of the Investment company, management enterprise and the depository

1. A person employed by the investment company or a member of managing bodies of the investment company shall have no right to work with the custodian or management enterprise of this investment company, or be a member of managing bodies of the custodian or management enterprise of this investment company.
2. A person employed by the custodian of the investment company or a member of managing bodies of the custodian shall have no right to work with the investment company, the assets of which are in custody of this custodian, or with the management enterprise of this investment company, or be a member of managing bodies of this management enterprise.
3. The custodian of the investment company shall be precluded from acquiring securities of the management enterprise of the same investment company.
4. Persons connected with the investment company shall be precluded from acquiring shares of the management enterprise or the custodian of the investment company granting 10 or more per cent of votes at the general shareholder meetings of these enterprises.
5. In the event the requirements set forth in this Article are violated, the Securities Commission shall have a right to instruct the management enterprise of the investment fund or the custodian to rectify the situation within the time set forth by the Securities Commission. In the event the situation is not rectified within the time set forth, the Securities Commission shall be entitled to revoke the license of the management enterprise and (or) the custodian or issue a motion to the investment company that its management enterprise or custodian be changed.

PROTECTION OF INVESTORS' INTERESTS

Article 19. The Duty to Act in the Best Interests of the Shareholders

1. Investment company, management enterprise and depository must carry out its activities in compliance with the effective laws and other legal acts and ensure that their activities should not be prejudicial to the shareholders' property rights and interests.

2. The investment company, management enterprise and depository as well as persons connected with them may not enter into any transactions concerning the investment company or its property, that would be prejudicial to the investment company or the rights and interests of its shareholders. Managers of the investment company, management enterprise and the depository shall not be liable for the damage that was caused to the investment company in order to reduce losses incurred as a result of the depreciation of its investment portfolio due to the reduction in value of securities comprising it.

3. Having established that the manager has made a transaction from which he gained benefit at the expense of its shareholders, as well as if the shareholders of the investment company incur losses (material damage) caused by unlawful actions of the manager, the shareholders of the investment company shall have the right to take him to court, requesting to transfer the rights and duties resulting from such transaction to the investment company or compensate for the (losses) damage caused by such transaction.

4. If the investment holding company benefit from its unlawful actions at the expense of the enterprise, controlled by it, or its shareholders or cause to it any other damage, the controlled enterprise or its shareholders shall have the right to demand through court to be compensated for losses (damage) caused to it.

Article 20 The Rights of the Securities Commission

1. When implementing this Law, the Securities Commission shall have the right to adopt legal acts assigned to its competence.

2. The Securities Commission shall have the right to examine, control and make investigations in order to reveal whether investment companies, management enterprises and depositories comply with this Law and other legal acts and regulations. When discharging these functions , the employees of the Securities Commission may, without asking for a permit, enter the premises of the above-mentioned enterprises, examine, take temporarily the documents (leaving behind their descriptions) or copy them, as well as question in writing or in word the managers of these enterprises or any other persons subordinate to them.

3. The instructions of the Securities Commission given to investment companies, property management enterprises or their managers concerning the elimination of the violations of laws and other legal acts shall be binding

4. The employees of the Securities Commission must keep commercial secrets of investment companies, gained in the course of his duties confidential. For the use of information not for its proper purpose or for other unlawful actions, these employees shall be liable under the laws of the Republic of Lithuania.

Article 21. Liability for the Violation of this Law

1. Investment companies, management enterprises, depositories and their managers shall be liable for the violation of this Law in accordance with the procedure established by the laws of the Republic of Lithuania.

2. The Securities Commission shall have the right :

1) to apply sanctions provided for in the Republic of Lithuania Administrative Code against the managers of investment companies, management enterprises and depositories as well as against the auditors of these enterprises for the violation of this Law and other legal acts;

2) to impose a fine in the amount of up to 3 percent of their annual income on those management enterprises or depositories, which inflict losses (damage) by their unlawful actions to investment companies or their shareholders.

The application of these sanctions shall not relieve the persons from the liability to compensate for losses (damage) inflicted through their fault to investment companies, their shareholders or third parties, as well as from the liability under other laws of the Republic of Lithuania.

3. The decisions of the Securities Commission in regard to the imposition of an administrative penalties may be appealed against to court in the manner established by the laws of the Republic of Lithuania. Decisions of the Securities Commission regarding the application of sanctions specified in item 2 of Par.2 of this Article may be appealed against to court within one month. The appeal shall not suspend the fulfilment of the instructions and decisions of the Securities Commission to eliminate violations of laws and other legal acts unless the court decides otherwise.

4. Fines must be paid into the budget not later than within 15 days of the receipt of the resolution to impose a fine on the investment company, management enterprise, depository or their managers. Fines shall be recovered from the income of the management enterprises or depositories without suit.

Chapter 6

FINAL PROVISIONS

Article 22. Application of this Law to the Operating Investment Stock Companies

1. Investment stock companies established during the period of the privatisation of state-owned property under the Republic of Lithuania Law on the Initial Privatisation of State Property must by 1 May 1996 alter their bylaws and reregister itself in compliance with the requirements provided for in this Law. If the investment stock company fails to fulfil this requirement, it must be liquidated in the manner established by the Government of the Republic of Lithuania provided for in Par. 15 of

Article 5 of this Law. The auditor must present the report on the financial position of this company to the general (shareholders') meeting of the investment stock company in which the reorganisation shall be considered.

2. Investment stock companies may be reorganised into investment companies in accordance with the requirements set forth in Article 10 of the Company Law of the Republic of Lithuania. The provisions of Par. 12 of Article 5 of this Law shall also apply to the reorganisation of investment stock companies. The preparation of the project for the reorganisation of the investment stock company into investment company is not mandatory.

3. The preference shares issued by investment stock companies must be converted into ordinary shares within one month from the enforcement of this Law, and the privileges granted by them shall be abolished. The founders' privileges must also be abolished if the bylaws of the investment stock companies provided therefor. Amendments to the bylaws relative thereto may be registered without convoking general meetings.

4. Investment stock companies must, within six months of the coming into effect of this Law, transfer for safe keeping cash and securities held by them to the depository selected by them. A copy of the agreement entered into with the depository must be submitted to the Securities Commission.

5. If after the reorganisation of the investment stock company into investment company of an appropriate type, its property will have to be transferred to the management enterprise for the purpose of its management, the agreement with the selected management enterprise must be approved in the general (shareholders') meeting prior to the date of the reregistering of this company.

6. The investment stock companies must, within the period between the coming into effect of this Law and their reregistration into investment companies, prepare information specified in Article 11 of this Law. The auditors shall not be required to report on such information.

7. The provisions contained in the first sentence of Par.10 of Article 5 shall come into effect as of 1 January 1997. By this term and in such cases when the management of the property of the investment company is not transferred to the management enterprise, at least one member of the Board of the investment company or an employee of the administration must possess qualifications certificate of a broker or any other qualifications certificate recognised by the Securities Commission.

8. If the investment stock company has been reorganised into investment fund, the announcement about the value of the own (net) assets of the investment fund and the redemption price of its shares must be published not later than within 30 days of its re-registration.

The investment funds reorganised in this manner must redeem its own shares within the following stages:

1) the redemption of shares may be commenced not earlier than after the third public announcement of the data specified in the first paragraph hereof ;

2) by 1 July 1996 not less than 1/2 of all the applications of shareholders to redeem the shares held by them must be satisfied;

3) from 1 January 1997 the shares of investment funds must be redeemed without any restrictions in the manner established by this Law.

9. If the shares of the investment stock company that is being reorganised into investment fund, were traded on the stock exchange, the trade in such shares must be terminated from the date of the re-registration of this investment stock company.

10. It shall be prohibited to establish new investment stock companies as of the date of the coming into effect of this Law.

I promulgate this Law passed by the Seimas of the Republic of Lithuania.

Algirdas Brazauskas
President of the Republic

Vilnius
5 July 1995
No. I-1018

THE MAIN CAPITAL MARKET INDICATORS IN 1998

The most significant indicators reflecting the capital market situation are trading volumes of securities expressed in terms of the turnover ratio and the price index.

LITIN is a price index which reflects price movements of the major securities on the secondary market. These securities comprise the Official List. The trading volume of shares on that list makes up about 33 % of all equity turnover on the Stock Exchange. These shares are the most liquid too. The dynamics of the Current List shares is reflected by the index LITIN-A. The shares on this List account for about 60 % of all equity turnover, but they are less liquid than those on the Official List. Shares of both Official and Current Lists make up the group of listed shares. The remaining shares are unlisted. As they are traded irregularly and account only for a limited amount of the trading volumes, they are not included into further analysis of the trade indicators.

In the graphs "Index LITIN and the Turnover of its Constituents in January - November 1998" and "Index LITIN-A and the Turnover of its Constituents in January - November 1998" index values are marked on the left-hand vertical axis, while trading volumes (in litas) are marked on the right-hand axis. The horizontal axes of the graphs are divided according to the trading dates on the Stock Exchange. The upper (thicker) curve shows the values of the index while the lower one (thinner) reflects the share trading volumes during January - November 1998.

The Effect of the South-East Asian Crisis

In 1997 the values of LITIN and LITIN-A were constantly going up until the very beginning of the South-East Asian Crisis. The crisis began on October 23, 1997 when share prices on Hong Kong Stock Exchange dropped by 10 %. On October 23, 1997 the LITIN index had reached 1202 points and LITIN-A was 2324. Both indices started going down on the following day, on October 24. By January 1, 1998 the LITIN index had precipitated by 300 points, i.e. went down to 902. LITIN-A dropped by 400 points and on December 31 was 1930 points.

At the initial stage of all this process the fall of prices was caused by psychological reasons mainly. Later, the fall was stimulated by the Estonian banks being forced to sell Lithuanian corporate stock to repay credits. Their positions in Lithuanian corporate stock exceeded LTL 200 million and the daily trade volume on the NSEL equaled LTL 4 million. It is obvious that the increased supply when they started selling their shares had a very big impact.

1998, First Quarter

We can see from the graphs that the values of LITIN and LITIN-A during the first quarter were changing fast. LITIN went down from 900 to 800, and LITIN-A decreased from 2000 to 1500. Yet, at the end of the first quarter the values of both indices leaped and reached or even exceeded the level of the beginning of the year.

The depreciation of the share value during the first quarter of the year was mainly caused by the sale of shares by Estonian banks. The increase in share value at the end

of the quarter, most probably, can be explained by the fact that many investors cherished hopes that the bottom of the share prices had already been reached as Estonian banks slowed down selling their investment. Moreover, the preliminary data of the financial statements of the companies being traded were good indicating that corporate profit and value continued to grow. Naturally, the trading at the end of the first quarter and at the beginning of the second had become more intense.

1998, Second Quarter

This period may be characterized by a steady decrease of share prices despite a comparatively active trading. At the beginning of May LITIN was almost 1000 points, while on July 1 it was merely 722 points. On July 10, after the National Association of Financial Brokers expressed their concern about the introduction of the capital gain tax, index LITIN dropped to 615. The fall of LITIN-A in the second quarter of the year was not so abrupt, yet, it was also substantial. At the beginning of the quarter the value of this index exceeded 1800 points, while at the beginning of July it dropped to 1600, i.e. it precipitated by 200 points.

The price dynamics during this quarter was mainly determined by the activities of Estonian banks on the market as they continued to sell. Investors also became more cautious in valuing the company performance with the changes in their share prices. As a result, at the end of the quarter the trading volumes increased much less in comparison with the increase at the end of the first quarter.

The beginning of the Russian crisis

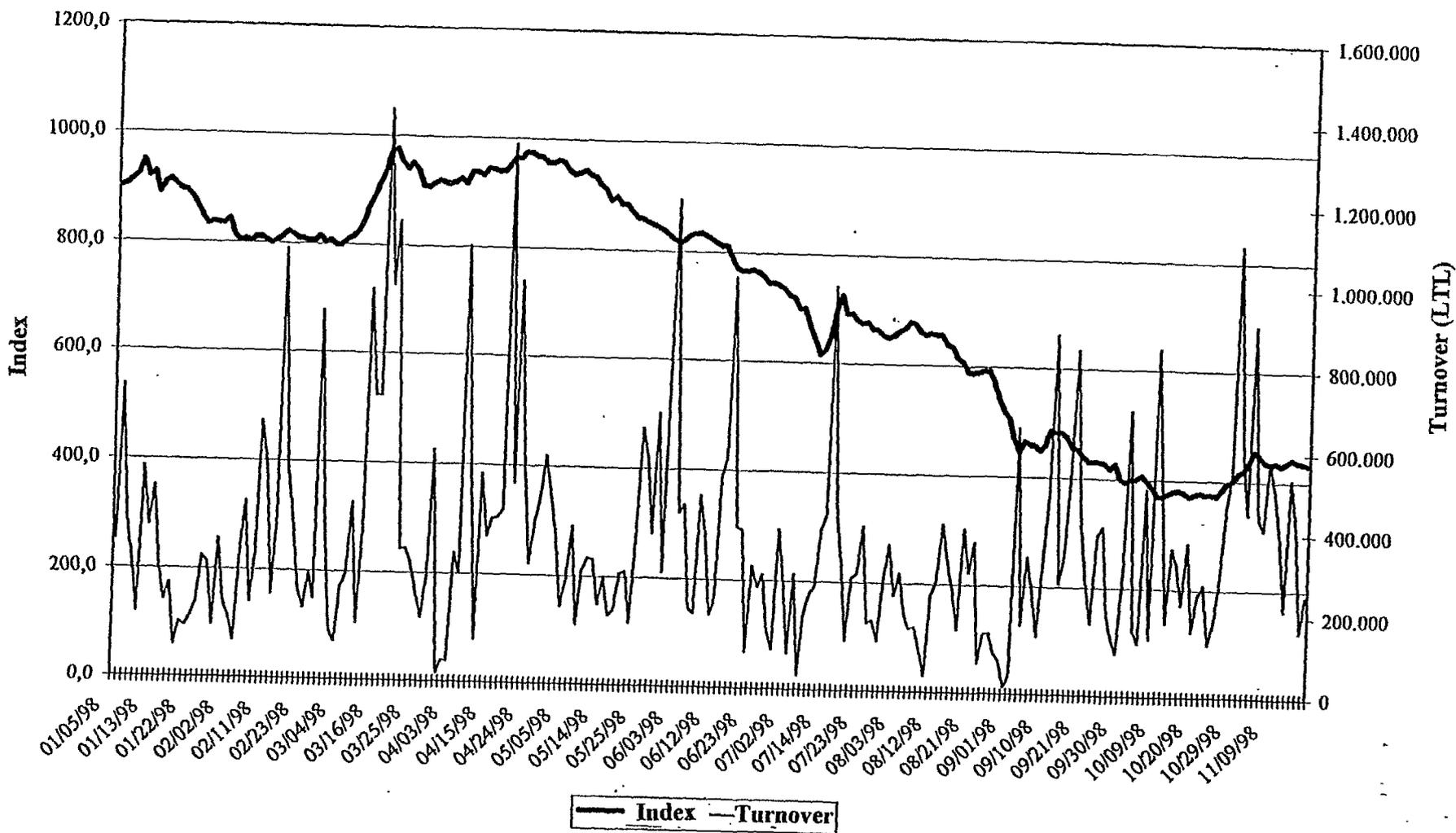
Decisions taken by the Russian Government and the Central Bank on August 17, 1998 caused a currency chaos in Russia, which moved the exchange rate of the dollar up from 6.2 to 8 rubles. This date is referred to as the beginning of the Russian crisis.

The graphs make it evident that the Russian crisis had accelerated the fall of the Lithuanian corporate stock. On August 17 LITIN equaled 614, while on October 1 it was below 400, i.e. it fell more than 200 points. On the same day LITIN-A was 1516, while on October 1 it reached merely 1328, i.e. it was also 200 points less.

Until now the crises in South-East Asia and Russia effected the Lithuanian capital market indirectly, i.e. through Estonian banks. The latter had been extended substantial credits from Western banks which were used for investment into Lithuanian companies. After the global financial situation had changed, the Estonian investors were forced to hastily sell the Lithuanian corporate stock at a loss, which determined the dynamics of LITIN and LITIN-A indices from the end of October 1997 until the beginning of November 1998. This conclusion is partly confirmed by the fact that at the end of October Estonian investors finished selling the Lithuanian corporate stock, which immediately reflected in the dynamics of the indices. In November LITIN went up over 400 and during the last weeks it did not fall. Shares comprising the index LITIN-A are less liquid. They are traded less actively either, therefore, they react to market changes much more slowly. The value of this index continues going downward.

In order to evaluate further dynamics of the Lithuanian corporate shares, two circumstances must be taken into account. First, the withdrawal of Estonian investors encouraged a similar reaction of other foreign investors. Unfortunately, local investors are scarce. In the situation of absence of the demand it is hardly probable that there will be a more significant rise in share prices in the near future. Second, the direct effect of the Russian crisis should become evident in the last quarter of 1998. The changed situation in Russia had effected the financial results of Lithuanian companies only in September, therefore the operational results of the third quarter of the year were comparatively good. Palpable losses will become evident only in the financial statements of the fourth quarter of 1998, which will also effect the share value of these companies and decrease in prices on the market.

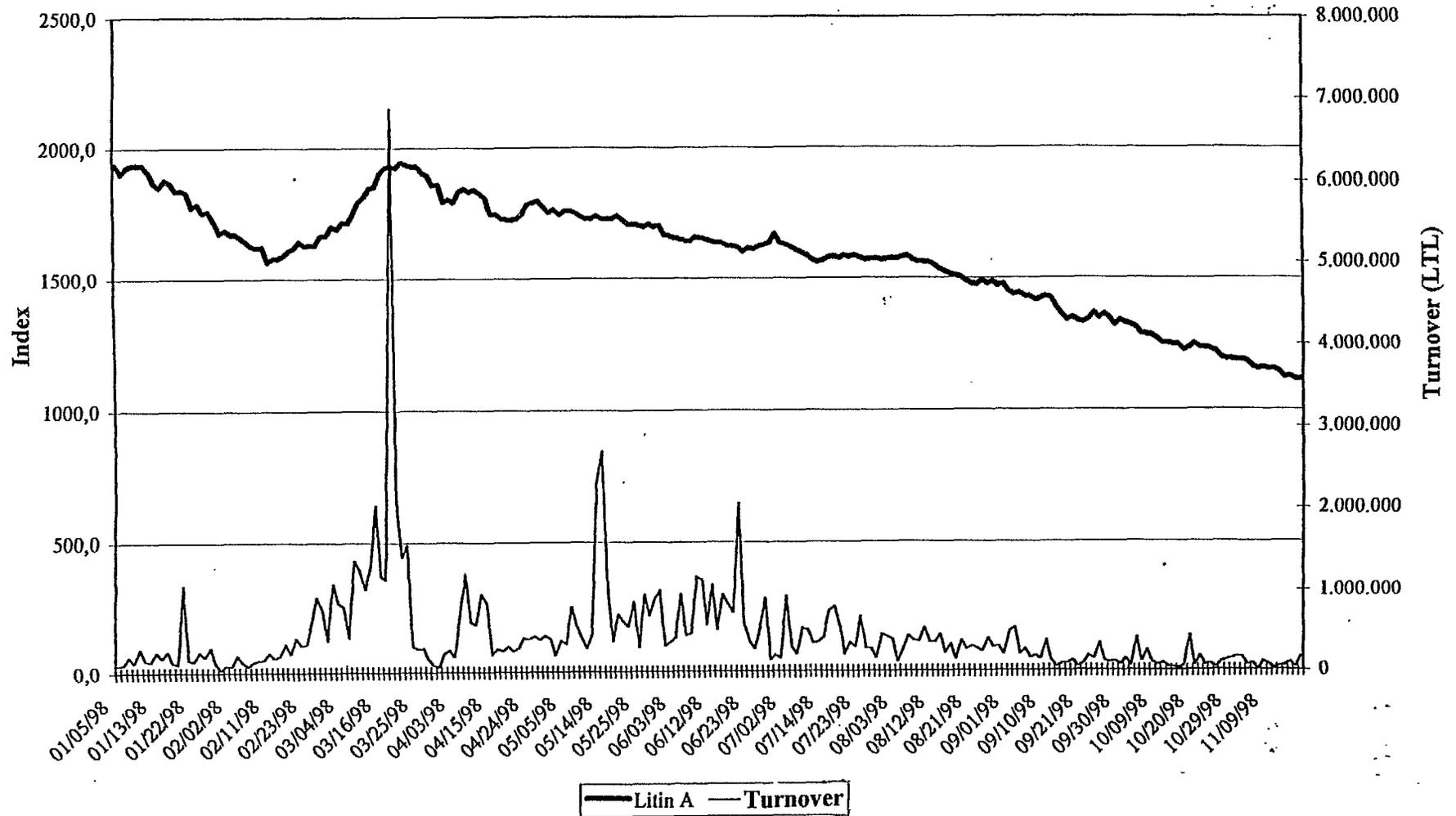
Index LITIN and Turnover of its Constituents in January - November 1998



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Index LITIN-A and Turnover of its Constituents in January - November 1998



The Pragma Corporation

Lithuanian Capital Market
Development Project
Stock Exchange Building
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MEMORANDUM

January 11, 1999 2:34PM

To: Aldas Kriauciunas
USAID - Vilnius, Lithuania

From: Nijole Maskaliuniene,
The Pragma Corporation, Vilnius

Re: **STATUS REPORT FOR THE MONTH OF DECEMBER, 1998**
Lithuania Capital Markets Development Project
CONTRACT EPE-I-95-00040-00, Task Order 05

CC: Ieva Veidemanis: USAID - Washington, D. C.
Kevin O'Hara: Pragma Corporation - Falls Church, Virginia
The Pragma Corporation: Vilnius Office File (Diana Sokolova)
The LSC, the NSEL, the CSDL, the NAFB

PROJECT DESCRIPTION

The Pragma Corporation ("Pragma") is implementing the Lithuanian Capital Markets Development Project ("Project") funded by the United States Agency for International Development ("USAID"). The Project is to provide legal and regulatory development assistance to the Lithuanian Securities Commission ("LSC") and organizational development assistance to the National Stock Exchange of Lithuania ("NSEL"), the Central Securities Depository of Lithuania (CSDL), and the National Association of Finance Brokers of Lithuania ("NAFB"). In addition, the Project is providing assistance in the procurement of software and operations capabilities to support an order-driven, continuous trading stock exchange.

PROFESSIONAL STAFFING

The Project is staffed by four local experts, Skirmantas Rimkus, a financial advisor, Gediminas Rečiūnas and Evaldas Valčiukas, legal advisors, and Dr. Arvydas Paškevičius, advisor in macroeconomics, working full time. Expat consultants work with the Project on a short-term contract basis. In December 1998, Mr. Stanley Judd, a legal advisor, worked with the team until December 28, 1998.

PRIMARY AREAS OF FOCUS

In December most of the team activities were concentrated on the issues of investment companies and corporate finance. Mr. Stanley Judd provided assistance in

the field of investment companies. That included revision of the proposed amendments to the Law on Investment Companies prepared by Evaldas Valciukas, comments on various provisions of the Civil Code concerning custody accounts, and inspections of management enterprises. (See Attachments "A", "B", "C" and "D").

Skirmantas Rimkus had a number of short-term assignments. First, he commented on the amendments to the Law on Investment Companies prepared by another Pragma consultant Evaldas Valciukas. The main comments concerned articles providing for annual accounting and reporting of mutual funds, the task directly related with his main assignment, namely, preparation of financial statements for mutual funds and investment companies. Then, he worked on the financial disclosure requirements of the Rule on Securities Registration and Public Offering in order to harmonize them with International Accounting Standards.

In December, the local advisor of the Pragma team Evaldas Valčiukas worked with the legal advisor from the USA, Mr. Stanley Judd, on the Law on Investment Companies. Although the final draft of the amendments was submitted to the Securities Commission in November, they will remain one of the most important tasks for the Project until they are finally adopted by the Seimas. As mentioned in the previous report, the draft amendments aim at improving the legal and regulatory basis for investment companies and mutual funds. When adopted, these amendments will eliminate contradictions between the Law on Investment Companies and the Law on Public Companies that showed up after the most recent amendments to the latter. The amendments are to bring the Law in line with the requirements of the European Union Directive 611/85/EEC, too. As a result, conditions for appearance of local investment funds (as of today, there are none) will be created on the basis of the European standard. Many provisions of the effective Law that caused controversy will be amended (e.g. governance of the fund will be simplified, etc.). (See Attachment "B").

Another project that Mr. Valčiukas was working on was the Rule on Registration and Public Offering of the Investment Fund's Shares. This Rule is a constituent part of a more general Rule on Registration and Public Offering of an Investment Fund's Shares. The advisor is regularly commenting and discussing the latter Rule (it is being prepared by the staff of the Investment Companies Department of the Securities Commission) to have the requirements of both Rules consistent. For the first time the procedure of registration, public offering and redemption of the investment fund's shares will be determined by these Rules.

In December, Dr. Paškevičius was working on the analysis of the database of the Lithuanian capital market. The Securities Commission requested that more sophisticated instruments, such as Access 97, be used for the capital market analysis. Furthermore, the Commission requested that analysts of the Securities Commission be trained in the methods of said analysis, so that they could continue this work when the Project is over. The possibilities of the practical aggregation of the databases of the Securities Commission, the Central Securities Depository and other institutions were discussed. This work is of a preparatory nature but it is very time consuming, and its results will be palpable only in the future.

SPECIAL TOPIC

In December, the Pragma team had a special assignment from the Securities Commission, namely, to prepare comments on the draft Law on Pension Funds. Problems of the pension funds have recently become quite an issue for the Securities Commission as the Government finally decided to delegate the regulatory and supervisory function of said funds to the Securities Commission. As currently the state social insurance system is the only way for the residents of Lithuania to provide for their retirement, a pension fund is to create a possibility for an optional source of income upon retirement. As long as there is no law regulating the appearance of a pension fund, there is no legal way to establish one. The importance of public confidence and protection of contributed assets require that the Law be given the utmost consideration. It also places a tremendous burden upon the Securities Commission both in terms of resources and social impact in case of failure. Therefore, the Securities Commission is already making arrangements for the implementation of the project. The Pragma team was asked to assist in reviewing the Law and also in drafting the regulations complementing it. Mr. Stanley Judd and all local advisors, Skirmantas Rimkus, Gediminas Reciunas, Evaldas Valciukas, and Arvydas Paskevicius, prepared comments on different sections of the Law. (See Attachments "E").

MAJOR ACHIEVEMENTS

On December 22, 1998 the Rule on Securities Registration and Public Offering was approved by the Securities Commission. This Rule is one of the most fundamental rules regulating the securities market, therefore, it was among the first to be adopted when the Securities Commission was established. It was passed in March 1993, long before the Law on Public Trading of Securities ("the Law") was passed (in January 1996), and had been in effect ever since. The developments in the securities market during the last five years made it essential to re-write the Rule to harmonize the securities registration and offering with the requirements of the Law, the EU Directives, new listing requirements adopted by the Stock Exchange and the recommendations of the IOSCO¹.

Although the Rule had been developed by the Corporate Finance Department of the Securities Commission for a long time, the Pragma team contributed considerably to its preparation and finalizing. Three consultants, Jurga Dermontaite, Skirmantas Rimkus, and Gediminas Reciunas worked on different sections of this Rule. Jurga Dermontaite has prepared Annexes to the Rule with regard to Requirements for the Prospectus of Public Share Offering and for the Prospectus of Public Debt Securities Offering for the companies with the authorized capital of more than 50 million litas that have more than 1000 shareholders; Requirements for the Prospectus of Public Share Offering and for the Prospectus of Public Debt Securities Offering for the

¹ International Organization of Securities Commissions

companies with the authorized capital of less than 50 million litas that have less than 1000 shareholders; Requirements for the Memorandums of Share and Debt Securities Offering (in case of private offerings); Requirements for the Prospectus Offering Shares Representing Certificates. Skirmantas Rimkus reviewed and finalized the financial section of the Rule. Gediminas Reciunas revised all the Rule to make different sections legally consistent. He also worked on the provisions dealing with the distinction between private placement and public offering (the Law on Public Trading of Securities requires that both private and public securities issues by public companies be registered with the Securities Commission) and regulation of public offerings (including underwriting).

WORKSHOPS/SEMINARS

In December there were no seminars attended by the Pragma team.

UPDATE ON PREVIOUS REPORT

COMPLETED:

- ☆ Draft Amendments to the Law on Investment Companies (a new draft)
- ☆ Rule and Guide for Staff on the Inspection of Management Enterprises
- ☆ Rule on Securities Registration and Public Offering

All documents were passed to the Securities Commission.

IN PROGRESS:

- Rule on Registration, Offering, and Redemption of Investment Fund's Shares
- Requirements for Financial Statements of Mutual Funds
- Capital Market Analysis

PLANS FOR NEXT MONTH AND ANTICIPATED ISSUES

In January 1999, Mr. Rimkus will complete the set of financial statements and principles of financial accounting for mutual funds, which was temporarily postponed because of the additional assignment given by the Securities Commission (like the

above mentioned work on the Rule on Securities Registration and Public Offering). Mr. Rečiūnas will be working on the Rule on Accounting of Securities and their Circulation for the Central Securities Depository. Mr. Valčiukas will finalize the Rules on Issuance and Redemption of the Investment Fund's Shares and will assist in completion of one of the most essential rules for the regulation of investment funds, the Rule on Registration and Public Offering of the Investment Fund's Shares. In January, Dr. Paškevičius was given a task by the Securities Commission to carry out analysis of shares of agricultural producers.

ATTACHMENTS:

ATTACHMENT A: STANLEY JUDD. TRIP REPORT

ATTACHMENT B: STANLEY JUDD. MEMORANDUM ON PROPOSED AMENDMENTS TO THE LAW ON INVESTMENT COMPANIES

ATTACHMENT C: STANLEY JUDD. RULES FOR STAFF, WITH ANNEXED GUIDE, ON THE INSPECTION OF A MANAGEMENT ENTERPRISE

ATTACHMENT D: STANLEY JUDD. MEMORANDUM ON THE DRAFT PENSION LAW

ATTACHMENT E: THE LAW ON PENSION FUNDS (SUBMITTED FOR THE APPROVAL OF THE SEIMAS)

TRIP REPORT

LITHUANIAN CAPITAL MARKET DEVELOPMENT PROJECT

DATE: December 24, 1998

LENGTH OF CONTRACT: December 5 to December 28 1999

NAME OF CONSULTANT: Stanley B. Judd

PURPOSE OF TRIP: To advise the Lithuanian Securities Commission on matters concerning investment funds and pension funds

WORK PERFORMED

AMENDMENTS TO THE INVESTMENT COMPANY LAW

I reviewed the proposed amendments to the Law on Investment Companies, discussed numerous matters with Evaldus, who had been responsible for drafting the changes, and brought numerous suggested changes in details and several matters of substance to his attention, and then wrote a memorandum to the Lithuanian Securities Commission containing my comments on several substantive matters concerning the proposed amendments. I then discussed the memorandum with Ms Irmina Judiekaite, the member of the Lithuanian Securities Commission responsible for the regulation of investment companies, and then met with the full Commission.

BANKING PRACTICES IN REGARD TO THE CUSTODY OF CASH

In response to Ms Judiekaite's request, I commented on various provisions of the Civil Code and of rules of the Lithuanian National Bank on bank deposits and on custody accounts of cash and advised her of their requirements and the procedures mandated to insure compliance with the requirements intended to protect against loss of cash of persons placed in the custody of a bank.

RULE AND GUIDE FOR STAFF ON THE INSPECTION OF MANAGEMENT ENTERPRISES

At the request of Mr. Virgilijus Poderys, the Chairman of the Lithuanian Securities Commission, I prepared rules and guidelines for staff on conducting an inspection of a management enterprise.

COMMENTS ON THE PROPOSED PENSION LAW

At the request of the Mr. Poderys, I reviewed the proposed pension law and wrote a memorandum to the Securities Commission containing my comments. I then met with Chairman Poderys, Ms Judiekaite, and members of the staff to discuss the pension law, my comments, alternative pension schemes, and other matters related to pension schemes.

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ATTACHMENTS

- t MEMORANDUM TO THE LITHUANIAN SECURITIES COMMISSION, DATED DECEMBER 9TH 1998, ON PROPOSED AMENDMENTS TO THE LAW ON INVESTMENT COMPANIES
- C RULES FOR STAFF, WITH ANNEXED GUIDE, ON THE INSPECTION OF A MANAGEMENT ENTERPRISE
- D MEMORANDUM TO THE LITHUANIAN SECURITIES COMMISSION, DATED DECEMBER 23RD, 1998, ON THE DRAFT PENSION LAW

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RULES ON THE INSPECTION OF MANAGEMENT ENTERPRISES OF INVESTMENT COMPANIES

1. General Part

1.1. These Rules on the Inspections of Management Enterprises of Investment Companies are prepared for the employees of the Investment Company Department of the Securities Commission who are responsible for the surveillance of investment companies and their management enterprises.

1.2. The objective of the inspection of the management enterprises of investment companies is to determine how the management enterprises are following the laws of the Republic of Lithuania on the Public Trading In Securities and On Investment Companies, the rules approved by the Securities Commission under those laws, and other legal acts or documents governing or regulating their activities. While engaged in an inspection, employees of the Securities Commission may, without any special permit, enter the premises of a management enterprise, examine and make copies of documents or temporarily withdraw documents (leaving behind an inventory of the documents taken), as well as ask questions in writing or orally of the managers of the management enterprise or of persons who are subordinate to them.

1.3. The terms "investment company," "investment fund," "closed-end fund," "investment holding company," "management enterprise," "depository," "persons related to a management enterprise," "managers," and other terms used in this rule and in the Law on Investment Funds or the Law on Public Trading In Securities shall have the same meaning as they have in those laws or the rules of the Securities Commission approved pursuant to those laws.

1.4. The inspection of a management enterprise consists of four stages:

- preparing for the inspection;
- conducting the inspection and making notes of an inspector's observations while the inspector is on site;
- preparing a report on the inspection;
- making conclusions and recommendations.

2. Preparing for the Inspection

2.1. A management enterprise may be subject to routine or special/cause inspections. Routine inspections should be carried out periodically. It may be desirable to carry out a routine inspection of a management enterprise in connection with an inspection of one or more investment companies for which the management enterprise serves as a management enterprise. Otherwise, the management enterprises selected for routine inspection may be selected randomly with, however, consideration being given to the length of time that has elapsed since the last inspection. Special or Cause inspections may be performed after a complaint has been filed or there is reason to believe that a

law or rule has been violated or because the Securities Commission may be interested in a course of business or practice in which a management enterprise is or may be engaged.

2.2. An inspector, once having selected a management enterprise for inspection, should determine the tasks of the inspection and depth of any examination, become acquainted with the company's application for the permit to be a management enterprise and the documents annexed to the application, any management agreement with an investment company to which the management enterprise is a party and which has been filed with the Securities Commission, and reports that the management enterprise has made to the Securities Commission. The inspector note any issue that may be a subject of special attention during the inspection.

3. Conducting the Inspection and Making Notes of the Inspector's Observations While the Inspector Is on Site

3.1. During the inspection attention should be given to the following subjects:

- the management enterprise's compliance with the provisions of the Law on Public Trading of Securities and the Law on Investment Companies applicable to management enterprises;
- the management enterprise's compliance with the provisions of the Rule on Issuance and Revocation of Permits for Management Enterprises of Investment Companies requiring a management enterprise to submit to the Securities Commission within ten days any amendment or supplement to any document submitted by the management enterprise to the Securities Commission in connection with its application to obtain a permit to be a management enterprise and to advise the Securities Commission within five days of certain changes in the capital of the management enterprise;
- the management enterprise's compliance with the terms of the management agreements it has entered into with investment companies
- the management enterprise's administration of its rules of conduct for managers and employees.

3.1.1. While examining a management enterprise's compliance with the provisions of the Law on Public Trading of Securities and the Law on Investment Companies, and the rules thereunder, attention should be paid to the following:

- whether any owner (shareholder) of the management enterprise or employee of the management enterprise is an owner or employee of another management enterprise;
- whether the management enterprise participates in the activities of other enterprises, has any share in their capital, or invests in securities;
- where the management enterprise acts as the management enterprise of an investment fund, or another investment company that has contracted with the management enterprise for the management enterprise to do the accounting for the investment company, whether the management enterprise does the accounting for the investment fund or any such other investment company in accord with applicable accounting regulations;

- whether the authorized capital of the management enterprise is not less than the minimum capital required, and whether borrowed capital is not more than one-half of (owned) capital;
- whether at least two managers of the management enterprise have a broker's certificate or any other certificate recognized by the Securities Commission;
- whether any person, or persons acting together with other persons as defined in Paragraph 1 of Article 9 of the Law on Public Trading of Securities, has or have acquired 10 percent or more of the voting shares of the management enterprise without the permission of the Securities Commission;
- whether the management enterprise has been reorganized without the permission of the Securities Commission;
- whether the management enterprise engages in any activity other than the asset management of investment companies and pension funds or other investment management or consulting activities;
- whether the management enterprise has submitted to the Securities Commission all periodic financial statements and reports that are required by the securities Commission;
- whether the management enterprise has caused an investment company of which it is the management enterprise to invest in the management enterprise, or in any company controlled by the management enterprise or by employees or persons connected to the management enterprise, without the approval of the Supervisory Council or Board of the investment company and the permission of the Securities Commission;
- where the management enterprise is the management enterprise of more than one investment company and those investment companies together own more than ten percent of the voting shares of any issuer, whether the management enterprise at any general meeting of shareholders of the issuer has voted on behalf of the investment companies shares exceeding ten percent of the voting shares of the issuer.
- whether the management enterprise of an investment company receives any salary, fees, or other compensation from any company in which the investment company owns or proposes to acquire securities, and whether the receipt of any such payment violates the rights or interests of the investment company or its shareholders, and, if the investment company is an investment holding company, whether payments of that kind have been disclosed to the investment holding company;
- whether the management enterprise receives any compensation from any source for acting as an intermediary in connection with the purchase or sale of any security or other asset by the investment company or any company controlled by the investment company, and whether any connected person of the management enterprise receives any compensation from any source for acting as an intermediary in connection with the purchase or sale of any security or other asset by the investment company or any company controlled by the investment company, except for the commission paid to intermediaries of public trading of securities in connection with the purchase or sale of securities;
- whether the management enterprise of an investment company has caused the investment company or any company controlled by the investment company to invest in any enterprise controlled by a connected person of the investment company;

- whether managers or employees of the management enterprise of an investment company or connected persons of the management enterprise have sold securities or other assets to the investment company other than to redeem shares of the investment company or purchased securities or assets from the investment company other than shares of the investment company or securities that are purchased from the investment company in order to avoid losses to the investment company related to a decrease in the value of the securities due to a fall in the exchange; i.e., market, value of the securities, and, if so, whether the transaction was properly approved by the Supervisory Council or Board of the investment company;
- whether the managers or employees of the management enterprise of an investment company or connected persons of the management enterprise have invested in securities of any issuer that has issued or proposes to issue securities that the investment company owns or that the management enterprise intends the investment company to acquire, and, if so, had the Supervisory Council or the Board of the investment company found that the transaction would not be prejudicial to the investment company or the rights and interests of shareholders, and, if so, does that decision appear to be correct.

3.1.2. While examining whether a management enterprise has filed with the Securities Commission all amendments or supplements to documents filed in connection with the application for a management enterprise permit and informed the Securities Commission of certain changes in capital, consideration should be given to the following:

- the application to the Securities Commission to become a management enterprise;
- the bylaws and other documents of incorporation of the management enterprise;
- the management enterprise's plan of activity which describes how the management enterprise intends to organize and perform its activities;
- any management agreement entered into by the management enterprise, or draft of a management agreement that may have been submitted with the application;
- rules of conduct of the management enterprise for managers and employees;
- list of shareholders of the management enterprise and the number of shares held by each shareholder;
- information on managers, owners of more than ten percent of the voting shares of the management enterprise or persons holding proxies to vote more than ten percent of the voting shares of the management enterprise, and employees holding permits granted by the Securities Commission
- data on the enterprises in which the management enterprise or persons connected with the management enterprise hold more than 20 percent of the shares;
- the most recent audited balance sheet of the management enterprise disclosing the ratio between owned and borrowed capital.

3.1.3. While examining the management enterprise's compliance with the terms of the management agreements it has entered into, consideration should be given to the following:

- if the management enterprise is required under a management agreement to file copies of the management agreement with an investment company's depository or financial intermediary, whether the management company has made those filings;
- whether it is the management enterprise that has chosen an investment company's depository, financial brokerage firm that will act as an intermediary of public trading of securities purchased or sold by the investment company, or the intermediary of public trading of securities (paying agent) who will manage the sale and the repurchase of the shares of an investment fund;
- whether the management enterprise of an investment company deals with an investment company's depository and financial intermediary in the manner provided for in the management agreement;
- whether the management enterprise of an investment company manages the securities and other assets of the investment company in accord with the purposes, objects, and methods of investment activity contemplated by the Law on Investment Companies and the by-laws of the investment company;
- whether the management enterprise of an investment company manages the securities portfolio of the investment company, does the accounting for the investment company, advises on the preparation of (1) the investment company's prospectus and any amendments to the prospectus, (2) the investment company's annual and semi-annual reports, and (3) financial statements of the investment company, pays certain expenses of the investment company as specified in the management agreement, manages an investment company's current activities, or performs other functions of the investment company in accord with the management agreement and in compliance with the laws of the Republic of Lithuania and other legal acts;
- whether the management enterprise, if the investment company has been in a situation that had to be reported to the investment company and /or the Securities Commission, reported the situation to the investment company and/or the Securities Commission;
- whether the management enterprise pays the investment company's expenses as provided for in management agreement including the amount of commissions paid to financial brokerage firms that act as intermediaries of public trading of securities of the investment company's portfolio, the amount of commissions paid to the financial brokerage that acts as a paying agent for the sale and purchase of the redeemable shares of the investment fund, and other expenses of the investment company that arise in the process of the management of the investment company that are to be paid for by the management enterprise pursuant of the terms of the management agreement;
- whether the fee paid to the management enterprise has been calculated in accordance with the provisions of the management agreement, whether those provisions are in accord with the law, and whether the total fee paid to the management enterprise by the investment company has been limited to an amount that is not greater than 2 percent of the average annual value of the net assets of the investment company or 20 percent of the net annual profit of the investment company; and if the fee was paid periodically over the course of a year and the total amount that was paid was in excess of the foregoing limit, whether the excess payment has been repaid.

3.1.4. While examining the management enterprise's administration of its rules of conduct for managers and employees, special consideration should be given to the following:

- whether the rules of conduct ensure enforcement of the prohibitions contained in section 2.7 of the Rule on Issuance and Revocation of Permits for Management Enterprises of Investment Companies;
- whether the rules of conduct require managers and employees to report all securities holdings to the management enterprise and to also report to the management enterprise any change in a security holding, i.e., sale or other disposition of a security, or purchase or other acquisition of a security, and whether there are circumstances in which pre-clearance of the sale or purchase of a security is required;
- whether there have been any violations of the rules of conduct, and , if so, what were the violations and how were the violations handled.

(Annex 1)

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OUTLINE OF A ROUTINE EXAMINATION OF A MANAGEMENT
ENTERPRISE

Permit number of the management enterprise:-

Full name of the management enterprise: _____

Beginning Date of Examination: __/__/__

Ending Date of Examination: __/__/__

The examination was carried out by:

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I. Pre-Inspection Review of the Files on a Management Enterprise

YES NO QUESTIONS

Have all applications by the management enterprise and any amendments or supplements and any financial or other reports filed by the management enterprise been obtained and reviewed?

Did a search of enforcement files indicate any adverse or other pertinent information regarding the management enterprise or any person or firm listed in response to items 7.2, 7.4. or 8 of an application?

Did a search of complaint files indicate any possible areas for special examination focus?

Has the management enterprise been examined previously?

If so, have the workpapers from the previous examination been reviewed?

If yes, were any deficiencies reported by that previous examination remedied? (Note: This item can only be answered during the examination). If no, detail.

Has all correspondence between the management enterprise and the Securities Commission regarding requests for interpretation by the management enterprise and responses by the Securities Commission been reviewed?

II. Initial Interview

The initial interview is critical as it will set the tone (and often the focus) for the examination. It should be conducted as soon as possible after the examiners' arrival at the management enterprise's offices. Attendees from the management enterprise should include its managers. Examiners should use this occasion to familiarize

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themselves with the names and positions of key personnel. While the interview should be general in nature, it should address, at a minimum, the following areas:

- Current extent of the management enterprise's business, including a general history and activities of all connected persons of the management enterprise.
- The relationship, if any, between the management enterprise or any connected person of the management enterprise and the financial intermediary who manages the sale or repurchase of the shares of any investment fund for which the management enterprise acts as management enterprise
- The relationship, if any, between the management enterprise or any connected person of the management enterprise and a financial intermediary of public trading of securities that executes security transactions for an investment company for which the management enterprise acts as the management enterprise.
- The relationship, if any, between the management enterprise or any connected person of the management enterprise and the depository of any investment company for which the management enterprise acts as the management enterprise.
- The policy of the management enterprise in regard to directing the purchase of securities of an issuer on behalf of any investment company for which it acts as a management enterprise when the management enterprise or a connected person of the management enterprise owns securities of that issuer.
- The names of (1) the investment companies for which the management enterprise acts as management enterprise, (2) the depositories of those investment companies, (3) the financial intermediaries for sale or repurchase of the shares issued by those investment companies, (4) the financial intermediaries of public trading of securities that execute securities transactions for those companies, (5) the head of the management enterprise, and (6) the two managers of the management enterprise who have broker's qualification certificates or other certificates recognized by the Securities Commission.
- General discussion of investment philosophy, including the current composition of the portfolio of each investment company for which the management enterprise acts as the management enterprise.
- The attitude of the managers of the management enterprise to the exercise of controls and the organizational and operational means by which the management enterprise controls its activities.

Examiners should request a tour of the management enterprise's operations following the interview.

III. Examination Outline

I. Books and records

YES NO QUESTIONS

Does the management enterprise keep its books and records in accordance with rules of the Securities Commission and in accordance with standard accounting practices?

Does the management enterprise maintain copies of all the management agreements to which it is a party?"

Does the management enterprise maintain and keep current the following records:

- Journals or summary journals
- General and auxiliary ledgers reflecting assets, liabilities, reserves, capital, and income and expense items?
- Order Memorandums showing the terms and conditions of the orders?
- All checkbooks, bank statements, canceled checks and cash reconciliation?
- All bills or statements, paid and unpaid?
- Trial balances, financial statements, and internal audit papers?
- All written correspondence received or sent by the firm, including any significant client complaints?
- Personal security transaction reports for the management enterprise and persons connected with the management enterprise?
- A record for each investment company of securities purchased and sold which includes the date, amount, and price for each transaction?
- A record for each security in which an investment company for which the management enterprise acts as management enterprise has a current position which shows the investment company's name and current ownership interest ?

Does it appear that the management enterprise is maintaining its books and records in the manner and for the period required?

Did a review of the bank statements , canceled checks, deposit slips, and check register indicate any questionable payments or receipts of moneys or other goods or services?

Did a review of the bank statements, canceled checks, deposit slips, and check register indicate that the general ledger and the journals are accurate and complete?

If a management enterprise does the accounting for an investment company for which the management enterprise acts as management enterprise, are the controls over employees and managers sufficient to ensure the accuracy of the records of the investment company that are kept by the management enterprise and the records of the management enterprise and to prevent false entries in regard to the investment company's assets, earnings, expenses, or any other matter concerning the investment company?

2. Custody

YES NO QUESTIONS

Are the assets of investment companies for which the management enterprise acts as the management enterprise in the custody of authorized depositories of the assets of investment companies?

Is each depository account in the name of an investment company and not in the name of the management enterprise for the benefit of an investment company?

3. Financial Condition of the Management Enterprise

Registrant's financial condition as of _____

Current Assets: _____

Current Liabilities: _____

Total Assets: _____

Total Liabilities: _____

Net Worth: _____

*Revenue: _____

*Net Income: _____



*Interest Expense: _____

Current Ratio _____ %
(current assets divided by current liabilities)

Capital Ratio _____ %
(borrowed capital divided by net (own) capital)

*For the year ending the date noted above

YES NO QUESTIONS

Did a review of the management enterprise's current financial condition raise questions concerning compliance with minimum capital requirements and the limit restricting borrowed capital to one-half of net (own) capital?

4. Internal Controls

YES NO QUESTIONS

What is the general philosophy of management toward creating and maintaining a strong internal control environment ? (The answer to this question should be based both on statements made during an interview with the staff and the review of the management enterprise's activities during the inspection.)

NOTE: If there is weak leadership at the top, as to the importance of controls, examiners should be alert for practices and customs in the management enterprise's operational or administrative activities that reflect this weak focus on controls at the top.

Has an internal audit been conducted, or any examination been made by an outside agency, for which a comment letter was provided? If so , request a copy of the letter(s)

If an investment company terminated an agreement with the management enterprise, did a review of the matter including an interview with the investment company reveal any significant problems?

Did a review of any complaints against the management enterprise indicate any problems?

5. Portfolio Management

YES NO QUESTIONS

Do the securities and other assets in which investment companies managed by the management enterprise are invested appear consistent with their investment objectives and policies?

Is an investment company's available cash balance identified and invested for the benefit of the investment company on a timely basis?

Does the transaction volume (portfolio turnover) for any investment company appear excessive considering the investment company's objectives and policies?

Does the management enterprise have a recorded basis for its investment decisions (i.e., research, on-site-visits, interviews, etc.)?

6. Conflicts of Interest

YES NO QUESTIONS

Do connected persons of the management enterprise, or employees of the management enterprise or of connected persons of the management enterprise who have access to information concerning a management enterprise's intended purchase or sale of securities for an investment company, file with the management enterprise periodic reports of their transactions in securities?

Are such records properly maintained?

Are such records reviewed by an officer of the management enterprise and if so, by whom?

Officer: _____

Did a review of these transactions indicate any instance where any of such persons may have engaged in improper trading practices, such as trading in advance of an investment company or any other trading in securities by any such person in a manner that is intended to result in profit to the person as a result of transactions by the investment company?

Does the management enterprise maintain policies reasonably designed to prevent the misuse of information that is confidential to the management enterprise and the investment companies for which it acts, such as the intended purchase and sale of securities by those companies.?

Has the management enterprise caused any investment company with which it has a management agreement to acquire any securities of a company controlled by the management enterprise or by any employee or connected person of the management enterprise?

If yes, was the transaction approved by the Supervisory Council of the investment company and by the Securities Commission?

Has the management enterprise caused any investment company with which it has a management agreement to acquire any securities issued by the management enterprise ?

Has the management enterprise caused any investment company with which it has a management agreement to acquire from, or to sell to, connected persons of the investment company, or the management enterprise or depository of the investment company, or connected persons of the management or depository, through non-exchange transactions, any securities or other assets, other than redeemable shares of the investment company?

If yes, was the transaction approved by the Supervisory Council of the investment company?

In any case state the details of any such transaction, and if the transaction was approved by the Supervisory Council, the basis given by the Supervisory Council for its approval.

Has the management enterprise caused the management enterprise, the investment company, the depository of the investment company, or persons connected with them to enter into transactions concerning the investment company or its property that are or would be prejudicial to the investment company or the rights and interests of its shareholders?

If yes, provide the details

Has the management enterprise of an investment company entered into a transaction from which it has profited at the expense of the shareholders of the investment company or has the management enterprise performed any unlawful act that has caused losses (material damage) to the shareholders of the investment company?

If yes, provide the details.

7. Brokerage/Execution

Indicate if the management enterprise or any connected person of the management enterprise acts in any capacity whereby it receives a commission or other payment

from any source on transactions of an investment company for which the management enterprise acts as management enterprise?

If so, describe the circumstances.

YES NO Questions

Did a review of the management enterprise's records of an investment company's transactions indicate excessive commissions, excessive portfolio turnover, trading errors, "as of" trades, or other unusual or abusive items regarding price, commissions, mark-ups/downs, execution, timing, selection of broker or dealer that was used or market in which a transaction was executed? If yes, provide the detail.

Which of the following best describes how executing financial intermediaries are selected:

Investment companies name the financial intermediaries they wish to be used to effect transactions of the investment company

The management enterprise selects the financial intermediaries used to execute transactions for investment companies served by the management enterprise.

A connected person of the management enterprise is a financial intermediary for public trading in securities and all transactions are placed through that person. If so, name the connected person and describe the basis of the connected person's relationship to the management enterprise.

Does the management enterprise negotiate commission rates for the investment companies for which it acts? If so, detail average rates on a centu per share basis and the financial intermediaries used. If no, determine why no negotiation takes place. If a connected person is used to execute transactions for an investment company for which a management enterprise acts as management enterprise, take a sample of transactions by the investment company and determine how the charges paid by the investment company to the connected person compare to charges paid on comparable transactions by other customers of the connected person, and how the charges of the connected person compare to the charges that are made by other financial intermediaries in the public trading of securities in regard to comparable transactions.

YES NO QUESTIONS

Does the management enterprise put together for block trade execution, the trading orders for an investment company and the trading orders for any other investment company or the management enterprise?

If yes, do the persons whose orders are put together receive the same average commission rate, and if the order is subject to multiple execution, the same average price?

Does the management enterprise or any connected person of the management enterprise receive anything of value from financial intermediaries in the public trading of securities in return for the management enterprise's selection of a financial intermediary to execute transactions in securities for investment companies for which the management enterprise acts as management enterprise?

If yes, detail arrangements, including services or products obtained and their price.

8. Litigation

YES NO QUESTIONS

Has the management enterprise or any connected persons of the management enterprise been involved in any litigation?

If yes, does the litigation bear upon or is it likely to have an impact upon the performance by the management enterprise of its management agreements with investment companies?

If yes, have the Supervisory Councils of the investment companies been informed of the litigation?

MEMORANDUM

To: The Lithuanian Securities Commission

From: Stanley B. Judd, The Pragma Corporation

Subject: Proposed Amendments to the Law on Investment Companies

Date: December 9, 1998

My comments on the draft of the law that I have read are the following.

1. Article 3, paragraph 3

This paragraph requires every enterprise that meets the criteria of items 1 and 2 of paragraph 1 to be reorganized as an investment company. Paragraph 1, however, defines an investment company as any stock company that accumulates the funds of natural and legal persons by way of a public offering of shares and has "at least one" of the attributes contained in items 1 or 2. Therefore, Article 3, paragraph 3 should be amended to require every enterprise that meets the criteria of items 1 or 2 of paragraph 1 to be reorganized as an investment company.

2. Article 5, paragraph 8, item 10

Item 10 of paragraph 8 of Article 5 requires an investment company's bylaws to contain information on "appreciation of the investment portfolio value and income on investment distribution policy and procedure" This language may suggest to someone that unrealized appreciation may be included in income and be distributed.

It might be better if item 10 required a company's bylaws to state "the company's policy and procedures in regard to dividends or other distributions."

3. Article 7, paragraph 1,

This paragraph contains a proposed amendment that would permit the bylaws of an investment fund to set a limit on the number of shares which may be acquired by one person, and would provide further that all shares acquired in excess of the limit shall not grant any voting rights.

This provision is highly unusual in making the voting right of a share dependent on the number of shares held by the owner of the share. The provision will lead to controversy over matters such as whether the shares owned by a person's wife, children, parents, siblings, controlled companies, etc. should be combined for purposes of determining whether the stated limit has been exceeded. It will also make difficult the determination of what constitutes a quorum or a majority of shares. The provision also does not indicate whether the transfer of a share to a person whose holdings would not exceed the limit would restore the share's voting rights.

4. Article 7, paragraph 4

I have been informed that this provision is being revised. I would just like to mention that the contemplated limitation of sales charges to 1% of redemption value may make it difficult for an investment fund to interest brokers in selling shares of the

investment fund unless a broker is connected to the management enterprise of the fund which stands to collect a management fee from the fund.

In the United States, many funds do not charge the maximum permitted sales charge of 8.5% of net asset value per share. A large part of those funds, however, make payments from a fund's assets to brokers to compensate them for having sold shares of the fund.

5. Article 9, paragraph 2, item 2.

This provision permits investment companies, other than investment holding companies, to acquire only those securities that are on the official or current list of stock exchanges operating in Lithuania. This provision would seem to apply to both investment funds and closed-end funds.

Investment funds offer redeemable shares. Closed-end funds do not. There is therefore, greater concern that the portfolio securities of an investment fund be liquid than there is that the assets of a closed-end fund be liquid. There is also greater concern that the portfolio securities of an investment fund be capable of valuation because shareholders have a right to redeem the shares of an investment fund at approximately their net asset value per share and such funds usually engage in a continuous offer of their shares based on the current net asset value per share. Thus, fair valuation of the shares of investment funds is essential to fair treatment not only of purchasers and redeemers of fund shares, but also to fair treatment of those shareholders who do not redeem their shares because if a fund pays a redeeming shareholder more than what he is entitled to, the remaining shareholders would be left with less than what they are entitled to.

Nevertheless, there is also a concern that the portfolio securities of closed-end funds be capable of valuation.

Depending on the quality of the securities on the official, current, or other list of a stock exchange in Lithuania, it may be appropriate to, as proposed, limit investment funds and closed-end funds to securities on the official and current lists of a Lithuanian stock exchange and permit only investment holding companies to acquire any securities listed on a Lithuanian stock exchange. Another possibility might be to limit investment funds to securities on the current or official lists of a stock exchange in Lithuania, limit a closed-end fund to any listed securities on a Lithuanian stock exchange, and permit investment holding companies to invest in those securities or any unlisted securities that are traded on a Lithuanian stock exchange.

Article 12¹, paragraph 3

This provision would limit a management enterprise and the diversified investment companies it manages to voting 10% of the voting shares of any issuer when the investment companies together own more than 10% of the voting shares of the issuer. Where one or more of the funds retains the right to vote the shares held by it, the proposed amendment states that the part of the shares that grants votes to the investment company "shall be determined in proportion to the participation of the investment company in the issuer's equity."

This language seems incomplete and should be amended to read as follows: "In that case, the number of shares of the issuer that may be voted by each investment company, or by the management enterprise for an investment company, shall have the same ratio to the total number of shares of the issuer that may be voted by all the affected investment companies and the management enterprise as the number of shares of the issuer owned by each investment company bears to the total number of shares of the issuer owned by all the affected investment companies."

In addition, language should be added to deal with the possible allotment of fractional shares. For example, it might be provided that if fractional votes are allotted, the owner of the largest fraction shall have the full vote and the other holders of fractional votes shall have no part of that vote and if more than one investment company is allotted a fraction that is the largest fraction allotted, the vote for the whole share should go to the investment company among those investment companies that is selected by lot.

Such an intensive description of a procedure might better be incorporated in a rule of the Securities Commission than in a law. In that case, the law should simply give the Security Commission the authority to deal with the matter by rule. Another option would be to allow the permissible vote to be divided in any manner to which the affected investment companies and the management enterprise may agree or, in the absence of such agreement, as the Securities Commission may require by rule.

Article 13, paragraph 2, and Article 8, paragraph 3

The provisions of Article 13, paragraph 2 would (1) delete the present provision of the law limiting the period of a management agreement to four years and (2) permit a management agreement to be terminated by the decision of the general meeting of shareholders only in case the management enterprise violates the agreement, the bylaws of the investment fund (sic), or the law. Paragraph 3 of Article 8 specifies that resolutions of the general meeting of shareholders with respect to the management agreement will require a 4/5 majority vote.

In the United States, a management agreement with an investment company can have a period of no more than two years from the date of execution unless thereafter it is specifically approved annually by the investment company's board of directors or by a vote of a majority of its outstanding shares. In addition, the law requires that a management agreement must provide that it is terminable, without the payment of any penalty, by an investment company's board of directors or a vote of a majority of its outstanding voting securities on sixty days notice to the management company.

By deleting the existing four year limitation on the period of a management agreement, the amendment would allow a management agreement to provide for an unlimited term. This does not seem to be desirable given the fact that an investment company and its management enterprise may change over time in many ways, including the investment company's size, which may make continuance of the agreement unfair to the investment company.

The provisions of the proposed amendment that would limit the bases on which an investment company may terminate a management agreement seems unduly narrow. The provision would restrict the functions of an investment company's Supervisory Board and would permit an incompetent management enterprise to continue in its management of an investment company. Furthermore, the requirement of paragraph 3 of Article 8 that a 4/5 majority vote at the general meeting of shareholders is necessary for the adoption of a resolution concerning the management agreement would seem to make the adoption of any such resolution difficult if not impossible.

Article 13, paragraph 3

This part of the existing law provides that the fee payable to a management enterprise for the management of the assets of an investment company may not be in excess of the following:

- 1) 2% of the annual value of the investment company's own (net) assets;
- 2) 20% of the annual net profit of the investment company.

This part of the law also provides that the fee may be paid in shares of the investment company if it is provided for in the management agreement.

In the United States, management agreements giving a management enterprise a fee based on a share of a fund's capital gains is prohibited because it is thought that such an arrangement encourages the management enterprise to adopt unduly speculative investment practices.

The payment of fees in shares would be prohibited in the United States because it is not permissible there for shares of an investment company to be issued for services. It also should not be permissible in Lithuania because it dilutes the value of fund shares.

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MEMORANDUM

December 23, 1998 4:29PM

To: The Lithuanian Securities Commission

From: Stanley B. Judd, Legal Adviser



Re.: Draft Pension Law

You have asked me to comment on the proposed Pension Law. I have, unfortunately, only had time to read the law once, and have not had the time or the opportunity to discuss the law with those who drafted it. As it currently stands, the law in the English translation that I have read is so confusing that I can only guess at its intentions.

As best as I can make out, the law envisions and provides for the existence of entities I will call "Pension Companies." These companies are permitted to have separate accounts that I will call "Pension Funds." A Pension Company or its creditors will have no claim on the assets of the Pension Fund that is a special account of the Pension Company.

A Pension fund is to have Participant Accounts in the Pension Fund. The assets of the Pension Fund are divided pro-rata among the Participant Accounts according to their relative size. The size of a Participant Account is determined by the contributions to the Participant Account and each Participant Account's pro-rata share of that part of the Pension Fund's earnings, i.e., income and gain, on the assets of the Pension Fund, less certain "costs," that is paid by the Pension Company to the Pension Fund. The assets of the Pension Fund and the other assets of the Pension Company are to be invested in diversified securities

The Pension Company guarantees that the annual total return on the Pension Fund's assets after deductions for all costs will not be less than some amount that may not be less than the average interest rate on a bank deposit. The law does not state what the amount is, how it is determined, whether it is subject to a Pension Company's discretion, and whether the manner of calculating the amount to be paid may be changed from time to time at the discretion of the Pension Company.

The Pension Company is required to establish a Reserve Guarantee Fund to support the Pension Company's guarantee to pay an amount to Participating Accounts, whatever its guarantee is. The Securities Commission is to make rules concerning the capital adequacy and liquidity of the Reserve Guarantee Fund.

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The law does not state what costs may be charged against the assets of a Pension Fund and how those costs are to be separated from the other costs of the Pension Company, which other costs, I presume, are not to be borne by the Pension Fund or its Participant Accounts. I would imagine that there will be significant costs in selling a pension scheme to contributors and prospective participants. The law is silent on who will bear the costs of such sales or the costs of the operations of the Pension Company, such as its rent, costs of equipment, personnel costs, administrative costs and other costs of the Pension Company.

If a Pension Company retains a management enterprise to manage the assets of the Pension Fund, the law is not clear on whether the assets of the Pension Company must also be managed by the management enterprise. In addition, the law is silent on whether the Pension Company or the Pension Fund is responsible for paying the fee of the management enterprise or whether the management enterprise is to charge two separate fees, one for managing the assets of the Pension Fund, and the other for managing the assets of the Pension Company. Furthermore, I note that if a pension Company transfers the management of the assets of the Pension Fund and the Pension Company to a management enterprise, the management enterprise must commit to cover the Pension Company's liabilities to participants in the Pension Fund of the Pension Company with the management enterprise's own capital.

The most important deficiency of the law is that it does not state (1) what are the permissible annual returns that may be promised by a Pension Company and how they are to be calculated, (2) whether the Pension Company can change the promised amount or the manner in which it is calculated from time to time, (3) whether the Pension Company can promise to share with the Pension Fund earnings on Pension Fund assets in excess of the amount the Pension Company has guaranteed, or (4) whether in the absence of such a promise, the Pension Company may promise to share such earnings annually in a manner to be determined in the discretion of the Pension Company.

If the Pension Company will be entitled under a pension scheme to the entire return on a Pension Fund's assets in excess of the minimum amount promised by the Pension Company to the Pension Fund, I do not believe that this scheme, if understood by contributors and potential participants, would be viable unless the amount promised is significantly greater than the minimum amount required by the law.

The duty of the Securities Commission is to make sure that a Pension Company is subject to rules that require it to disclose to potential contributors and the persons for whom they would be making contributions what is the arrangement for the allotment or division of costs between a Pension Fund and a Pension Company and what is the division, if any, of the return on the assets of a Pension Fund that is in excess of the minimum return that the Pension Company has guaranteed, which minimum may not be less than the average annual rate of interest on bank deposits.

The law should be amended to make the contemplated structure of a pension scheme easier to understand, possibly by adopting the terms I have suggested, i.e., Pension

Fund and Pension Company, for the terms currently used in the proposed law. The law should also be amended to state how the costs of a Pension Fund that are to borne by the Pension Fund are to be determined and how they are to be separated from the other costs of the Pension Company. The law should also be amended to define, and add a term for (such as "guaranteed return") the minimum return promised by the Pension Company on the Pension Fund assets. The law should also be amended to state clearly whether the Pension Company may promise, but not guarantee, a return on a Pension Fund's assets above the guaranteed return, and if so, how such a share of the return is to be determined and calculated..

Paragraph 3 of Article 20 of the proposed law requires there to be a significant penalty upon a participant's withdrawal form a pension scheme. The penalty is equal to the greater of the last three years' return on the participant's account or five percent of the amount withdrawn. The penalty is, I believe, payable to the Pension Company. All the more reason for requiring the Pension Company to disclose clearly to potential contributors and participants the obligations of the Pension Company to participants. Moreover, while it may be permissible for the law to permit a penalty on a withdrawal by a participant, it seems to me to be unusual for the law to require the payment of a penalty by the participant, especially such a large penalty. Furthermore, the requirement that there be a penalty on a participant for withdrawal from a pension scheme seems to be unfair in light of the fact that under Paragraph 5 of Article 15 of the law, the right to change the pension scheme is vested in the Board of the Pension Company. In this connection, see also Paragraph 6 of Article 16, which provides that a pension fund (which I refer to in this memorandum as a "Pension Company") shall have no right unilaterally to annul the pension agreement made for the benefit of a pension scheme participant without the agreement of the participant, "with the exception of the cases provided for in this law."

I also note that the law refers to pension benefits for disabled participants, but the law does not indicate what are the pension benefits in that case. .

Finally, there is one provision of the proposed law that I think should be deleted. That is Item 2 of Paragraph 1 of Article 19. That provision obligates a participant "not to disseminate information received from the pension fund which may be detrimental to the interests of the pension fund."

In my understanding of the proposed law, the term "pension fund," as used in the law, means Pension Company. Thus, the law would obligate a participant in a Pension Fund of a Pension Company not to disseminate information received from a Pension Company that may be detrimental to the interests of the Pension Company.

Information that may be detrimental to a Pension Company, however, may be information whose dissemination is in the interest of the Pension Fund of the Pension Company, the holders of Participating Accounts in the Pension Fund, the contributors to the Participating Accounts, and other persons, including the Securities Commission and other regulators. To prevent such information from being disseminated, is to prevent interested persons from being properly informed. To protect the interests of Pension Companies and their shareholders, even where those interests clash with the interest of contributors, participants, regulators, etc., is not an appropriate purpose of

a pension law.

I intend to leave Lithuania on Sunday, December 27th, 1998. I am, therefore, circulating this memorandum in English today in order to make it possible for us to discuss the matter before the Christmas holiday. A translation of the memorandum in Lithuanian will be delivered to you later.

REPUBLIC OF LITHUANIA LAW ON PENSION FUNDS

Chapter 1. GENERAL PROVISIONS

Article 1. Objective of the Law.

1. The objective of this Law is to create the legal basis for the establishment of supplementary voluntary retirement schemes in order to strengthen the level of income of persons participating in a scheme upon retirement.
2. The Law shall set forth the procedure of development of pension schemes and their implementation, the establishment of the pension funds, conditions and procedures of issuance and revocation of permits for the pension funds to operate, the specific character of their activities, re-organization and liquidation; it shall also set forth the main principles of the state regulation of supplementary voluntary retirement schemes.
3. This Law shall not regulate relations that arise from the insurance activities related with provision of pensions to the residents, with the exception of those stipulated in Article 26. The activities and related to them relations of the enterprises engaged in annuity insurance shall be regulated by the Insurance Law.
4. The activities of the pensions funds and employers related to the supplementary voluntary retirement provisions shall also be regulated by other laws and legal acts of the Republic of Lithuania to the extent that they do not contradict the provisions of this Law.

Article 2. Definitions

1. **Pension fund activities** shall mean financial and economic activities aimed at providing supplementary retirement income on the basis of pension agreements by accumulating the monetary funds in the pension accounts opened for the participants of the pension schemes in the pension fund and by investing said funds into the diversified investment portfolio as well as paying pension benefits to the pension scheme participants on terms and conditions set forth in the pension scheme.
2. A **pension fund** shall mean a company established and operating pursuant to the procedure of the Company Law and this Law.
3. A **pension scheme** shall mean the whole set of the legal and organizational means providing for the terms and conditions of payment of pension contributions and benefits, the strategy of investing of the pension fund's assets and other rights and obligations of the pension contributors, pension scheme participants and the pension fund.
4. A **participant of the pension scheme** shall mean a person on behalf of which a personal pension account is opened in the pension fund.

5. A **pension contributor** shall mean a pension scheme participant, his/her employer or any third person who pays pension contributions or a portion of them.

6. A **pension account** shall mean a personal account of the participant of the pension scheme opened with the pension fund under a pension agreement, in which the pension contributions and investment income allocated to him/her are accumulated in the name of the participant.

7. **Pension annuity** shall mean a periodical pension benefit paid to the pension scheme participant for his/her life, the full risk of repayment of which is born by the payer of the benefits, i.e. insurance agency, which fulfills the life insurance.

8. A **depository** shall mean the same as stipulated in Article 2 of the Law on Investment Companies.

9. **The diversified investment portfolio** shall mean an investment portfolio, which complies with the following requirements:

- 1) not more than 5 per cent of the pension fund's assets invested in securities of a single issuer or a single property object;
- 2) not more than 10 per cent of voting shares of a single issuer are acquired;
- 3) not more than 10 per cent of non-voting shares of a single issuer are acquired;
- 4) not more than 10 per cent of debt securities of a single issuer are acquired with the exception of the cases stipulated in item 5 of this paragraph;
- 5) not more than 30 per cent of assets is invested into securities of the same issue issued or guaranteed by the state (local government), and the investment portfolio is comprised of securities of at least 6 different issues issued or guaranteed by the state (local government). A pension fund may invest up to 10 per cent of its assets into securities issued by a single investor, but the total amount of such investments may not exceed 40 per cent of the fund's total value of assets.

10. **The management enterprise** shall mean the same as stipulated in Article 2 of the Law on Investment Companies.

11. **The managers** shall mean the same as stipulated in Article 2 of the Law on Investment Companies.

12. A **person connected** with the pension fund's management enterprise shall mean:

- 1) any enterprise, agency or organization in which the management enterprise has shares (a portion of shares, or other participating interest) that gives more than 10 per cent of the total number of votes;
- 2) a person controlling or controlled by the management enterprise;
- 3) managers of the management enterprise;
- 4) a person who is in possession of the securities of the management enterprise that give him/her more than 5 per cent of the total number of votes.

13. **An entity controlling a legal entity** shall mean a natural or a legal person which:

- 1) being a shareholder (member), holds more than one third of the total number of votes or on the basis of the agreement with other shareholders (members) alone controls more than one third of the total number of votes;
- 2) is entitled to select (nominate) the majority of the members of the Supervisory Council (the Board) or heads of the management;
- 3) in fact controls the decision-making by the legal entity.

14. **Persons connected with the pension fund** shall be as follows:

- 1) persons in possession of more than 5 per cent of the shares of the pension fund;
- 2) enterprise or other organizations, more than 10 per cent of the shares of which is owned by the pension fund;
- 3) managers of the pension fund or enterprises connected with it and organizations;
- 4) persons in control of the pension fund.

15. **An employer** shall mean an enterprise, agency, organization, which base their labor relations with their employees under an employment agreement or membership.

16. **The investment portfolio** shall mean the collection of investments held.

17. **Own assets of the pension fund** shall mean the investment portfolio which is acquired through investing own capital in the manner prescribed by this Law and own funds.

18. **Pension assets** shall mean the amount of assets of the pension schemes.

19. **Assets of the pension scheme** shall mean the assets acquired in exchange for the pension contributions (including the temporary non-invested portion of said funds) and income (expenses) from investments received upon investing these assets (funds), that are included into personal pension accounts of the participants of a particular pension scheme.

20. **Income (expenses) from the asset investments** shall mean the sum of the income (expenses) of assets of the pension scheme and income (expenses) received due to the (appreciation) depreciation of value of these assets.

21. **A block of securities** shall mean 1/10 or larger portion of the same class securities of one issuer.

Chapter 2. The Establishment and Activities of a Pension Fund

Article 3. A Pension Fund

1. A pension fund shall be an economic entity of limited liability, which is liable for its obligations only to the extent of its own assets. A pension fund shall not be liable for the state obligations, and the state shall not be liable for the obligations of the fund, except the cases when the state takes such obligations upon itself.

2. The words "pension fund" or the abbreviation of said "PF" may only be used in the name of an enterprise established as a pension fund in the manner prescribed by the Company Law and in this Law engaged in the activities of a pension fund. The name of the pension fund must comply with the requirements applied to the names of enterprises, agencies and organizations approved by the Government of the Republic of Lithuania.

3. The provisions of the Company Law shall apply to pension funds unless this Law provides otherwise.

Article 4. Establishment of a Pension Fund

1. A pension fund shall be established only in a closed way.

2. A pension fund may not be established for a limited period of time.

3. The expenditures of establishing of a pension fund shall be covered from the additional contributions by the founders of the pension fund.

4. In addition to other requirements stipulated in Article 7 of the Company Law, the following shall be specified in the by-laws of the pension fund:

- 1) procedure of participation in the pension fund's schemes, withdrawal from the scheme and moving to other schemes;
- 2) the procedure of suspension of participation in the pension fund's schemes;
- 3) funds and reserves of the pension fund, and the order of formation and utilization thereof;
- 4) the order of covering of the pension assets management costs;
- 5) the order of approval, change and termination of pension schemes;
- 6) the order of appointment of an auditor and internal control services;
- 7) the order of submitting of the financial statements on the execution of the pension schemes to the participants of the pension schemes, employers, and any third persons paying contributions who had signed pension agreements;
- 8) the order of notification by the pension fund to the participants of the pension schemes, employers, and any third persons paying contributions who had signed pension agreements;
- 9) the order of calculation and distribution of the investment income from the assets of the pension schemes.

5. The By-laws of the pension fund must set forth that the asset management agreement with the asset management enterprise be approved in the general (shareholders) meeting.

6. The By-laws may stipulate other provisions that do not contradict this Law and other laws of the Republic of Lithuania.
7. The By-laws, amendments and supplements to them shall come into effect upon their coordination with the Securities Commission and registration in accordance with the procedure set forth in the legal acts of the Republic of Lithuania.
8. A pension fund may establish its subsidiaries in the manner established in the By-laws.
9. Pension agreements shall be signed, pension accounts opened and the accumulation of pension contributions started only when the pension fund is registered, the permit to engage in the activities of a pension fund is received and a particular pension scheme coordinated with the Ministry of Social Security and Labor is registered in the manner prescribed by the Securities Commission.

Article 5. Permit to Engage in the Activities of a Pension Fund

1. A pension fund may engage in its activities only upon receipt of the permit issued in the manner prescribed by the Securities Commission. The permit to engage in the activities of a pension fund may be issued for a pension fund being newly established or for the already operating company, the general (shareholders) meeting of which has resolved to engage in the activities of a pension fund.
2. In order to receive the permit, a company shall submit to the Securities Commission an application, which shall contain the following:
 - 1) name of the company, its registered office and the enterprise code;
 - 2) registered authorized capital and net (own) capital;
 - 3) information about technical and qualification preparation to engage in the activities of a pension fund (names, addresses, telephone numbers, etc. of the persons holding qualification certificates recognized by the Securities Commission) if the management of the pension fund's assets is not transferred to the management enterprise.
3. The following supporting documents shall be attached to the application for the permit:
 - 1) founding documents (the founding agreement, the minutes of the founding meeting, the certificate of the registration of the pension fund's name);
 - 2) By-laws;
 - 3) financial statements of the previous and current year with the opinion of the independent auditor;
 - 4) documents certifying that the company's shareholders have the capital necessary for the activities of a pension fund;
 - 5) agreement with the management enterprise (where the assets are transferred to it for management) and the depository;
 - 6) data about the owners of the pension fund specifying their names, addresses, the portion of capital and votes held, their participation in the capital of other enterprises and the portion of capital held in them. In the

event the owner of the pension fund is a legal entity, the data about persons controlling it;

- 7) data about the selected depository;
- 8) data about the selected management enterprise (where the pension fund transfers management of its investment portfolio to it);
- 9) the business plan for the three coming years;
- 10) pension schemes coordinated with the Ministry of Social Security and Labor in accordance with the procedure established by it;
- 11) other documents set forth in the rules of the Securities Commission. The

Securities Commission shall be entitled to request additional documents and information necessary for the issuance of the permit.

4. The certificate and the documents proving the payment for the shares of the pension fund being established, shall be submitted to the Securities Commission no later than 7 working days before the date of the discussion concerning the issuance of the permit.

5. The resolution with regard to the issuance of the permit must be made by the Securities Commission no later than in three months since the date of submission of the documents stipulated in the paragraphs 2 and 3 of this Article. In the event the Securities Commission requests additional documents or information, the period of 3 months shall be calculated from the date the supplementary documents and information are submitted. Refusal to issue the permit must be motivated in writing and may be appealed in court.

6. The Securities Commission may refuse to issue the permit to engage in the activities of a pension fund, where:

- 1) an incomplete set of documents specified in paragraphs 2 and 3 of this Article was submitted;
- 2) the documents submitted for the permit fail to comply with the requirements of this or other laws;
- 3) misleading or erroneous information was provided in the documents submitted for the permit;
- 4) the pension scheme was not coordinated with the Ministry of Social Security and Labor;
- 5) not all shares of the pension fund are paid up or the founders have acquired only a portion of the shares of the first issue;
- 6) the founders of the pension fund (if the founder is a legal entity, the managers of the entity or controlling persons) have bad reputation (there is evidence of misconduct or frequent violations of financial discipline, penalties have been imposed for the abuse of their official position or

administrative penalties for violations of the legal acts regulating the securities market, they have been tried for deliberate crimes);

7) own capital of the company that intends to engage in the activities of a pension fund fails to meet the requirements set forth in Article 27 of this Law.

7. The Securities Commission may restrict the activities of a pension fund, if:

- 1) the detected violations may have a negative effect upon the financial status of the fund or the interests of the pension scheme participants;
- 2) the pension fund negligently and deceptively manages the register of the participants of the pension schemes and contributors and the financial accounting, improperly builds up the financial statements;
- 3) the pension fund signs pension agreements, opens pension accounts and/or starts accumulating pension contributions in the new pension scheme which is not registered at the Securities Commission;
- 4) own capital of the pension fund or the management enterprise to which the pension assets are transferred does not meet the requirements established by the Securities Commission;
- 5) the pension fund does not follow the requirements of this Law or regulations passed on the basis of this Law or provisions of other legal acts directly referred to in this Law.

8. The Securities Commission, due to the reasons stipulated in part 7 of this Article, may restrict the activities of the pension fund for the period no longer than 3 months. During this period the Securities Commission shall make a decision regarding cancellation of the restrictions of the pension fund's activities or revocation of the permit. The resolution with regard to restriction of the activities must specify the reasons of the restriction and terms during which the violations must be rectified.

9. The Securities Commission shall be entitled to appoint an administrator to supervise the activities of the pension fund during the period of restricted activities. The rights and obligations of the administrator shall be established by the Securities Commission. Upon nominating the administrator, the managers of the pension fund (management enterprise) must obtain his/her agreement on every decision related with the activities of the pension fund, stipulated in the resolution of the Securities Commission with regard to restriction of the activities.

10. The Securities Commission must revoke the permit, if the pension fund is being liquidated. It may also revoke the permit if at least one of the following is true:

- 1) the permit was obtained having knowingly provided wrong or deceptive information, forged documents or having hidden the facts which could have caused the refusal to issue the permit;
- 2) the pension fund did not start its activities in the period of one year since the receipt of the permit;

- 3) the pension fund does not ensure the safety of funds entrusted to it, or has become incapable of fulfilling its liabilities to the participants of the pension schemes;
- 4) the pension fund negligently or deceptively manages the accounting, improperly builds up financial statements;
- 5) the pension fund fails to eliminate shortcomings due to which the activities of the pension fund were restricted in the established period of time;
- 6) the pension fund fails to comply with the requirements stipulated in this Law, other laws directly referred to in this Law, or regulations approved on the basis of these Laws.

11. Prior to the issuance of the decision to restrict the activities of the pension fund or to revoke the permit, the Securities Commission must inform the pension fund and create the conditions to provide explanations.

12. The pension fund shall be entitled to hire an independent auditor to inspect its performance, where the Securities Commission identifies the grounds for revocation of the permit stipulated in paragraphs 4 and 5 of Article 10 of this Law. The opinion of the independent auditor must be submitted to the Securities Commission in the period of two months since the date of request to carry out the audit, unless the Commission provides for some other term. The issue regarding revocation of the permit may be discussed without the findings of the independent auditor, if the pension fund does not submit the said findings to the Securities Commission within the set period of time, or refuses to carry out an independent audit, or fails to provide any information stating that the independent audit will be carried out.

Article 6. The Specific Character of the Pension Fund's Activities

1. The following risk management ratios shall be established for the pension funds, except those that transfer the pension scheme's assets to the management enterprise:

- 1) capital adequacy;
- 2) liquidity;
- 3) maximum open position in a foreign currency.

2. The ratios, methods of their calculation, and periodicity of reporting about meeting of the established standards shall be set forth by the Securities Commission.

3. The pension fund shall not engage in any other activities except the ones related with the activities of a pension fund.

4. The pension fund shall be prohibited from:

- 1) extending a loan, guaranteeing or securing the liabilities of any third person, pledging the securities or other assets held except for the case provided for in item 2 of this paragraph;

2) taking a loan, except a short-term one (under 1 year maturity) to maintain the liquidity; its amount may not exceed 10 per cent of the net (own) capital of the pension fund;

3) acquiring and holding securities or other assets, the possession of which could cause the violation of the requirements of the diversified investment portfolio, except a fund being newly established which is exempt from the diversification requirements for 6 months from the receipt of the permit to engage in the activities of a pension fund;

4) participating in organizations with the unlimited liability of the participants;

5) being the founder of an enterprise;

6) issuing bonds;

7) taking upon itself liabilities that are not related with the activities of a pension fund.

Article 7. The Management Enterprise of a Pension Fund

1. A pension fund may manage pension assets and its own assets itself (provided it complies with the requirements stipulated in paragraph 1 of Article 36) or may transfer the management to a single management enterprise, which shall:

1) have an appropriate permit issued by the Securities Commission. The procedures and conditions for issuance and revocation of such permits shall be established by the Securities Commission;

2) meet minimum net (own) capital requirement specified in paragraph 2 of Article 27 of this Law and the capital adequacy, liquidity, and maximum open position in a foreign currency ratios applied to pension funds, which are set forth by the Securities Commission;

3) commit, in the agreement concluded with the pension fund, to cover the pension fund's liabilities to the participants of pension schemes with its own capital.

2. The provisions of the Law on Investment Companies shall apply to the management enterprise of a pension fund, unless this Law provides otherwise.

3. The methods of calculating the capital adequacy requirement and the periodicity of reporting about compliance with it shall be set forth by the Securities Commission.

4. The Securities Commission shall be entitled to suspend the effectiveness of the agreement with the management enterprise, if the Commission has issued a decision regarding restriction of activities of the management enterprise or revocation of its permit.

Article 8. Re-organization of a Pension Fund

1. The permission of the Securities Commission must be obtained for the re-organization of a pension fund.

2. The provisions of the Company Law shall apply to the re-organization of the pension fund, provided they do not contradict this Law .

3. The re-organization project of a pension fund must specify, in addition to other information stipulated in the Company Law, the number of pension schemes and their participants, provide data about the pension schemes and their assets, own assets of the pension fund, the management enterprise, the depository, terms and conditions of taking over and transfer the pension fund's liabilities, property and non-property rights of the participants of the pension schemes after the re-organization, the terms of acquisition of said rights. The reorganization project must be approved by the general shareholders meeting of every single pension fund undergoing re-organization, the Securities Commission, the Ministry of Social Security and Labor.

4. Every pension fund must announce about the re-organization following the procedures established by the Securities Commission.

5. In order to become operable after the re-organization, pension funds must obtain a new permit from the Securities Commission as stipulated in Article 5. In the event that at least one of the pension funds to become operable after the re-organization does not obtain a permit, the resolution of the general shareholders meeting regarding the re-organization of a pension fund shall become invalid.

6. Information on the course and the terms of re-organization must be provided to shareholders of a pension fund, participants of a pension scheme, contributors, the Securities Commission and the Ministry of Social Security and Labor upon request. The Securities Commission shall be entitled to issue binding instructions to a pension fund, which is being re-organized.

7. The pension fund undergoing re-organization, upon the consent of the Securities Commission, may transfer a pension scheme (schemes) and corresponding pension agreements to another pension fund, provided the receiving pension fund does not change their conditions and takes over all the liabilities in respect of the participants of a pension scheme.

8. If a participant of a pension scheme expresses a wish to move to another pension scheme due to the fund's re-organization within 6 months from the date of issuance of the permit to the pension fund undergoing re-organization by the Securities Commission, the transfer of this participant's personal pension account to another pension scheme must be done free of charge.

Article 9. Liquidation of a Pension Fund

1. A pension fund shall be liquidated in accordance with the procedure set forth in this Law and the Company Law.

2. A pension fund may be liquidated:

1) by the resolution of the general shareholders meeting, provided it is supported by the Securities Commission;

2) by the resolution of the Securities Commission when the permit to engage in the activities of a pension fund is revoked in accordance with procedure set forth in this Law;

3) when the procedure of bankruptcy is declared by the court ruling.

3. A pension fund may be liquidated by means of the resolution of a general shareholders meeting only if it has transferred all the assets of the pension schemes and all the pension agreements to another pension fund in the manner prescribed by the Securities Commission. The pension fund, which takes over the pension agreements, may not worsen the conditions of pension schemes with regard to the scheme participant and shall take over all the liabilities on behalf of these participants.

4. Not later than in 3 days following the decision of the general shareholders meeting to liquidate a pension fund, the resolution along with the data about the appointed liquidator shall be reported in writing to the Securities Commission and the Register manager. The Securities Commission shall be entitled to change the liquidator mentioned above.

5. Having resolved to liquidate a pension fund, the Securities Commission shall appoint its liquidator. The liquidator shall report the resolution to liquidate a pension fund and the data about the liquidator to the Register manager in the manner prescribed by the Enterprise Register.

6. Each pension fund must announce the liquidation in the manner prescribed by the Securities Commission. The information about the course and terms of the liquidation must be provided to every participant of a pension fund, a shareholder, a contributor, the Securities Commission and the Ministry of Social Security and Labor upon request. The Securities Commission shall be entitled to issue binding instructions for a pension fund undergoing liquidation.

7. In the event a pension fund is being liquidated by the decision of the Securities Commission, the liquidator shall organize the transfer of the pension scheme assets and pension agreements of the participants of these schemes to another pension fund. The remaining assets after the transfer of all liabilities under pension schemes of the pension fund undergoing liquidation to another pension fund must be sold through a tender (auction, bidding), or through the Stock Exchange and may be distributed among the shareholders of the pension fund undergoing liquidation in proportion to the number of shares held by them.

8. Pension assets may not be used to meet the claims of the creditors or the shareholders of the pension fund undergoing liquidation.

9. The liquidation report checked by an independent auditor shall be submitted by the liquidator to the Securities Commission.

10. The provisions of paragraphs 7 and 8 of Article 8 shall apply upon transfer of the assets of the pension schemes.

Article 10. The Pension Fund Bankruptcy Procedure

1. Initiation of the bankruptcy case, investigation in court and liquidation or re-organization due to bankruptcy procedure shall be fulfilled on the basis of the Enterprise Bankruptcy Law, to the extent it does not contradict the provisions of this Law.

2. The pension fund's bankruptcy case shall be investigated only in the judicial manner. The pension fund's bankruptcy case shall be initiated by court on the basis of the declaration of the Securities Commission of the insolvency of the pension fund.

3. In the course of investigation of a pension fund's bankruptcy case the creditors' meetings shall not be called. The creditors' interests shall be represented by the committee comprised in the manner prescribed by the Securities Commission. The committee shall be composed of the representatives of the pension schemes, other creditors and representatives of the Securities Commission.

4. Starting from the day of initiation of the bankruptcy case, all the activities of the pension fund shall be suspended, except the ones necessary to ensure the performance of the administrator and the ones stipulated in paragraph 5. All pension contributions to pension accounts and benefit payments from the accounts shall be suspended. The estimate of expenditures needed to ensure the performance of the administrator shall be approved and amended by the court on the recommendation of the administrator.

5. The administrator appointed by the court shall organize the transfer of the pension schemes (along with the pension schemes' assets and pension accounts) to another pension fund (funds). Own assets of the pension fund shall be used to cover the liabilities taken over by the pension fund before the date of initiation of the bankruptcy procedure until the transfer of pension accounts to another pension fund (in proportion to every pension scheme being transferred). The administrator shall have the right to transfer a pension scheme (schemes) and corresponding pension agreements without the consent of the pension scheme's participants, if the pension fund which is taking over this pension scheme does not change the conditions and takes over the liabilities in respect of the pension scheme participant. In this case, if, within 6 months after the transfer of the pension agreement to another pension fund, a participant of a pension scheme expresses a wish to join yet another pension fund, his/her personal pension account shall be moved to that pension fund free of charge.

6. After the court resolves to liquidate the pension fund, the pension agreements which were not transferred to another pension fund before the resolution to liquidate was reached, shall be declared terminated by the court ruling, provided the scheme participant did not terminate this agreement before that ruling.

7. The liquidator shall, within the period set forth by the court, comprise the list of creditors and the scope of their claims on the day of issuing the resolution regarding the fund's liquidation. The data about the claims of the pension scheme participants coordinated with each participant shall be approved by the committee stipulated in paragraph 3 of this Article.

8. The claims of the pension scheme participants to regain the pension assets owned by them must be satisfied before the process of satisfying of the claims of the fund's creditors begins.

9. The claims of the pension fund's creditors shall be satisfied in accordance with the following procedure:

1) the first priority shall be given to the claims related to employment relations, claims to compensate the damage of mutilation or other damage caused to health, or fatality of the pension scheme participants;

2) the second priority shall be given to payment of court and administration expenses and claims, the basis of which had appeared only after the date when the decision to liquidate the fund was announced;

3) the third priority shall be given to satisfaction of the claims of all other creditors;

4) the claims of all subsequent creditors shall be subordinated until after full satisfaction of claims of priority creditors. In the event the funds are insufficient to fully satisfy the claims of one priority, those claims shall be satisfied in proportion to the amount own by each creditor.

10. In the event of bankruptcy of a pension fund, its creditors shall have no right to lien on the pension assets.

Article 11. Associations of Pension Funds

The pension funds shall be entitled to unite into the associations following the procedures set by the laws of the Republic of Lithuania.

Chapter 3. Management of the Pension Funds

Article 12. Pension Fund Management

1. In addition to the restrictions set forth in the Company Law and the Law on Civil Service, an auditor, the members of another pension fund supervisory council and the board, persons related with the pension fund's depository or management enterprise as well as persons tried for crimes committed against property, finance and economic procedures may not become members of the Supervisory Council and the Board of the pension fund.

2. The Securities Commission shall be entitled to commission the pension fund's Board (Supervisory Council if the Board is not formed) to convene an extraordinary general shareholders meeting.

Article 13. Liability of the Members of the Pension Fund's Management Bodies

Members of the pension fund's Supervisory Council, the Board, the head of the management and other administrative employees who have violated the laws of the Republic of Lithuania, the By-laws of the pension fund, the pension scheme or the duty to act in the best interests of the pension scheme participants by their decisions, deeds or omissions must compensate the pension fund for the losses inflicted to the scheme participants. The members of the Supervisory Board and the Board shall be liable jointly. A member, who voted against such a decision, shall be released from the duty to compensate losses, if his/her protest is recorded in the Minutes of the meeting. The member who did not participate in the meeting shall not be held liable if he/she, in 7 days after he/she has become aware or should have become aware of said decision, had presented his protest in writing to the chairperson of the meeting.

Article 14. Control of the Activities

1. After the business year is over, an independent auditor shall audit the annual reports and annual accounts (financial statements) of the pension fund.
2. In accordance with the procedures stipulated in the By-laws, the pension fund may establish commissions to control the activities of the pension fund.
3. Conditions of the pension fund's agreement with the audit company must be coordinated with the Securities Commission. Conditions of the agreement that were not coordinated with the Securities Commission shall be invalid.
4. The audit of a pension fund shall be carried out on the basis of the legal acts regulating audit and the work of auditors and the terms and conditions of the agreement between the pension fund and the auditor.
5. The pension fund must submit to the auditor documents requested by him/her.
6. The auditors findings must contain the opinion about the financial capability of the pension fund to fulfill the liabilities stipulated in the pension agreements, it shall also contain information on all violations of this Law and other legal acts regulating financial activities of the pension fund.

Chapter 4. Pension Schemes and their Participants

Article 15. Pension Scheme

1. The pension funds shall organize their activities on the basis of the pension schemes.
2. A pension scheme (schemes) shall be approved and changed by the Board (Supervisory Council if the Board is not formed) of the pension fund following the procedures provided for in the By-laws. It shall be coordinated with the Ministry of Social Security and Labor and registered with the Securities Commission in the manner prescribed by its rules.
3. The pension scheme shall contain the following:

- 1) name of the pension fund, its registered office;
- 2) name of the pension scheme;
- 3) procedure and conditions for joining, withdrawing from or dismissing from the pension scheme;
- 4) rights and obligations of the scheme participants;
- 5) ways and procedures of payment of pension contributions;
- 6) ways of payment of pension benefits, types and opportunities of their choice, retirement age;
- 7) ways of annuity acquisitions;
- 8) the investment strategy of a scheme (the order of investment of pension assets and investment sectors);
- 9) procedure of accumulation and distribution of pension scheme assets;
- 10) procedure of deductions from the investment income of pension funds and inclusion of said into pension accounts;
- 11) ways and procedure of submitting the reports about the performance of the pension scheme and statements of pension accounts to the pension schemes participants;
- 12) conditions and procedures of drawing a pension agreements and termination thereof;
- 13) procedure of moving to another pension scheme and the period during which the pension fund must transfer the funds from the pension account to the pension account in another pension fund indicated by the pension scheme participant. This period may not be longer than 3 months;
- 14) procedure of changing the pension scheme;
- 15) procedure of termination of the pension scheme;
- 16) the order of establishing the level of profitability of the pension scheme;
- 17) the order of establishing the compensation for the management enterprise of the pension fund.

4. Pension schemes may also have other provisions that do not contradict to this Law and the requirements established by the Ministry of Social Security and Labor and the Securities Commission.

5. The right to change the pension scheme shall be vested in the Board of the pension fund.

6. The pension fund must create opportunities for all the persons to familiarize themselves with the registered pension schemes and changes (amendments) to them.

7. The pension fund must inform in writing every pension scheme participant, contributor, the Ministry of Social Security and Labor and the Securities Commission about the amendment to the pension scheme at least 30 days before the amendments come into effect. The pension schemes and amendments to them shall become effective in no less than 30 days since the date of their registration with the Securities Commission.

Article 16. Pension Agreement

1. A pension agreement shall mean an agreement between a pension fund and a contributor (contributors), on the basis of which the pension fund takes upon itself an obligation to provide pensions to the pension scheme participants in accordance with the specific pension scheme, while the contributor takes upon itself an obligation to pay pension contributions. Before drawing the agreement, all persons for the benefit of whom the agreement is being drawn, must be made aware of the pension scheme the members of which they are going to become after the pension agreement comes into effect. The pension scheme shall be a part of the pension agreement.

2. A pension agreement shall be concluded between the pension fund and a pension scheme participant or other person on behalf of the pension scheme participant.

3. A pension agreement, which is made by the employer or any other person for the benefit of a pension scheme participant may be personal, when made between the pension fund and a contributor for the benefit of one scheme participant; and group agreement, when made for the benefit of more than one scheme participant. The employer shall be entitled to make a pension agreement for the benefit of his/her employees. A pension agreement may be a supplement to the collective employment agreement.

4. In the event the obligation to pay pension contributions is taken by the employer, an employee shall have the right to indicate a pension fund with which the employer must make a pension agreement for the employee's benefit, unless the collective employment agreement provides otherwise.

5. The pension agreement must provide for an opportunity to terminate the pension agreement at any time upon the request of the pension scheme participant. Other compulsory conditions for the pension agreement shall be established by the Securities Commission with the coordination of the Ministry of Social Security and Labor. Conditions of a pension agreement that contradict the requirements set forth by the Securities Commission and the Ministry of Social Security and Labor shall be invalid.

6. A pension fund shall have no right to unilaterally annul the pension agreement made for the benefit of a pension scheme participant without the agreement of the participant, with exception of the cases provided for in this law.

7. A pension fund shall register all the contributors who made pension agreements, as well as all the participants for the benefit of whom such agreements were made, and all the participants who receive benefits. The order of registration shall be established by the Securities Commission.

8. Upon signing the pension agreement, the pension fund shall open a personal pension account for each participant of the pension scheme.

Article 17. A Participant of the Pension Scheme

A person may become a participant of a pension scheme upon making a pension agreement in accordance with the procedure stipulated in this Law.

Article 18. Rights of a Pension Scheme Participant

1. A pension scheme participant shall be entitled to:
 - 1) receive benefits as provided for in this Law, the By-laws of the pension fund, the pension scheme and the pension agreement;
 - 2) receive a share (adding it to the pension account) of the investment income of pension assets received pursuant to the pension scheme in proportion to the amount of funds held in the pension account;
 - 3) receive information about the performance of the pension fund, its financial and economical status, assets and financial obligations, resources held in his/her personal pension account and calculated income from investments;
 - 4) with the advance notice in writing, temporarily suspend the payment of contributions, order and periodicity of payments, change the amount of pension contributions;
 - 5) bequeath the funds held in the pension account;
 - 6) benefit from other rights set forth in this Law, the pension schemes and the pension agreement.

Article 19. Duties of the Pension Scheme Participant

1. A pension scheme participant shall be obliged to:
 - 1) follow the provisions of the pension scheme and pension agreement;
 - 2) not to disseminate information received from the pension fund which may be detrimental to the interests of the pension fund.
2. If a pension scheme participant fails to fulfill his duties, he may be removed from the pension scheme following the procedure set forth in the pension fund By-laws.

Article 20. Withdrawal of a Pension Scheme Participant from the Pension Scheme and Termination of the Participation in the Pension Scheme

1. Participation in a pension scheme expires when the pension fund fulfills its liabilities to the pension scheme participant, when the participants withdraw from the pension scheme, when the participant dies, or when the pension fund is liquidated.
2. Termination of the pension agreement made for the benefit of a pension scheme participant without moving to another pension scheme, or dismissal of the participant from the pension scheme shall be deemed withdrawal of the pension fund member from the pension scheme.
3. When withdrawing from the pension scheme, a participant must receive the funds held in the personal pension account after deducting the higher of the income

from investment added to the account in the period of the last 3 years, or 5 percent from the withdrawn amount. Proceeds gained from sanctions mentioned above shall be attributed to the pension fund assets.

4. When a scheme participant withdraws from the pension scheme, the pension fund must settle accounts with him no later than in three months since the date of the participants' application in writing to withdraw from the scheme, and within the amount of funds held in his account on the date of application without applying the requirements set forth in Articles 24 and 25 of this Law.

5. The pension fund, its shareholders, pension scheme contributors shall be prohibited from restricting, directly or indirectly, the right of the participant to withdraw from the scheme, or to deduct a bigger part of pension assets accumulated on behalf of the participant than that provided for in this Law.

Article 21. Participant's Shift to Another Pension Scheme

1. Termination of the pension agreement and entering into a new pension agreement with the same or different pension fund shall be deemed a shift by the pension fund member to another pension scheme.

2. The shift of a participant to another pension scheme within the same pension fund must be executed in accordance with the terms and conditions provided in the pension scheme and the pension agreement and carried out free of charge.

3. The pension fund, shareholders of the pension fund or contributors shall be prohibited to restrict, directly or indirectly, the right of a pension scheme participant to shift from one pension scheme to another.

4. The pension fund from the scheme of which a participant shifts to another pension fund, shall provide the receiving fund with:

- 1) the copies of the pension scheme and the pension agreement entered into with the participant of the pension fund or any third person on behalf of the pension scheme participant along with the copies of all the amendments to these documents;
- 2) records about all the contributions paid for the benefit of the participant;
- 3) records about the amounts paid out to the participant;
- 4) pension assets belonging to the participant on the day of filing the application in writing to be moved to another pension scheme.

Article 22. Termination of a Pension Scheme

1. A pension scheme may be terminated by the decision of the pension fund's Board (the Supervisory Council if the Board is not formed) or the ruling of the court.

2. A pension scheme may be terminated by the decision of the pension fund's Board (the Supervisory Council if the Board is not formed), if:

- a) the pension fund has fulfilled all liabilities to all the participants of a particular pension scheme;
- 2) participants of a particular scheme are moving to another pension scheme and/or withdraw from this particular pension scheme;
- 3) the pension fund is being liquidated;
- 4) in other cases provided for in the pension scheme.

3. A pension fund may terminate a pension scheme without the agreement of the participants of the pension scheme only in the event it has transferred all the pension scheme's assets and pension agreements to another pension fund in accordance with the procedures established by the Securities Commission. In this case the pension fund which takes over pension agreements may not change the conditions of the pension scheme and shall take over all the liabilities with regard to the participants of the pension schemes.

4. Should, due to the termination of the pension scheme and within 6 months since the date of resolution to terminate the pension scheme, a participant of the pension scheme expresses a wish to move to another pension fund's pension scheme, the transfer of the participant's personal pension account to another pension fund must be done free of charge.

5. The decision to terminate the pension scheme shall be brought to notice of the pension scheme's participants, contributors, the Ministry of Social Security and Labor and the Securities Commission.

Chapter 5. Pension Contributions and Benefits

Article 23. Pension Contributions

1. Pension contributions shall be paid only in cash.
2. Employers may pay contributions, or a portion of them for the benefit of their employees.
3. A contributor who at the same time is a pension scheme participant, shall not be held liable with his assets for the violation of procedures of pension contribution payment. Liabilities of other contributors shall be established in the employment agreement, collective agreement or other agreement according to which any third party takes upon itself a liability to pay pension contributions on behalf of pension fund's participant.
4. Termination or violations of contribution payment may not cause termination of the pension agreement or restriction of the property rights of the pension scheme's participants to the pension assets.
5. It shall be prohibited to pay pension contributions and receive pension benefits in the name of the same pension scheme participant.

6. In cases when pension contributions are paid not by the participant of a pension scheme himself, such contributions shall become the property of the pension scheme participant from the moment of their payment to the pension account.

7. In the event the contributor who is not a participant of the pension scheme does not pay agreed contributions in time, the pension fund must inform in writing the pension scheme participant no later than in 7 days from the day of the first violation.

8. An employee, based on the pension agreement signed by the employer, shall pay pension contributions only voluntarily.

9. The employer shall have no right to transfer the duty of payment of contributions agreed in the pension agreement to the employee.

Article 24. Pension Benefits

1. The right to the pension benefit shall be acquired upon reaching the retirement age of the pension scheme participant stipulated in the pension scheme, which may not be less than that set forth by the State Social Insurance Retirement Pension by more than 5 years, except the cases provided for by the Government of the Republic of Lithuania.

2. A participant of the pension scheme, who in accordance with the procedures set forth in the Law on State Social Insurance Retirement Pensions is found an invalid of the first or second group, shall acquire the right to pension benefits from the day it is found an invalid.

3. A participant of a pension scheme shall be entitled to postpone the payment of pension benefits. In order to do so, the pension scheme participant must submit to a pension fund the request in writing no later than in three months before he becomes of the retirement age. A scheme participant shall be entitled to revoke the postponement of payment of pension benefits in writing at any time. In this case payments of pension benefits must start no later than in two months from the day of submitting the request to revoke payment of benefits in writing.

4. Payment of pension benefits shall start no later than in three months from the day of furnishing to the pension fund the pension scheme documents proving the right to pension benefits. The list of said documents shall be subject to the approval by the Ministry of Social Security and Labor.

5. No other payments but those stipulated in this Law, may be made from the pension account.

Article 25. Ways of Payment of Pension Benefits

1. Based on the choice of the pension scheme participant, pension benefits may be paid in the following ways:

- 1) as a single benefit not exceeding the maximum amount stipulated in paragraph 2 of this Article;
 - 2) as an amount held in the pension account, by paying it in portions periodically, but no less frequent than on a quarterly basis;
 - 3) by purchasing pension annuity in the life insurance enterprise.
2. The maximum amount of a single benefit paid from the pension account shall be set at the level necessary to ensure that the amount remaining in the pension account be sufficient for the pension scheme participant to buy annuity of the size of the state social insurance basic pension from the life insurance agency. The size of said amount shall be established by the Insurance Supervision Agency pursuant to its rules and shall be reported to the Ministry of Social Security and Labor.
3. If the amount in the pension account is paid in portions, it may not exceed the maximum size, which is calculated by dividing this amount by the average life expectancy of the pension scheme participant. The average life expectancy shall be calculated by the Department of Statistics under the Government of Lithuania every year and reported to the Ministry of Social Security and Labor. The maximum size of a portion shall be calculated for a pension scheme participant on the annual basis.
4. If a pension scheme participant is entitled to receive a pension from the state social insurance budget or a pension from the state budget, the restrictions of the size of pension contributions stipulated in paragraphs 2 and 3 of this Article shall not be applicable.
5. A pension scheme participant shall choose a way of payment of pension benefits no less than 3 months before the start of benefit payments.
6. A pension scheme participant who receives pension benefits in accordance with procedures set forth in part 2 of paragraph 1 of this Article may change the way or procedures of benefit payment, or suspend payment of benefits with two months' notice to the pension fund. The payment of pension benefits shall be restarted in two months since the date of submitting by the beneficiary the request to restart payment.

Article 26. Pension Annuities

1. Depending on the participant's choice of the pension scheme, a pension annuity may be purchased in a life insurance company for the funds accumulated in his/her pension account. Pension funds serve as an intermediary for the pension scheme participant when acquiring a pension annuity.
2. A pension annuity is acquired upon signing the insurance agreement by the pension scheme participant with the payer of the pension annuity. Only a life insurance agency may be the payer of a pension annuity.
3. Operations of payers of pension annuities shall be supervised by the State Insurance Supervision Agency under the Ministry of Finance in accordance with the procedures approved by the laws of the Republic of Lithuania.

4. Procedures of intermediation by the pension fund in acquisition of a pension annuity shall be established by the Securities Commission in cooperation with the State Insurance Supervision Agency under the Ministry of Finance.

Chapter 6. Pension Fund Finances

Article 27. Own Capital

1. Composition of the pension fund's own capital is established in Article 30 of the Company Law of the Republic of Lithuania
2. The minimum own capital of a pension fund shall be no less than LTL 4 million.
3. A pension fund must form the guarantee reserve of the pension fund's assets, following the procedures stipulated in Article 31 of this Law.
4. Own capital must be invested in a diversified investment portfolio subject to the same requirements as set forth for the pension assets established in Articles 2 and 35 of this Law.
5. In the event that after the end of a financial year the investment income of the pension fund is insufficient to fulfill its obligations (that may not be lower than stipulated in paragraph 2 of Article 32) under pension schemes, the own capital of the pension fund shall be used to maintain the profitability stipulated in the scheme.

Article 28. Authorized Capital

1. The authorized capital of a pension fund shall be comprised of the capital set forth in the by-laws of the fund, fully paid up and registered in the procedure established by the law.
2. Property contributions may not account for more than 20 per cent of the authorized capital of a pension fund. Only real estate necessary for the direct operations of a pension fund may form a property contribution.
3. The authorized capital may not be paid up by cash intended to secure obligations to third persons.
4. A pension fund shall have no right to reduce the authorized capital, except reduction due to incurred losses.

Article 29. Borrowed Capital

A pension fund may not have other borrowed capital than short-term loans to maintain liquidity, for which restrictions are set forth in part 2 of paragraph 3 of Article 6.

Article 30. Pension Fund's Income and Costs

1. A pension scheme's income on asset investment, after deductions to cover liabilities to the pension scheme participants within the frame of the pension schemes, shall be deemed pension fund income on pension scheme assets.

2. In addition to other costs, the formation costs of the pension fund's guarantee reserve shall be deemed the pension fund's costs.

Article 31. Pension Fund's Guarantee Reserve

1. A pension fund's guarantee reserve shall be formed from the income on investments of the pension fund's assets having deducted the sums to the pension scheme participants in order to fulfill obligations under the pension schemes which may not be less than stipulated in paragraph 2 of Article 32. The minimum amount of this reserve and procedures of its formation shall be set forth by the Securities Commission.

2. The guarantee reserve may be used only to cover the liabilities under the pension schemes.

3. Profit of a pension fund may not be distributed for dividends and bonus shares (tantjems), if, following the resolution of the general meeting of shareholders, the capital adequacy ratio, minimum own capital and the amount of the guarantee reserve become less than the amount established by the Securities Commission.

Article 32. Pension Scheme Assets

1. Assets of every pension fund, including income (costs) from investments, shall be calculated separately from the pension fund's own assets.

2. Minimum profitability of every pension scheme every year may not be less than the weighted average of annual interest on personal time deposits in the banks of Lithuania.

Article 33. Pension Accounts

1. A personal pension account for every participant of the pension scheme shall be opened in the pension fund to accumulate pension contributions and income on pension assets investment as set forth in the by-laws of the pension fund.

2. The procedure of accounting of the amounts accumulated in the pension accounts of pension scheme participants shall be established by the Securities Commission.

Article 34. Entitlement to the Pension Assets

1. The pension assets belong to the pension scheme participants by right of ownership. After the death of a participant the pension assets held in the pension account shall be inherited in accordance with the laws of the Republic of Lithuania.

2. A pension fund or its management enterprise shall not be held liable for the liabilities to the third persons by the assets of the pension scheme. Pension scheme assets managed by the pension fund and (or) management enterprise, may not be used to satisfy the claims of the creditors of the pension fund and (or) management enterprise, and shall be refunded to the owners in accordance with the procedures set forth in the Law.

3. A pension fund shall be liable with its own assets for the liabilities towards the pension scheme participants undertaken within the scope of pension schemes.

Chapter 7. Investment, Management and Custody of Pension Assets

Article 35. Investment of Pension Assets

1. Pension assets of every scheme shall be invested into diversified investment portfolio comprising securities, real estate and deposits of commercial banks.

2. Securities into which investments may be made shall be as follows:

- 1) securities issued or guaranteed by the state (municipality);
- 2) deposit certificates issued by banks;
- 3) securities listed in the Official Trading List of the Stock Exchange of the Republic of Lithuania;
- 4) newly issued securities, where the conditions of their issuance provide for the commitment of the issuer to apply for official listing and there are guarantees that the issued securities will be admitted to this list within one year following the issue;
- 5) securities recognized as liquid by the Securities Commission.

3. The Securities Commission may impose restrictions upon investments of pension assets into commercial banks deposits and investment into securities stipulated in paragraph 2 of this Article.

4. Pension assets may not be invested into:

- 1) securities issued by the pension fund;
- 2) securities issued by the management enterprise with which pension fund had entered into asset management agreement;
- 3) securities issued by enterprises or other organizations connected with the management enterprise.

5. The total amount of investments into securities issued by the persons connected to the pension fund (controlling it) may not exceed 25 per cent of the total value of pension assets.

6. Funds of pension scheme participants must be invested on the basis of the investment strategy stipulated in the pension scheme and the agreement with the management enterprise.

7. Not more than 20 per cent of pension assets may be invested into real estate.

Article 36. Management of Pension Assets

1. A pension fund, which does not transfer management of pension assets to the management enterprise, must have at least two pension fund managers or administration employees holding the qualification certificate recognized by the Securities Commission. The Securities Commission must be notified about changes of the employees holding certificates in five days.
2. Pension assets management agreement must comprise provisions stipulated in paragraph 1 of Article 13 of the Law on Investment Companies. The asset management agreement must be approved by the pension fund's shareholders meeting. The agreement may be terminated prematurely based on the decision of the Supervisory Council of the fund. The management enterprise may not be changed without the consent of the Securities Commission
3. The management enterprise shall be responsible for recovery of damages incurred to the pension fund or pension scheme participants through the management enterprise's fault. The premature termination of the asset management agreement does not release the management enterprise from the liability to recover damages to the pension fund or pensions scheme participants.

Article 37. Duty to Transfer Pension Assets for Custody in the Depository

1. A pension fund must keep the pension assets (cash and securities) in a selected depository. The depository shall act in compliance with the provisions of Chapter 4 of the Law on Investment Companies, unless this Law provides otherwise. The Securities Commission, in coordination with the Bank of Lithuania, may set forth additional requirements for the depository in which pension assets are safekept. The depository itself may not act as a pension fund or a management enterprise. The depository may not be a shareholder of the pension fund or its management enterprise.
2. The agreement with the depository shall be approved by the pension fund's Supervisory Council (or the Board where the Supervisory Council is not formed). A pension fund may not have more than one depository of securities or cash.
3. The depository shall conduct separate accounting of assets of each pension scheme.
4. The depository must make an agreement with the pension fund in which the procedures and fees for services shall be stipulated.
5. When carrying out an independent audit of the pension fund, the depository must provide for all the information related to the accounting of assets entrusted to it as well as copies of documents that are related to asset management and are needed when carrying out the pension fund's audit.

6. The depository shall exercise control over compliance of operations with securities conducted by the pension fund or the management enterprise (where management of the pension fund's assets is transferred to it) to the requirements set forth in this law, the by-laws of the pension fund and the pension schemes.
7. Following the procedures established by the laws of Lithuania, the depository shall be held responsible for compensation of losses (damage) caused by it to the participants of pension schemes. The depository shall not be held responsible for the obligations assumed by the pension fund to the participants of pension schemes.

Chapter 8. Protection of Interests of Pension Scheme Participants

Article 38. Duty to Act in the Interests of Pension Scheme Participants

1. A pension fund, its management enterprise or the depository must act in the interests of pension scheme participants, organize their work on the basis of effective legislation, the pension fund's by-laws and other legal acts; and ensure that their operations do not violate the property rights and interests of the pension fund's shareholders and pension scheme participants. A pension fund, its management enterprise and the depository may not conclude any transaction which could cause damage to the rights and legal interests of the pension fund's shareholders and its pension scheme participants.
2. The Supervisory Council of the pension fund, its management, its management enterprise and the depository shall be held fully responsible for the damages caused to the pension fund by illegitimate or commercially unsound actions.
3. If identified that the manager of the pension fund has concluded a transaction from which he/she or related with him persons have received benefit on the account of the pension fund or its scheme participants, or had caused damage by illegitimate actions, the pension fund's shareholders and participants of the pension schemes shall be entitled to claim that the manager transfer to the pension fund the rights and duties arising from said transactions or compensate the damage caused by this transaction.
4. If upon investing the pension assets, the pension fund violates the requirement for the diversified investment portfolio through exercising the pre-emptive right stipulated by the laws of the Republic of Lithuania or by other reasons not depending on it, the pension fund must no later than within 3 months sell the portion of securities, acquisition of which had caused violation of the requirement for diversified investment portfolio.

Article 39. Accounting and Accountability

1. Procedures of accounting of the pension fund's own assets and the pension scheme assets shall be set forth by the Securities Commission after coordinating them with the Ministry of Finance.

2. The management enterprise and the depository, with which the pension fund had entered into pension asset management and asset custody agreements, must provide the pension fund with all the documents needed for carrying out the required accounting. The list of such documents and procedures of submitting of them shall be set forth by the Securities Commission.
3. The pension fund shall conduct a separate accounting of every pension scheme.
4. Management enterprises and depositories must conduct separate accounting of the managed pension assets and the fund's own assets.
5. In four months since the end of the financial year the pension fund must file with the Securities Commission and announce publicly the financial statements audited by an independent auditor. The annual statements of the pension fund must contain the opinion of an independent auditor concerning reliability of the pension fund's accounting and its compliance with the established regulations. Upon the request of the Securities Commission, the auditors must submit the complete auditor's report and explanations on the financial statements.
6. Management enterprises and depositories must submit to the Securities Commission reports, the content, form and procedures of completing which shall be set forth by the Securities Commission.

Article 40. Notification of the Pension Fund's Scheme Participants

1. A pension fund must publicly announce and file with the Securities Commission accounts on its activities and financial status:
 - 1) annual financial statements together with the independent auditor's opinion, - no later than within 4 months from the end of the business year.
 - 2) semi-annual statements for the first six months of the business year, - no later than 2 months from the end of the accountable period.
 - 3) financial statements of the first six months of the business year together with the independent auditor's opinion, - no later than within 2 months from the end of the accountable period.
2. Requirements for the contents of financial statements, methods and procedures of publication thereof shall be set forth by the Securities Commission.
3. A pension fund must, at least once a year, according to the procedure stipulated in the pension scheme, provide a statement of the personal pension account to each pension scheme participant, as well as inform the pension scheme participant about the amendments to the legislation with regard to operations of pension funds, management enterprises and depositories that had come into effect after the last notice, as well as the results of the audit.

Article 41. State Supervision of the Operations of Pension Funds

1. State supervision of the operations of pension funds shall be carried out by the Securities Commission. In pursuit of implementation of this Law the Securities Commission shall be entitled to issue legal acts within its terms of reference.

2. When issuing permits for pension funds and exercising supervision over their operations, the Securities Commission, in addition to the functions stipulated in this law, shall carry out the following functions:

- 1) draft, approve, amend and declare invalid the rules that regulate issuance of permits for establishing, restructuring, operations and liquidation of the pension funds;
- 2) draft, approve, amend and declare invalid the forms of statements to be forwarded to the pension scheme participants, establish procedures of submitting and publication of said documents;
- 3) provide official explanations and recommendations on all the issues of the pension fund activities;
- 4) issue and revoke operation permits for the pension funds and their management enterprises and restrict their operations;
- 5) monitor, analyze, inspect and supervise in other ways operations of pension funds and their management bodies;
- 6) set forth the rules for managing the pension accounts;
- 7) apply sanctions stipulated in the Administrative Code of the Republic of Lithuania to the heads of pension funds, management enterprises, depositories and auditors of said enterprises for violations of this law and other legal acts;
- 8) apply sanctions provided for in this and other laws to the persons who had violated this law and the rules and regulations approved by the Securities Commission;
- 9) organize and carry out the inspections of the management enterprises and depositories;
- 10) carry out other functions established by this Law.

3. When carrying out the inspections officials of the Securities Commission have the right to:

- 1) receive explanations from the persons related with the violations under investigation;
- 2) to temporarily (up to 30 days) take with them documents of the inspected pension funds, their management enterprises and depositories that may be used as evidence of violations. When taking documents they must leave the motivated resolution regarding taking the documents and the description of taken documents;
- 3) request to make copies of the accounting documents, agreements and other documents which are considered by the Securities Commission important for the inspection;
- 4) freely enter the premises of the pension funds, their management enterprises, depositories, check accounting books, documents and other information sources needed for the inspection, provided they produce the service certificate and the resolution of the Securities Commission or its chairman;

5) to receive the data, certificates and copies of the documents about financial operations related with the object of investigation, if they provide the motivated resolution of the Securities Commission or its chairman.

4. The Securities Commission shall be entitled to appeal to court against persons who impede the implementation of the rights of the Securities Commission provided for in paragraph 3 of this Article, necessary to investigate the violations of the law. These cases shall be heard by the District Court of Vilnius. The court, upon the receipt of the application by the Securities Commission, no later than in 24 hours, must analyze it and issue the resolution obligating the person concerned to perform actions requested by the Commission and abstain from actions impeding the investigation, or reject the application of the Securities Commission. The Securities Commission shall not be charged the stamp duty for submitting the application in question. In the event the term allotted for the investigation of the case expires on a day-off, the term shall be counted starting from the first business day following the day-off. Upon the receipt of the application, a copy thereof shall not be sent to the person concerned, and the request to submit opinion on the application to the court shall not be submitted. The applicant shall be notified on the course of investigation. This information may be provided verbally. Participation of third persons, their representatives and other interested persons in the court session is not obligatory, and summons to them shall not be sent. The verdict arrived at by the District Court of Vilnius shall not be appealed and comes into effect from the moment the decision is passed.

5. Instructions of the Securities Commission to the pension funds, management enterprises, depositories or their managers regarding elimination of violations of the laws and other legal acts shall be binding.

6. Employees of the Securities Commission must ensure confidentiality of all the commercial secrets, of which they have become aware when performing their duties. Employees shall be held responsible in accordance with the laws of the Republic of Lithuania for using information not for the targeted purposes, or for other illegitimate actions.

7. The Ministry of Social Security and Labor shall monitor the compliance of pension schemes with requirements stipulated in this Law, control payment of benefits, protection of the rights of pension scheme participants when modifying the schemes, supervise the compliance of the pension agreements with the collective and employment agreements.

8. Supervisory institutions provided in this law may request to carry out their orders, and shall be entitled to inspect, control or carry out investigation in order to ensure that pension funds, management enterprises or depositories comply with this Law and other legal acts and regulations related to it.

9. Pension funds may appeal to court against the decisions of the supervisory institutions stipulated in this Law where they have negative impact upon their operations.

Chapter 9. Liability for Violations of the Law

Article 42. Effects of Violations of the Law

1. Economic entities that violate this Law must:
 - 1) act on the instructions given by the Securities Commission to terminate operations, restore the situation to its original condition, rescind or change agreements, comply with other orders;
 - 2) compensate for damages;
 - 3) fulfill sanctions imposed by the Securities Commission.
2. The Securities Commission shall be entitled to impose pecuniary penalties on:
 - 1) economic entities operating as pensions funds without a permit stipulated in paragraph 1 of Article 5 of this Law - up to double amount of the illegitimately received income;
 - 2) economic entities operating as management enterprises of pension funds without a permit stipulated in paragraph 1 of Article 7 of this Law - up to double amount of illegitimately received income;
 - 3) pension funds which enter into pension agreements based on pension schemes not registered with the Securities Commission - in the amount of up to 100 000 Lit.
3. The application of sanction stipulated in the Administrative Code and paragraph 2 of this Article shall not release the managers of economic entities from civil, administrative and criminal liability provided by the laws of the Republic of Lithuania.
4. The decision of the Securities Commission regarding imposition of the administrative penalties may be appealed against in court following procedures set forth in the laws of the Republic of Lithuania. Decisions of the Securities Commission regarding application of sanctions stipulated in the paragraph 2 of this Article may be appealed against in court within one month. The appeal shall not suspend the fulfillment of the orders or resolutions of the Securities Commission to eliminate violations of the laws or other legal acts, unless the court provides otherwise.
5. Pecuniary penalties shall be paid into the State budget no later than within one month from the date of receipt by the pension fund, management enterprise, depository or their managers of the resolution to impose a penalty.
6. In the event that within the period stipulated in paragraph 5 of this Article the economic entity fails to pay the imposed fine and fails to produce to the Securities Commission a copy of the court's decision suspending or annulling the decision to impose a pecuniary penalty, said penalty shall be exacted from the income of the economic entity without the need to bring a case.

7. In one month since the date of receipt of the resolution of the Securities Commission economic entities may appeal to the court regarding revocation or amendment of the said resolution.

8. The appeal to the court shall not suspend the fulfillment of the orders and resolutions of the Securities Commission, unless the court provides otherwise.

Article 43. Final Provisions

1. This Law shall come into effect as of July 1, 1999.

I promulgate this law approved by the Seimas of the Republic of Lithuania.

PRESIDENT OF THE REPUBLIC