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ACCESS TO CREDIT INITIATIVE

UKRAINE & MOLDOVA

NINTH QUARTERLY REPORT

OCTOBER 1, 2006 – DECEMBER 31, 2006

June 6, 2007
This report was produced for review by the United Agency for International Development. It was prepared by the USAID Access to Credit Initiative implemented by The Pragma Corporation.

ACCESS TO CREDIT INITIATIVE
UKRAINE

NINTH QUARTERLY REPORT

October 1, 2006 – December 31, 2006
Contract Number: 121-C-00-04-00713

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Chief of Party: David Lucterhand

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A. PROJECT OVERVIEW

I. PROJECT DESCRIPTION

ATCI is tasked with developing the primary and secondary mortgage market with its associated infrastructure; increased capacity for the leasing industry including the development of certified leasing professionals; the ability for municipalities and utilities to use debt instruments to modernize vital infrastructure, and a credit bureau to facilitate the growth of credit for mortgages and other retail lending. While the credit bureau/credit rating component is subordinated to the mortgage component, it is being treated as a stand alone for purposes of implementation. The preliminary work plan was presented and accepted by USAID in November 2004. In October 2006, the ATCI contract was amended to include development of fixed-income operations in Ukraine. Additionally, ATCI activities were expanded to include Moldova. A new work plan reflecting changes in project priorities or emphasis will be prepared during the tenth quarter for Ukraine. Additionally, the work plan for Moldova will be prepared for review and approval by USAID.

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

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

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

II. SIGNIFICANT EVENTS AND ACHIEVEMENTS

- ATCI OPENS OFFICE IN MOLDOVA
- CML COURSE V IS COMPLETED IN DNEPROPETROVSK / EIGHTEEN CERTIFIED
- ATCI DELIVERS REGIONAL SEMINAR IN SEVASTOPOL TO SSMSC ON MORTGAGE BONDS
- MIN FIN AND ATCI AGREE TO CO- SPONSOR DEBT MANAGEMENT FORUM
- MISSION DIRECTOR EARL GAST ATTENDS SIGNING CEREMONY FOR PROTOCOL OF INTENTION WITH THE CITY OF LUGANSK ON BOND ISSUANCE.
- SLIDE PRESENTATION ON *STRATEGIC AND OPERATIONAL OPTIONS FOR A UKRAINIAN MUNICIPAL FINANCE FACILITY* IS GIVEN TO DEPUTY FINANCE MINISTER KRAVETS, DEPUTY CONSTRUCTION MINISTER GRIGORY SEMCHUK, AND REPRESENTATIVES OF BANKS AND CITIES.
- ATCI MEETS LVIV MAYOR SADOVIY; COMMENCED ASSISTANCE TO LVIV WITH BOND ISSUANCE.
- PRESENTATION ON MUNICIPAL FINANCE FACILITY GIVEN TO COMMUNAL ENTERPRISE CONGRESS CHAIRED BY DEPUTY MINISTER OF CONSTRUCTION SEMCHUK.

- STANDARD AND POOR'S COMPLETES CREDIT RATING OF LUGANSK.

- TWENTY-SIX PERSONS RECEIVE CLS (CERTIFIED LEASING SPECIALISTS) DESIGNATION FROM THE CLP FOUNDATION

- CITY OF BERDYANSK SUBMITS ITS APPLICATION FOR BORROWING APPROVAL TO THE MINISTRY OF FINANCE.

- RATINGS WHITE PAPER COMPLETED

III. PROJECT EXECUTIVE SUMMARY

This Report provides details on the events and activities summarized below, as well as other events and activities regarding the USAID Access to Credit Initiative, as implemented by consultants for The Pragma Corporation (the Project), for the period from October 1, 2006 through December 31, 2006. The report is comprised of four components: Mortgage, Fixed income with a subordinated Municipal Finance component; Leasing and Credit Bureau / Credit Rating. Each component section of the report will have a summary with specific activity tasks identified and the status of each task with appropriate commentary, relevant attachments, and reference to administrative issues, if any.

Mortgage

Primary

ATCI continued its development of the primary mortgage in league with SMI and UNIA completing the second and third CML modules of Course V. The CML candidates who received the training were from local financial institutions in and around the Dnepropetrovsk region. Eighteen candidates received certification. ATCI's COP participated in the certification ceremony. The next and final training will consist of train the trainers in cooperation with ATCI's counterparts: SMI and UNIA.

Secondary Market

Covered Bond Regulation Completed

During the quarter under review, ATCI consultant Gennadyi Shemshuchenko completed drafting the mortgage pool monitoring regulations for SSMSC. The regulation will govern the activities of the issuer, the auditor and the bond manager in covered bond issues in accordance with the law "On Mortgage Bonds." The Draft regulations were submitted to the SSMSC for consideration and submission to the Ministry of Justice for review.

Pilot Issues

During the quarter, ATCI continued to work with Ukrsibbank, Ukrsotsbank and Ukrgazbank on pilot issues under the law "On Mortgage Bonds." All the banks are prepared to issue, though Ukrsibbank could delay somewhat due to a change in the bank's operating soft-ware and ownership changes.

After six months of monitoring, the banks determined that their individual CPR (Consolidated Prepayment Rates) are in the range of 21 to 26 percent per annum; by comparison, current CPR in the US are about 10.5-11.0 percent. The elevated CPR suggests that the auditor's agreed-upon procedure should be performed quarterly, as opposed to every six months or even once a year, the mandated minimum in the law.

Bond Manager and Management Agreement
With registration of the pertinent regulation imminent, ATCI has mounted an effort to identify banks which might act as bond managers. During the quarter, ATCI met with HVB for general discussions of the role and responsibilities of bond manager. Subsequently, HVB expressed an interest in participating in the pilot issue.

Since neither the law nor the regulation define the relationship between the issuer and the bond manager in sufficient detail, ATCI began drafting a Management Agreement. Ideally, the agreement would be tripartite, encompassing the activities and relationships with the auditor as well.

Associated Market Infrastructure
ATCI's third direction of activity in mortgage is development of associated market infrastructure. During the previous quarter, ATCI in cooperation with the International Real Property Foundation, conducted an assessment of real estate sales practices and the state of real estate appraisal in Ukraine. IRPF submitted its report along with a suggested solution package. This, in turn, evolved into a proposed SOW that would lead to certifications in accordance with world standards of practice. This SOW was approved by USAID on a cost share basis with the IRPF during the quarter. ATCI and IRPF began delivery of Phase I – appraisal standards in the ninth quarter.

Lastly, the Peoples Group completed its assessment of lending in the agricultural sector. TPG's findings, conclusions, and recommendations were presented to USAID and UNIA.

Fixed Income

ATCI and the Ministry of Finance agreed to co-sponsor a Debt Management Forum designed to focus senior leadership on the need for development of the domestic government securities market. Additionally, ATCI is forming a special advisory group composed of former Finance Ministers and National Bank Governors to review the agenda for suitability.

Municipal Finance

Pilot Bond Issues

ATCI helped the City of Berdyansk prepare and submit its application for borrowing approval to the Ministry of Finance in late December. The application proposes an innovative credit enhancement structure that uses put options.

Mission Director Earl Gast attending a signing ceremony with Lugansk Mayor Kravchuk in November, marking the formal beginning of ATCI's collaboration with Lugansk on a proposed UAH 30M bond. We concluded a contract with Standard and Poor's for completion of a credit rating of the City of Lugansk and they delivered the rating (B on the international scale) in late December. We completed the Lugansk Bond Capacity Assessment. Lugansk will be our third pilot bond city.

MFF

Development of a municipal finance facility (bond bank) continued during the quarter. Dr. John E. Petersen visited Ukraine to assist with a two-hour presentation in the Ministry of Finance Conference room. Attending were Dep. Finance Minister Kravets, Dep. Construction Minister Semchuk, Association of Cities Director Pittsyk; Director of MinFin Office of Public Debt V. Vysotskyi; and commercial bank representatives. Also invited were Dep. Finance Minister Makatsariya and First. Dep. Economy Minister Maksiuta.

Leasing

In this Quarter ATCI concluded a license agreement with the US Certified Leasing Professional Foundation ("CLPF"). The license agreement will allow ATCI to use CLPF's logo and other materials in the CLS Program. In addition, CLPF is a co-issuer, along with UKRLEASING, of the CLS Certificates. The license will be transferred to the Ukrainian Society of Certified Leasing Specialists ("USCLS") once USCLS is duly organized.

Certified Leasing Specialist (CLS) Certificates were awarded to 26 individuals, including several who will serve as trainers for subsequent CLS candidates, continued capacity building work with AMACO and LeaseIT, began advisory work in Moldova along with beginning the planning process to expand the CLS Program to Moldova as well as making arrangements to assist the Moldovan Leasing Industry in the formation of a Leasing Association.

Credit Bureau/Credit Rating

Credit Bureau

Ministry of Justice of Ukraine Adopts Licensing Requirements for Credit Bureaus

As indicated in previous quarterly reports, the Cabinet of Ministers of Ukraine issued a Resolution assigning the Ministry of Justice of Ukraine to serve as the authorized body responsible for licensing and regulation of credit bureau operations. Pursuant to the Ukrainian Credit Bureau Law, the authorized body was mandated to draft the regulations governing licensing requirements and other rules for credit bureau operations in Ukraine.

ATCI, FNBCH, IBCH/Creditinfo, MOJ, and State Committee for Entrepreneurship jointly drafted and agreed on a draft licensing regulation. On December 27, 2006, the Ministry of Justice approved and registered the Regulation on Licensing Requirements for Ukrainian credit bureaus. However, this Regulation differed from jointly agreed draft and included the provision mandating credit bureaus to have a comprehensive data protection system envisaged by the Law of Ukraine "On Protection of Information in Information and Telecommunication Systems". Except for this specific provision, licensing requirements are considered by market participants to be very business friendly. But the provision regarding comprehensive data protection system poses a serious danger for Ukrainian credit bureaus. Credit bureaus can obtain a license simply based on the submission of documents stipulated by the law (document confirming the paid-up charter capital, credit bureau bylaws, etc.). However, following the receipt of a license, they must comply with licensing requirements and having a comprehensive data protection system is the integral part of licensing requirements. Currently, none of credit bureaus have this comprehensive system, and according to experts, it might take up to three years to fully develop such a system. Therefore, any complaint from any interested party regarding inadequate data protection could potentially lead to withdrawal of a license.

ATCI and market participants fully recognize this danger and have "pressed" the Ministry of Justice to address this issue and find a reasonable compromise. Resolution of this issue is expected in January 2007 since according to the law by January 27, 2007 Ukrainian credit bureaus must have received a license. After that date, any data processing operations without a license will be illegal.

Credit Rating

ATCI Efforts Aimed at Improving the Status of Credit Rating Industry

To promote the development of an effective credit rating industry in Ukraine, ATCI engaged Michael McMullen, international credit ratings expert, to prepare a White Paper on the status of the ratings industry in Ukraine, as well as to make recommendations directed at improving the market for rating services. Mr. McMullent spent twenty years with MOODY'S INVESTORS SERVICE and participated in a wide range of assignments and projects for banks, financial institutions, and NGOs, such as USAID, World Bank, Thomson BankWatch. After a series of meetings with market participants, regulators and other interested parties, as well as with assistance of local ATCI advisors, Mr. McMullen finalized the final version of the White Paper and submitted it to ATCI. The paper was distributed to all interested parties (SSMSC, market participants, donor funded projects, etc.) at the end of November 2006. The White Paper recommends abandoning the practice of mandatory rating and the national scale approved by the Government.

Gender

During the quarter, ATCI conducted training activities in two of its four major components while striving for gender balance.

ATCI conducted CML mortgage training for twenty-two bank staff persons – of the eighteen who were certified, eight (44%) were women.

Other

NONE

IV. PROJECT STAFFING

The following personnel were engaged in project activities this quarter:

- David Lucterhand, Chief of Party
- Richard Genz, Senior Advisor, Municipal
- Richard Caproni, Senior Advisor, Leasing
- Steve Moody, Senior Advisor, Mortgage
- Rick Dvorin, Country Manager, Moldova
- Jim Butler, Senior Advisor
- Arthur Heath, Senior Advisor, Municipal
- Javier Piedra, Senior Advisor, Credit Bureau
- Jon Michael McMullen, Senior Advisor, Credit Rating
- Ken Peoples, Senior Advisor, Mortgage
- Frank Naylor, Senior Advisor, Mortgage
- Norman Flynn, Senior Advisor, Mortgage
- Bill Malkasian, Senior Advisor, Mortgage
- Robert Homans, Senior Advisor, Leasing
- George Badescu, Senior Advisor, Mortgage
- John Petersen, Senior Advisor, Municipal

V. ADMINISTRATIVE ISSUES

Start – up of ATCI Moldova. ATCI staff members were mobilized to set –up operations in Moldova.

Senior Advisor for leasing Rich Caproni was replaced by Robert Homans.

The COP has requested that ATCI increase salaries approximately 15% and in special cases, significantly higher for some technical positions. A memorandum to the CO with justification for the request was submitted to the CO by Pragma, Falls Church. ATCI is waiting for a response.

ATCI/Ukraine website is developed and becomes operational: www.atci.com.ua

LIST OF ATTACHMENTS

NONE

B. MORTGAGE

I. COMPONENT DESCRIPTION

This Report provides details on the events and activities relating to the Mortgage Component of the USAID Access to Credit Initiative, as implemented by The Pragma Corporation, during the period from October 1 through December 31, 2006.

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

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

II. SIGNIFICANT EVENTS

- CML COURSE V IS COMPLETED IN DNEPROPETROVSK / EIGHTEEN CERTIFIED
- POWERPOINT REGARDING RURAL LENDING FINDINGS PRESENTED TO USAID; DRAFT RURAL LENDING ASSESSMENT COMPLETED
- IRPF CONDUCTS APPRAISAL SURVEY
- IMPLEMENTING COVERED BOND REGULATIONS ARE SUBMITTED FOR SSMSC AND MINISTRY OF JUSTICE APPROVAL
- REGIONAL SEMINAR ON COVERED BONDS IN SEVASTOPOL IS DELIVERED TO SSMSC STAFF

III. EXECUTIVE SUMMARY

ATCI continued its development of the primary mortgage in league with SMI and UNIA Seminar 1 – October 17-20, 2006; Seminar 2 – November 21-24, 2006; and Seminar 3 – December 19-22, 2006.

Out of 22 participants, 18 were certified (8 women), completing all modules of CML Course V. The CML candidates who received the training were from local financial institutions located in Odessa, Kharjkiv, Lugansk, Kiev and Dnepropetrovsk.

Eighteen candidates received certification. *(See attachment 1)* ATCI's COP participated in the certification ceremony in Dnepropetrovsk.

Cooperation continued with ATCI's counterpart UNIA to develop mortgage market statistics for the UNIA with an ATCI employee seconded to UNIA staff. This effort contributed to UNIA's publication of the Overview on the Mortgage Market in Ukraine Mortgage for the second quarter *(See attachment 2)* and joint work to draft implementing regulations for submission to the SSMSC re: the mortgage covered bond law.

Secondary Mortgage Market

State Mortgage Institution (SMI)

SMI received its state guarantee for one billion UAH and is preparing corporate bonds for issuance. SMI senior leadership changed with a new Chairman being appointed by the Cabinet of Ministers. SMI also anticipates an additional one billion for the 07 budget will be authorized giving a total of two billion in state guarantees, once bonds are issued.

Covered Bond Regulation Completed

During the quarter, the draft regulations for the SSMSC completed by ATCI consultant Gennadyi Shemshushenko for mortgage pool monitoring were posted on the SSMSC website for a thirty day comment period. The regulation will govern the activities of the issuer, the auditor and the bond manager in covered bond issues in accordance with the law "On Mortgage Bonds."

The regulation maintains the limitations on mortgage pool formation set forth in the law: the LTV of loans in the mortgage pool shall be no greater than 75%; no more than 15% of loans in the mortgage pool may be commercial real estate mortgages; and mortgages—both retail and commercial—must comprise at least 75% of the mortgage pool's assets. The mortgage pool itself must be at least 110% of the face value of the issue.

The regulation provides greater detail on the activities of the auditor. The law requires the auditor to conduct a periodic "review" of the mortgage pool; the regulation further stipulates that the "review" shall, in fact, be an "agreed-upon procedure," intended to confirm the issuer's own analysis of the mortgage pool. The regulation allows auditors to use their own in-house sampling methodology to construct a mortgage pool sample for periodic analysis.

Likewise, the regulation divides the duties of the bond manager into the routine and the extraordinary and clearly defines them.

Subsequently, with minimal changes, the regulations were sent to the Ministry of Justice for registration. ATCI expects to receive the final version of the regulations during the tenth quarter.

Pending receipt, ATCI and its pilot bond will be ready for issuance during the tenth quarter.

Pilot Issues

ATCI continued to work with Ukrsibbank, Ukrsotsbank and Ukrgazbank on pilot issues under the law "On Mortgage Bonds." All the banks are prepared to issue, though Ukrsibbank could delay somewhat due to a change in the bank's operating software and change in ownership.

After six months of monitoring, the banks determined that their individual CPR (Consolidated Prepayment Rates) are in the range of 21 to 26 percent per annum; by comparison, current CPR in the US are about 10.5-11.0 percent. The elevated CPR suggests that the auditor's agreed-upon procedure should be performed quarterly, as opposed to every six months or even once a year, the mandated minimum in the law.

Elevated CPR dramatically shortens the duration of the mortgage pool—in the current case, to less than 40 months, which means that none of the pilot issues should have a term longer than three years. A three-year term means that coupon yields on the pilot issues should be in the 10.0-11.0 % range, or about at the level of deposit rates.

The timing of issuance of pilot issues will depend on if and when MinJust registers the regulation presented to the Commission as previously mentioned.

Bond Manager and Management Agreement

With registration of the pertinent regulation imminent, ATCI has continued its efforts to identify banks which might act as bond managers. The issue is not as straightforward as it might seem.

First, the law says that the bond manager may be any legal entity and does not specify banks specifically. The use of a bank as bond manager, however, is strongly recommended by the structure of its duties which, in the case of issuer bankruptcy, might include managing the issuer's mortgage portfolio as a "bridge bank," pending liquidation. However, if banks are to serve as bond managers, issuers have made it clear that they will not cooperate with "competitor" banks, meaning banksHVB for general discussions of the role and responsibilities of bond manager. Subsequently, HVB expressed an interest in being a bond manager.

Since neither the law nor the regulation define the relationship between the issuer and the bond manager in sufficient detail, ATCI is drafting a Management Agreement. Ideally, the agreement would be tripartite, encompassing the activities and relationships with the auditor as well.

Associated Market Infrastructure

ATCI's third direction of activity in mortgage is development of associated market infrastructure. During the quarter previous quarter, ATCI in cooperation with the International Real Property Foundation, conducted an assessment of real estate appraisal in Ukraine. IRPF submitted its report along with a suggested solution package. This, in turn, evolved into a proposed SOW that would lead to certifications in accordance with world standards of practice. This SOW was approved by USAID on a cost share basis with the IRPF and, during the quarter, the IRPF began delivery of Phase I, conveyance of international standards of appraisal practices.

Lastly, the Peoples Group completed its assessment of lending in the agricultural sector and presented its results to USAID and UNIA *(see attachment 3)*. ATCI is providing support for this effort and expects the final report during the tenth quarter after which, it will present TPG's findings, conclusions, and recommendations to USAID.

Lastly, ATCI at the request of the SSMSC, delivered a seminar to regional SSMSC staff in Sevastopol on covered bonds and how they work with emphasis on the structure of the issue and what the SSMSC should look at when regulating the bonds of this kind *(See attachment 4)*.

IV. ADMINISTRATIVE ISSUES

UNIA's Executive Director has been serving in this capacity without a specific salary for nearly two years. ATCI discussed with UNIA's Chairman, Mr. Yushko, ways to remedy this problem. One solution was for ATCI to fund the position but conditioned on the basis of having an open and competitive executive search and through ATCI's participation on the search committee. This approach was discussed with and approved by ATCI's CTO. Mr. Yushko thanked ATCI for this offer and asked that the project delay advertising for the position until the beginning of 2007.

Consequently, ATCI expects to address this issue in the tenth quarter.

V. DESCRIPTION AND STATUS OF TASKS

Task 1. Mortgage - Certified Mortgage Lender Program

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **IUE review of training materials for applicability to Ukraine**	• WORK COMPLETED IN COOPERATION WITH THE UNIA AND SMI TO REVISE CML COURSEWORK FOR DELIVERY IN UKRAINE IN 2005. NEW MATERIAL IS INTRODUCED CONTINUALLY IN RESPONSE TO CHANGING MARKET CONDITIONS.
• **Selection of candidates for CML training**	• IN COOPERATION WITH UNIA AND SMI, ATCI SELECTS THE BANKS AND OTHER INSTITUTIONS FOR STAFF TRAINING. SECOND REGIONAL CML (COURSE V)TRAINING WAS COMPLETED IN DNEIPROTROVSK.
• **Develop and administer CML training**	• COURSE MODIFICATION FOR DELIVERY IN UKRAINE COMPLETE AND BEING DELIVERED.
• **Deliver two complete CML courses**	• DURING THE QUARTER, CML MODULES FOR COURSE V WERE DELIVERED. EIGHTEEN PERSONS RECEIVED CERTIFICATIONS.
• **Assess rural lending, titling registration, appraisal of profitable agricultural production units**	• THIS ACTIVITY WAS CONCLUDED DURING THE QUARTER.

Task 2. Mortgage - Assistance to Banks

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Standardize rules and procedures for retail mortgage lending**	• THE MORTGAGE BOND LAW LEGISLATES THE COVERAGE RATIOS AND LTVS FOR INCLUSION IN COVERED BONDS. ADDITIONALLY, INVESTORS HAVE RECOURSE TO THE ISSUER IF MORTGAGES BECOME NON-PERFORMING. ONLY MORTGAGES THAT USE STANDARDIZED UNDERWRITING PRACTICES WILL BE PRACTICABLE FOR COVERED BONDS. THIS, IN TURN, WILL AIDE IN FURTHER STANDARDIZATION. BANKS ARE USING STANDARDIZED UNDERWRITING PRACTICES IN PREPARATION FOR PILOT ISSUES.
• **Select candidate banks for receipt of on –site technical assistance**	• THE SAME BANKS THAT HAVE STAFF PARTICIPATE IN CML TRAINING ARE THE SAME WHO RECEIVE ON - SITE TECHNICAL ASSISTANCE.
• **Provide on – site technical assistance**	• PROVIDED TO BANKS (UPON REQUEST) WHOSE STAFF HAVE ACHIEVED CML DESIGNATION.

Task 3. Mortgage - Home Loan Guarantee

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Analyze market for existing mortgage insurance practices**	• THIS ANALYSIS WAS COMPLETED DURING THE FOURTH QUARTER.
• **Assess legal and regulatory framework**	• ASSESSMENT IS CONTINGENT ON ATCI IDENTIFYING A SPONSOR .FOR THE GUARANTEE FUND INSIDE THE GOU.
• **Complete Feasibility Study**	• THIS WILL COMMENCE AFTER COMPLETION OF THE ASSESSSMENT AND THE SPONSOR AGREES TO PROCEED
• **Complete Business Plan**	• THIS WILL FOLLOW THE FEASIBILITY STUDY
• **Assist in operational set-up of guarantee facility**	• NOTHING DONE THIS QUARTER
• **Provide on-site technical assistance to facility**	• NOTHING DONE THIS QUARTER
• **Promote the use of mortgage insurance**	• ATCI IS LOOKING TO IDENTIFY A SPONSOR TO DISCUSS THE ROLE OF A STATE MORTGAGE GUARANTEE FUND. UNTIL SUCH TIME, PURSUIT OF THIS EFFORT WILL BE MINIMAL.

Task 4. Mortgage - Life Insurance Products

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Analyze insurance and mortgage markets for existing products**	• ATCI COMPLETED AN ANALYSIS OF RELATED MORTGAGE INSURANCE PRODUCTS AS WELL AS THE INSTITUTIONS OFFERING THEM. SEVERAL COMPANIES ARE OFFERING MORTGAGE TERM-LIFE INSURANCE PRODUCTS. HOWEVER, THE ANALYSIS DETERMINED THAT BANKS ARE NOT REQUIRING THESE POLICIES BECAUSE THEY ADD TO THE COST OF THE MORTGAGE. FURTHER, MUCH OF THE "LIFE" INSURANCE IS RELATED TO ONLY ACCIDENTAL DEATH. ALSO, TERM PREMIUMS APPEAR EXCESSIVE DUE TO THE ABSENCE OF COMPETITION. ATCI EXPECTS TO HAVE AN ASSESSMENT BY AN ACTUARY COMPLETED IN LATE 2007.
• **Assess legal and regulatory framework**	• NO ACTION TAKEN THIS QUARTER
• **Assess existing actuarial data**	• NO ACTION TAKEN THIS QUARTER
• **Select candidate insurers**	• PRELIMINARY ANALYSIS HAS BEEN COMPLETED/ASSESSMENT WILL TAKE PLACE DURING LATE 2007
• **Develop term sheet and rate structure**	• NO ACTION TAKEN THIS QUARTER
• **Draft Product policy**	• NO ACTION TAKEN THIS QUARTER
• **Conduct Road Show with mortgage lending banks and financial institutions**	• NO ACTION TAKEN THIS QUARTER

Task 5. Mortgage - Appraisers/Brokers Associations

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Assessment of UTO and other organizations**	• ASSESSMENT COMPLETED BY IRPF AND SOLUTION PACKAGE OFFERED. SOW WAS APPROVED DURING THE QUARTER. PHASE I REGARDING APPRAISAL STANDARDS WAS COMPLETED DURING THE NINTH QUARTER.
• **Facilitate development and use of unified methodology**	• NO ACTION TAKEN THIS QUARTER
• **Work with UAREP**	• NO ACTION TAKEN THIS QUARTER
• **Study tours to U.S.**	• NO ACTION TAKEN THIS QUARTER
• **Design, establish and sustain the transaction and price database**	• NO ACTION TAKEN THIS QUARTER

Task 6. Mortgage - Mortgage Backed Securities

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Establish Legal Working Group to assess legal and regulatory basis**	• ATCI IS PARTICIPATING WITH UNIA AND THE SSMSC IN DRAFTING THE IMPLEMENTING RULES AND REGULATIONS. SUBMISSION OF THE DRAFT RULES TO THE SSMSC OCCURRED DURING THE NINTH QUARTER. ATCI ANTICIPATES THAT THE MINISTRY OF JUSTICE WILL REGISTER SOME VERSION OF THE REGULATIONS AFTER REVIEW OF THEIR COMPATIBILITY WITH EXISTING COVERED BOND LEGISLATION.
• **Select Candidate Issuer**	• ATCI IS WORKING WITH UKRAGASBANK, UKRASOTSBANK, AND UKRASIBBANK. .MOST PORTFOLIOS ARE DOLLAR DENOMINATED. MORTGAGES DENOMINATED IN LOCAL CURENCY ARE IMPORTANT TO MITIGATE CURRENCY RISK IN DOMESTIC ISSUANCE. THIS IS NOT THE CASE FOR INTERNATIONAL ISSUANCE. LETTERS OF CONFIDIENTIALITY HAVE BEEN SIGNED BY EACH BANK. CURRENT ACTIVITY INVOLVES PORTFOLIO ANALYSIS TO DETERIMINE THE QUALITY OF MORTGAGE COLLATERAL, DENOMINATION OF THE MORTGAGES SELECTED FOR INCLUSION IN THE POOL AND SUITABILITY FOR ISSUANCE; AND DEVELOPMENT OF STANDARDIZED MECHANISMS FOR AUDITING THE COVERAGE OF THE MORTGAGE POOL. EQUALLY IMPORTANT IS TO DETERMINE THE STATE OF SOFTWARE DEVELOPMENT THAT CAN GENERATE THE NECESSARY REPORTS THAT COMPLY WITH LEGAL REQUIREMENTS AS WELL AS THE REQUIREMENTS OF THE BOND MANAGER. THIS WORK CONTINUED THROUGHOUT THE QUARTER
• **Draft investment memorandum**	• DRAFTING IS PREDICATED ON COMPLETION OF THE IMPLEMENTING RULES AND REGULATIONS. ATCI IS WAITING FOR MINISTRY OF JUSTICE REVIEW OF DRAFT REGULATIONS SUBMITTED FOR APPROVAL BY THE SSMSC. .
• **Identify potential investors**	• THE COP AND ADVISORS MET WITH POTENTIAL INSTITUTIONAL INVESTORS TO DESCRIBE COVERED BONDS AND TO GAGE INVESTMENT INTEREST. LIFE INSURANCE COMPANIES AND ASSET MANAGERS OF PRIVATE PENSION FUNDS APPEAR TO BE LIKELY INVESTORS BASED ON THE SIZE OF THE FIRST PILOT. ALSO BANKS ARE LIKELY BUYERS FOR PORTFOLIO DIVERSIFICATION. PFTS IS THE LIKELY MECHANISM FOR SECONDARY DISTRIBUTION AFTER UNDERWRITING IS COMPLETED • SMI HAS INVESTED MOST OF ITS CHARTER CAPITAL IN SOME WHOLE MORTGAGES. A STATE GUARANTEE (EVEN PARTIAL) WOULD CONSTITUTE A CREDIT ENHANCEMENT. NEARLY ALL OF SMI'S EFFORTS HAVE BEEN DEDICATED TO PROCURING A STATE GUARANTEE WHICH THEY HAVE NOW RECEIVED. STEP ONE INVOLVES THE ISSUANCE CORPORATE BONDS MOST PROBABLY PLACED WITH LOCAL BANKS. BASED ON THE TEMPO OF CREDITING, ATCI EXPECTS TO SEE A COVERED BOND PILOT ISSUANCE SOMETIME IN THE SECOND HALF OF 2007. THIS ASSUMES THAT REGULATORY FIXES BY THE SSMSC TO DEFICIENCIES IN THE COVERED BOND LAW CAN BE ACHIEVED IN TIME.
• **Price and Place Issue**	• NO ACTION TAKEN THIS QUARTER

LIST OF ATTACHMENTS

ATTACHMENT 1 Photograph of Dnepropetrovsk CML Recepients

ATTACHMENT 2 UNIA'S Overview on the Mortgage Market in Ukraine - 2006

ATTACHMENT 3 Rural Lending Assessment

ATTACHMENT 4 SSMSC Regional Mortgage Seminar

C. FIXED INCOME

I. COMPONENT DESCRIPTION

This Report provides details on the events and activities relating to the Fixed Income Component of the USAID Access to Credit Initiative, as implemented by The Pragma Corporation, during the period from October 1 through December 31, 2006

The objective of the fixed income component is to expand the availability of capital to borrowers as an alternative to bank financing. Experience in developing such markets in other countries has demonstrated that corporate bonds and other fixed income instruments can offer borrowers longer-term financing at lower cost when compared to the lending practices of most banks. In fact, most banking systems rely on short-term deposits to fund loans and are comfortable with only lending working capital to businesses. While the universe of fixed-income instruments is vast, ATCI is concentrating on identifying corporations with sufficient means and inclination to issue corporate bonds. Municipal bonds, mortgage-backed bonds, and the securitization of other asset pools are expected once enabling legislation is passed. Specific objectives include issuing at least one pilot for each type of bond. Since most government securities are viewed by investors as being the least risky and frequently are used as a benchmark for pricing other debt securities issued in the market, related objectives include working with the GOU and GOM to develop longer-term Treasury securities for construction of a long-term Government yield curve. In Moldova, ATCI will concentrate on developing a corporate debt market with the specific objective of at least three pilot corporate issues and longer - dated maturities.

II. SIGNIFICANT EVENTS AND ACHIEVEMENTS

- MINISTRY OF FINANCE AGREES TO CO-SPONSOR DEBT MANAGEMENT FORUM

III. EXECUTIVE SUMMARY

In matters related to regulatory reform, ATCI worked with the SSMSC to develop implementing regulations for the covered bond law. These regulations were submitted to the Ministry of Justice for approval. ATCI is waiting for the final version of the regulation to be registered by the Ministry.

ATCI efforts to develop a pilot corporate bond are represented by the pilot covered mortgage bond which is also corporate bond issue. Details regarding the pilot issue are discussed in the mortgage component.

To commence work in developing a long-term government yield curve, ATCI met with the Mr.Vysotskyi, Head of Debt Management Department at the Ministry of Finance to gage the Ministry's interest co-sponsoring with ATCI a debt management forum. The purpose would be: to explore what steps the Government of Ukraine should take to manage its debt requirements efficiently; to examine the role *domestic* government debt markets play in efficient capital allocation; to analyze the institutional framework requisite for market development such as the role of primary dealers, use of pre-announced auction calendars, development of a debt management strategy, mitigation of risk in debt management, establishing a debt management office (DMO) and comparisons to how debt management offices (DMOs) are organized and work in other countries. To analyze what has worked in other countries facing similar circumstances and what has not. The Forum will explore the practical aspects of formulating a debt management strategy and necessary elements for successful development of the primary and secondary market in government securities; the use and role of re-purchase agreements in contributing to market liquidity; and what changes to the legal framework might be necessary. The Forum will provide an opportunity for government officials, and market professionals to share information and perspectives for use by senior leadership when framing policy choices for adopting a plan of action that leads toward development of a liquid domestic Government securities market in Ukraine. The Ministry's response was positive and agreed to co-sponsor the event and establish a working group to coordinate all details.

Invitees are expected to include: Senior leadership of the Government of Ukraine involved in policy decisions affecting the financing of government debt to include: Members of Ukrainian National Security and Defense Council; Ministers, Deputy Ministers and their senior staff, Members of the Rada, Senior leadership of the National Bank of Ukraine, Commissioners of the SSMSC and Financial Services Regulator, and the senior management of market participants. The proposed date is March 22, 2007

The Ministry's response was positive and representatives agreed to co-sponsor the event and establish a working group to coordinate all details.

IV. ADMINISTRATIVE ISSUES

NONE

V. DESCRIPTION AND STATUS OF TASKS

Task 1. Fixed Income - Regulatory Reform

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Strengthen capacity of National Securities Commission (SSMSC)**	• ATCI WORKED CLOSELY WITH THE SSMSC TO DEVELOP THE IMPLEMENTING REGULATIONS FOR THE COVERED BOND :LAW • SEMINAR ON MORTGAGE COVERED BONDS DELIVERED TO REGIONAL SSMSC STAFF
• **Draft SSMSC and NSCM regs re investment advisors & rating agencies**	• ATCI COMPLETES RATINGS WHITE PAPER FOR SSMSC
• **Seek broader SSMSC, FSR and NSCM enforcement**	• NOTHING DONE THIS QUARTER
• **Participate in AUB and Fin. Svcs. Working Groups – amend pledge and bankruptcy laws and trusts**	• NOTHING DONE THIS QUARTER

Task 2. Fixed Income - Pilot Corporate Bonds (See mortgage component)

Task 3. Fixed Income – Long-term government yield curve

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Assess treasury debt market**	• ATCI WITH ASSISTANCE FROM ITS RESIDENT FULBRIGHT SCHOLAR ANALYZED THE STATE OF DOMESTIC TREASURY ISSUANCE IN PREPARATION FOR THE DEBT MANAGEMENT FORUM
• **Assist design of repurchase market**	• THIS IS EXPECTED TO BE DISCUSSED DURING DEBT MANAGEMENT FORUM AND RESULT IN A PLAN OF ACTION FOR IMPLEMENTATION

Task 4. Fixed Income – Develop Pilot Municiple Bonds (See municipal finance component)

Task 5. Fixed Income – Resolve constraints to municipal bonds issuance (See municipal finance component)

Task 6. Fixed Income – Pilot Municipal Bonds (See municipal finance component)

Task 7. Fixed Income – Issue Pilot Muni Bonds (See municipal finance component)

Task 8. Fixed Income – Legislative work/Dissemination

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **CLC and IBS-CG to draft and promote new legislation**	• NOTHING DONE THIS QUARTER
• **Assist PFTS and SSMSC with listing and disclosure**	• CONSULTATIONS HELD RE: LISTING OF COVERED BOND PILOT
• **Collaborate with MOF, SSMSC, PFTS etc to learn and benefit from pilot experience**	• CONSULTATIONS HELD RE: LISTING OF COVERED BOND PILOT
• **Regional workshops**	• ATCI CONDUCTS WORKSHOP FOR SSMSC ON MORTGAGE BONDS
• **Prepare best practices, distribute with AUC**	• (SEE MUNICIPAL COMPONENT)

Task 9: Develop Pooled Municipal Fianance Facility (See Municipal Finance Component)

ATTACHMENTS: NONE

D. MUNICIPAL

I. COMPONENT DESCRIPTION

This Report provides details on the events and activities relating to the Municipal Component of the USAID Access to Credit Initiative, as implemented by The Pragma Corporation, during the period from October 1 through December 31, 2006.

The municipal finance program of the Access to Credit Initiative helps cities and communal service enterprises issue long-term bonds for essential infrastructure. The program is also in train to promote the development of a municipal finance facility in Ukraine.

Technical assistance from the program's team of Ukrainian and international experts in finance, accounting, and law will enable at least three municipalities or communal enterprises to issue bonds. The pilot bonds will demonstrate practices that creditworthy issuers employ to win investor confidence, such as transparent accounts, full disclosure, and financing capital projects that "pay for themselves" with cost savings.

Pilot bonds will disclose legal and regulatory obstacles to bond issuance. The bond program will develop solutions and advocate for their enactment. Legal goals include promotion of stable, predictable central government transfers to municipalities, greater fiscal autonomy for cities, and full-cost recovery tariffs for utility companies.

Key counterpart organizations supporting the bond program are the Association of Ukrainian Cities and the Ministry of Construction, Architecture and Housing and Communal Economy.

II. SIGNIFICANT EVENTS AND ACHIEVEMENTS

- SLIDE PRESENTATION GIVEN TO DEPUTY CONSTRUCTION MINISTER GRIGORY SEMCHUK ON *STRATEGIC AND OPERATIONAL OPTIONS FOR A UKRAINIAN MUNICIPAL FINANCE FACILITY* .

- MISSION DIRECTOR EARL GAST ATTENDS SIGNING CEREMONY FOR PROTOCOL OF INTENTION WITH THE CITY OF LUGANSK ON BOND ISSUANCE.

- SLIDE PRESENTATION ON *STRATEGIC AND OPERATIONAL OPTIONS FOR A UKRAINIAN MUNICIPAL FINANCE FACILITY* GIVEN TO DEPUTY FINANCE MINISTER KRAVETS, DEPUTY CONSTRUCTION MINISTER GRIGORY SEMCHUK, AND REPRESENTATIVES OF BANKS AND CITIES.

- MEETING WITH LVIV MAYOR SADOVIY; COMMENCED ASSISTANCE TO LVIV WITH BOND ISSUANCE.

- PRESENTATION ON MUNICIPAL FINANCE FACILITY GIVEN TO COMMUNAL ENTERPRISE CONGRESS CHAIRED BY DEPUTY MINISTER OF CONSTRUCTION SEMCHUK.

- STANDARD AND POOR'S COMPLETES CREDIT RATING OF LUGANSK.

- CITY OF BERDYANSK SUBMITS ITS APPLICATION FOR BORROWING APPROVAL TO THE MINISTRY OF FINANCE.

III. EXECUTIVE SUMMARY

Development of a municipal finance facility (bond bank) continued during the quarter. Dr. John E. Petersen visited Ukraine to assist with a two-hour presentation in the Ministry of Finance Conference room (*see Attachment 5)*. Attending were Dep. Finance Minister Kravets, Dep. Construction Minister Semchuk, Association of Cities Director Pittsyk; Director of MinFin Office of Public Debt V. Vysotskyi; and commercial bank representatives. Also invited were Dep. Finance Minister Makatsariya and First. Dep. Economy Minister Maksiuta.

Separately, we presented the concept to Dep. Construction Minister Semchuk alone in a two-hour meeting.

ATCI helped the City of Berdyansk prepare and submit its application for borrowing approval to the Ministry of Finance in late December. The application proposes an innovative credit enhancement structure that uses put options.

Mission Director Earl Gast attending a signing ceremony with Lugansk Mayor Kravchuk in November, marking the formal beginning of ATCI's collaboration with Lugansk on a proposed

UAH 30M bond. We concluded a contract with Standard and Poor's for completion of a credit rating of the City of Lugansk and they delivered the rating (B on the international scale) in late December. We completed the Lugansk Bond Capacity Assessment. Lugansk will be our third pilot bond city.

We began assisting Lviv with its first bond issue, proposed to be UAH 100 million with an IFC guarantee of some portion of the borrowing. We will provide less intensive assistance to Lviv, as we phase out our pilot bond activity. During the quarter, we helped the city prepare data for credit rating, to be prepared by Standard and Poor's.

We participated in two more meetings of the Ministry of Finance's working group on the proposed Law on Local Borrowings and Local Guarantees, chaired by Deputy Minister of Finance Yefimenko. The group produced recommended amendments to the Budget Code instead of a stand-alone comprehensive Law on Local Borrowing. Relatively few of ATCI's recommendations were included in the Ministry's proposed amendments. The amendments were circulating for comment from other ministries at the end of the quarter.

Michel Noel of The World Bank/Washington met with us in Kyiv re: legal framework for local borrowing.

Discussed IFC investment in municipal finance facilities with Mr. Vincent Gouarne, Acting Director, IFC Subsovereign Development Fund (Washington) and Ms. Elena Bourgainskaia, Vice President for Infrastructure Finance, IFC/Moscow. November 8, 2006.

We made several contacts with Deputy Construction Minister Semchuk to seek a presentation appointment for Minister Rybak (who also is vice prime minister). Mr. Semchuk chaired the annual Communal Enterprise Congress, where we made a presentation about the MFF concept.

Plan of Action

1. Present the Municipal Finance Facility concept to key officials in the new government.
2. Identify a senior official who can serve as champion to promote establishment of a municipal finance facility.
3. Track Berdyansk's application to MinFin for borrowing approval. When approval is granted, help the city select an underwriter and register with SSMSC.
4. Assist the City of Lugansk with application to MinFin for borrowing approval.
5. Assist Lviv with negotiations with IFC and preparation of MinFin application for borrowing approval.
6. Collaborate with the World Bank on legal reforms when WB releases its new report on the subject in January.
7. Develop strategy for future municipal finance activities, depending on response from the State on creation of a municipal finance facility.

IV. ADMINISTRATIVE ISSUES

1. ATCI continued recruiting for a Fixed Income Advisor.

2. Senior Advisor Richard Genz will resign from ATCI on March 1, 2007

V. DESCRIPTION AND STATUS OF TASKS

Task 1. Municipal Finance – Constraints to Bond issuance

Defined Activity	PROGRESS MADE DURING QUARTER/PROPOSED FUTURE ACTIONS
• **Monitor GOU intergov't finance practices for credit risks**	NO ACTIVITY ON THIS ISSUE.
• **Participate in Drafting on Law on Local Borrowing**	PARTICIPATED IN FOUR MEETINGS OF THE MINISTRY OF FINANCE WORKING GROUP TO DRAFT A LAW ON LOCAL BORROWINGS AND LOCAL GUARANTEES. COLLABORATED WITH WORLD BANK CONSULTANT ON EVALUATION OF LEGAL FRAMEWORK FOR LOCAL BORROWING.

Task 2. Municipal Finance – Prepare for a Pilot Issue

Defined Activity	PROGRESS MADE DURING QUARTER/PROPOSED FUTURE ACTIONS
• **Initiation of pilot**	SIGNED PROTOCOL OF INTENTION WITH LUGANSK MAYOR. BEGAN COLLABORATION WITH LVIV ON ITS FIRST BOND. COMPLETED LUGANSK BOND CAPACITY ASSESSMENT AND SECURED CREDIT RATING FROM STANDARD AND POORS.. SUBMITTED BERDYANSK APPLICATION TO MINISTRY OF FINANCE.

Task 3. Municipal Finance – Issuance and Municipal Finance Facility Development

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Implementation**	PRESENTATION OF STRATEGIC AND OPERATIONAL OPTIONS FOR CREATING MFF, FOR DEP. FINANCE MINISTER KRAVCHUK; DEP. CONST. MINISTER SEMCHUK; DIRECTOR OF ASS'N OF CITIES PITTSYK; AND BANK REPRESENTATIVES.

Task 4. Municipal Issuance – Legislation and Dissemination

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Workshops and public education**	PRESENTATION TO ANNUAL COMMUNAL ENTERPRISE CONGRESS AND DEP. CONSTRUCTION MINISTER SEMCHUK RE: MUNICIPAL FINANCE FACILITY. EXHIBIT ON MUNICIPAL FINANCE AT ANNUAL MEETING OF ASSOCIATION OF UKRAINIAN CITIES.

LIST OF ATTACHMENTS

ATTACHMENT 5 Presentation on Strategic Options for Creating a Municipal Finance Facility for (former) Dep. Finance Minister Kravets and Dep. Const. Minister Semchuk. Ministry of Finance Conference Room, October 26, 2006.

E. LEASING

I. COMPONENT DESCRIPTION

This report details events and activities relating to the Leasing Component of the USAID Access to Credit Initiative, implemented by the Pragma Corporation, during the period from July 1 through September 30, 2006.

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

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

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

ATCI will continue to promote reform of the legislative and regulatory framework for leasing to facilitate industry development and entry of foreign capital into the market.

II. SIGNIFICANT EVENTS

- COMPLETED ARRANGEMENTS FOR A LICENSE AGREEMENT WITH THE US CERTIFIED LEASING PROFESSIONAL FOUNDATION ("CLPF"), ALLOWING ATCI TO USE CLPF'S LOGO AND MATERIALS. IN ADDITION CLPF IS A CO-ISSUER, ALONG WITH UKRLEASING, OF THE CLS CERTIFICATES. THE LICENSE WILL BE TRANSFERRED TO THE UKRAINE SOCIETY OF CERTIFIED LEASING SPECIALISTS ("USCLS") ONCE IT IS ESTABLISHED. USCLS WILL THEN HAVE OVERLL RESPONSIBILITY FOR ADMINISTERING ALL ASPECTS OF THE CLS PROGRAM.

- AWARDED CERTIFIED LEASING SPECIALIST ("CLS") CERTIFICATES TO 26 INDIVIDUALS WHO PASSED ALL 3 CLS EXAMS. AWARDS WERE GIVEN OUT JOINTLY, BY THE USAID MISSION DIRECTOR AND THE PRESIDENT OF UKRLEASING.

- HELD A 1 DAY SEMINAR FOR THE UKRAINE LEASING INDUSTRY, FOR THE PURPOSE OF INTRODUCING THEM TO THE TRAINING PROVIDORS, WHO WILL BE OFFERING TRAINING TO ADDITIONAL CANDIDATES FOR THE CLS CERTIFICATE.

- TRAVELED TO DUBAI, WITH THE PRESIDENT, UKRAINE COUNTRY DIRECTOR AND CHIEF FINANCIAL OFFICER OF AMACO, FOR THE PURPOSE OF MEETING WITH THE CHIEF FINANCIAL OFFICER OF AMACO'S PARENT COMPANY, REGARDING AMACO FINANCE. RECEIVED ASSURANCES FROM THE HEAD OF THE PARENT COMPANY OF THEIR COMPANY'S INTENT TO PROVIDE INITIAL EQUITY CAPITALIZATION OF AMACO FINANCE.

- ASSISTED LEASEIT IN OBTAINING AN ADDITIONAL SOURCE OF DEBT CAPITAL, NECESSARY TO FUND THEIR LEASES OF SMALL IT EQUIPMENT. ADDITIONALLY, ALL OF LEASEIT'S EXISTING FUNDING SOURCES HAVE RAISED THEIR BORROWING LIMITS. SINCE BECOMING OPERATIONAL IN OCTOBER, 2005, LEASEIT'S OUTSTANDING PORTFOLIO HAS GROWN TO $570,000.00, AS OF 12/31/06. MUCH OF LEASEIT'S FUNDING HAS COME AS A RESULT OF ASSISTANCE FROM ATCI.

- RHOMANS TRAVELED TO MOLDOVA AND MET WITH 6 MAJOR LESSORS SERVING THE MOLDOVAN MARKET, AND IDENTIFIED SEVERAL POTENTIAL ADVISORY OPPORTUNITIES. DEVELOPED INITIAL PLANS TO EXPAND THE CLS PROGRAM TO MOLDOVA. MET WITH REPRESENTATIVES FROM THE COMPETITIVENESS ENTERPRISE ENHANCEMENT PROJECT ("CEED"), FOR THE PURPOSES OF COORDINATING ASSISTANCE TO MOLDOVAN LESSORS, AS WELL AS TO ASK THEIR ASSISTANCE IN STARTING UP A MOLDOVAN LEASING ASSOCIATION.

- REACHED A PRELIMINARY AGREEMENT WITH LEASEUROPE, TO BE A CO-SPONSOR OF A REGIONAL CONFERENCE TO BE HELD IN KYIV ON MARCH 26 & 27, 2007. THE CONFERENCE WILL BE HOSTED BY THE UNION OF UKRAINIAN LESSORS ("UUL") WHICH HAS RECEIVED SIGNIFICANT ASSISTANCE FROM ATCI AND, WITH ATCI'S ASSISTANCE, JOINED LEASEUROPE IN 2006. THIS CONFERENCE WILL BE THE FIRST MAJOR INTERNATIONAL LEASING CONFERENCE EVER TO BE HELD IN UKRAINE.

- ASSISTED THE CITIZENS NETWORK FOR FOREIGN AFFAIRS ("CNFA") WITH PLANS AND SCOPES OF WORK FOR 2 ADDITIONAL VOLUNTEER POSITIONS IN 2007. VOLUNTEERS WILL WORK WITH LEASING HOUSE, WHICH ALSO HOSTED VOLUNTEERS IN 2006, AND LEASING COMPANY UNIVERSALNA, A BANK-OWNED LEASING COMPANY.

III. EXECUTIVE SUMMARY

In this Quarter, ATCI concluded a license agreement with the US Certified Leasing Professional Foundation ("CLPF"). The license agreement will allow ATCI to use CLPF's logo and other materials in the CLS Program. In addition, CLPF is a co-issuer, along with UKRLEASING, of the CLS Certificates. The license will be transferred to the Ukrainian Society of Certified Leasing Specialists ("USCLS") once USCLS is duly organized.

Certified Leasing Specialist (CLS) Certificates were awarded to 26 individuals, including several who will serve as trainers for subsequent CLS candidates, continued capacity building work with AMACO and LeaseIT, began advisory work in Moldova along with beginning the planning process to expand the CLS Program to Moldova as well as making arrangements to assist the Moldovan Leasing Industry in the formation of a Leasing Association.

The recipients of the first CLS certificates included 11 individuals from the Leasing Industry including several Senior Officers of local leasing companies, 11 individuals from related industries in finance and consulting, including several who will serve as trainers in subsequent CLS training sessions, and 4 individuals from the IFC Leasing Project. The certificates were awarded jointly, by the USAID Mission Director and the President of UKRLEASING. (The Media Notice, Scene-Setter and list of Awardees are included in *(See attachment 6)*.

In addition to the awarding of the CLS Certificates ATCI hosted a one day seminar for the Ukraine Leasing Industry, with the purpose being to introduce industry participants to the training providers who will be responsible for giving training sessions to future CLS candidates.

At the seminar industry participants were able to meet with training providers and to find out more about their services, preliminary schedule of training sessions, etc. Subsequent training sessions are scheduled to begin in late January, 2007.

Advisory services consisted of working directly with AMACO and LeaseIT, to obtain initial equity capitalization of AMACO Finance and additional equity and debt capitalization for LeaseIT, respectively. In addition, ATCI assisted CNFA in the planning for 2 new volunteer positions, to be filled in the 1st and 2nd Quarters of 2007.

With respect to AMACO, in early December ATCI accompanied AMACO's President, Ukraine Country Director and Chief Financial Officer to Dubai, for the purpose of meeting with the CFO of AMACO's parent company, the Alkhorayef Group of Saudi Arabia ("Alkhorayef"). It is expected that Alkhorayef will be provide the initial equity capitalization for AMACO Finance. The result of the meeting was continued interest by Alkhorayef in providing the equity financing. In this regard Alkhorayef requested that AMACO update the business plan prepared by ATCI last May (see the 7th Quarterly Report), as it is now more than 6 months old. It is expected that the updated Plan will be ready the end of January. Subsequent to this meeting AMACO's team met directly with Saad Alkhorayef, President and CEO of Akhorayef. Mr. Alkhorayef asked AMACO to tell ATCI that Alkhorayef was "committed to the startup of AMACO Finance."

With ATCI's assistance LeaseIT entered into an additional revolving credit facility with TransBank, with a maximum availability of UAH500,000.00. In addition, during this Quarter LeaseIT made a substantial reduction, of UAH200,000.00, on its existing revolving line with VABank (see 8th Quarterly Report).

As of December 31, 2006, LeaseIT's total availability, under its existing revolving credit lines, was approximately UAH 3 million. As of the same date their portfolio size was approximately UAH 3.1 million.

In spite of being able to obtain additional sources of funding, and expanding the availability of existing sources, LeaseIT is having difficulties accommodating demand for its service. In this regard, with ATCI's assistance, LeaseIT has begun discussions with Kazimir Partners, a US private equity fund with approximately $500 million under management. It is hoped that additional equity capitalization will allow LeaseIT to expand sources of funding at a faster rate. Kazimir has expressed interest in investing in LeaseIT, subject to obtaining additional information which ATCI is assisting in helping LeaseIT provide. It is hoped that LeaseIT will obtain at least a Letter of Intent during the 1st Quarter of 2007.

In early December ATCI visited Moldova for the purpose of meeting with several Moldovan leasing companies, beginning the process of introducing the CLS Program to Moldova and meeting with the CEED Program, another USAID sponsored program who is presently working directly with 1 Moldovan lessor. The trip yielded several promising opportunities for additional advisory services, as well as substantial interest in the CLS Program. In addition, CEED has offered assistance in the formation of a Moldovan Leasing Association, which is a necessary condition to expansion of the CLS Program as well as for the Moldovan Leasing Community to joining LeasEurope. ATCI's office in Moldova has been able to hire a leasing expert with substantial industry experience. This individual was extremely helpful during the trip, and continues to be of substantial assistance. (The trip report for Moldova is included as *Attachment* 7).

In December, ATCI met with representatives of LeasEurope, in connection with ATCI's possible involvement in a regional conference scheduled to be held in Kyiv on March 26 & 27, 2007, the first major international leasing conference ever to be held in Ukraine. The Union of Ukrainian Lessors ("UUL") will be hosting this conference. ATCI provided valuable assistance to UUL, in its effort to be accredited by LeasEurope (see the 7th Quarterly Report).

ATCI and LeasEurope agreed that ATCI will be a co-sponsor of the conference. In return ATCI will be able to have a booth at the conference, which it intends to use to promote the CLS Program. Furthermore, LeasEurope has tentatively agreed to include 2 items of interest to ATCI in the conference agenda, including ideas to increase the leased volume of capital equipment. LeasEurope has also tentatively agreed to invite a delegation of lessors from Moldova, even though there is currently no Moldovan Leasing Association (LeasEurope is made up of national leasing associations, as opposed to individual lessors). ATCI expects final arrangements concerning its sponsorship to be completed in January, 2007.

In December, ATCI met with CNFA to plan 2 additional volunteer positions for 2007. Hosts for both positions will be Leasing House and Leasing Company Universalna, both in Lv'iv. The first volunteer will concentrate in marketing and product development. The SOW for this position is already posted on CNFA's web site. The 2nd position will follow on the first, and will emphasize sales strategies including, hopefully, the use of Universalna's bank branch network for generating leasing volume. It is believed that this will facilitate increased leasing volume, especially agricultural leases. In this regard, at ATCI's recommendation, the SOW for the 2nd position is currently being revised. ATCI has been of additional assistance in helping CNFA identify volunteer candidates, by introducing it to several places in the US where they may find such candidates, including "ListServ" used by members of the National Association of Equipment Lease Brokers ("NAELB").

IV. ADMINISTRATIVE ISSUES

On November 7, 2006, Robert Homans succeeded Richard Caproni as Head of the Leasing Component of ATCI.

As part of the establishment of the CLS Program, ATCI is registering a Ukrainian NGO, to be called the Ukraine Society of Certified Leasing Specialists ("USCLS"). Since November ATCI has experienced consistent problems with the City of Kyiv Ministry of Justice in obtaining proper certification. This, in spite of the fact that the procedure ATCI has followed was identical to the procedure followed by CIPA, in the registration of the Ukrainian NGO that now administered the CIPA Project. A way must be found to legally facilitate proper certification of USCLS with the City of Kyiv Ministry of Justice.

V. DESCRIPTION AND STATUS OF TASKS

Task 1. Financial Leasing – Building Participant Capacity

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Development of CLP Program for Ukraine**	▪ COMPLETED LICENSE AGREEMENT WITH CLPF. ▪ AWARDED CLS CERTIFICATES TO 26 INDIVIDUALS, INCLUDING SEVERAL WHO WILL SERVE AS TRAINERS FOR SUBSEQUENT CLS CANDIDATES.
• **Develop and deliver training seminars for industry participants**	▪ HOSTED 1 DAY SEMINAR FOR THE PURPOSE OF INTRODUCING THE CLS TRAINING PROVIDERS TO INDUSTRY PARTICIPANTS.
• **Development of CLS Program in Moldova**	▪ MET WITH INDUSTRY PARTICIPANTS TO GUAGE THE POTENTIAL INTEREST FOR A CLS PROGRAM IN MOLDOVA ▪ IDENTIFIED 2 POSSIBLE TRAINING PROVIDORS ▪ MET WITH THE "CEED" PROJECT (USAID/CHEMONICS) FOR THE PURPOSE OF OBTAINING THEIR ASSISTANCE IN CREATING A MOLDOVAN LEASING ASSOCIATION

Task 2. Financial Leasing – Information Network

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Work with key industry stakeholders to agree upon necessary reforms to create a favorable legal, tax and regulatory environment for leasing in Ukraine**	• ATCI SUBMITTED SEVERAL RECOMMENDATIONS TO THE MINISTRY OF FINANCE ON IMPROVING THE TAX TREATMENT OF LEASES. • ATCI CONTINUES TO WORK DIRECTLY WITH VARIOUS INDUSTRY STAKEHOLDERS TO RAISE THE PROFILE OF LEASING AMONG RELEVANT GOVERNMENT OFFICIALS AND IMPLEMENT REFORMS TO IMPROVE THE LEGAL AND TAX ENVIRONMENT FOR LEASING IN UKRAINE.
• **Conduct nation-wide informational and educational campaign on international best practice in leasing**	• MET WITH LEASEUROPE FOR THE PURPOSE OF ARRANGING CO-SPONSORSHIP OF A REGIONAL LEASING CONFERENCE TO BE HELD IN KYIV IN MARCH, 2007 • ATCI WILL CONTINUE TO WORK WITH INDUSTRY ASSOCIATIONS AND OTHER RELEVANT PARTIES TO ORGANIZE EVENTS AND DISTRIBUTE INFORMATION THAT RAISES THE PROFILE AND INCREASE UNDERSTANDING OF LEASING AND ITS BENEFITS WITHIN UKRAINE'S GOVERNMENT AND BUSINESS COMMUNITIES.

Task 3. Financial Leasing - Consulting Services

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Provide advisory services to market participants**	▪ ACCOMPANIED SENIOR OFFICERS OF AMACO TO DUBAI, TO MEET WITH ITS PARENT COMPANY, FOR THE PURPOSE OF OBTAINING INITIAL EQUITY CAPITALIZATION FOR AMACO FINANCE; ▪ ASSISTED LEASEIT IN OBTAINING APPROXIMATELY UAH 500,000 IN ADDITIONAL BORROWING CAPACITY; ▪ INTRODUCED LEASEIT TO KAZIMIR PARTNERS, A POTENTIAL EQUITY INVESTOR; ▪ TRAVELED TO MOLDOVA AND MET WITH SEVERAL MOLDOVAN LESSORS, AND IDENTIFIED SEVERAL POTENTIAL ADVISORY OPPORTUNITIES; ▪ ASSISTED CNFA IN THE PLANNING AND HOSTING OF 2 NEW VOLUNTEERS, SPECIALIZING IN MARKETING & PRODUCT DEVELOPMENT AND SELLING STRATEGY; ▪ ATCI WILL CONTINUE TO FACILITATE RELATIONSHIPS BETWEEN LESSORS, BANKS, EQUITY INVESTORS, AND VENDORS TO FACILITATE INCREASED LEASING ACTIVITY BASED ON INTERNATIONAL BEST PRACTICE.

LIST OF ATTACHMENTS

ATTACHMENT 6 Press Notice, Scene Setter and list of Awardees for the CLS Award Ceremony

ATTACHMENT 7 Report for the trip to Moldova

F. CREDIT BUREAU/CREDIT RATING AGENCY

I. COMPONENT DESCRIPTION

Credit Bureau

This report provides details on events and activities relating to the Credit Bureau component of the USAID Access to Credit Initiative, as implemented by the Pragma Corporation, during the period from October 1, 2006 through December 31, 2006. Additionally, the component includes the development of domestic credit ratings.

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

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

Development of domestic rating capacity in Ukraine is predicated on having a regulatory basis that fosters competition and independence and embodies world standards of practice.

II. SIGNIFICANT EVENTS

- MINISTRY OF JUSTICE OF UKRAINE ADOPTS LICENSING REGULATION FOR CREDIT BUREAUS
- ATCI HOLDS A SEMINAR ON MORTGAGE BONDS AND CREDIT BUREAU ISSUES FOR SPECIALISTS FROM CENTRAL AND REGIONAL OFFICES OF SSMSC.
- IBCH CONDUCTS A TEST SALE OF CREDIT REPORT

III. EXECUTIVE SUMMARY

ATCI continued to provide on-going consultancy to ensure compliance with international standards of best practice during the development phase of a credit reporting system, and to provide advice to the overall market with respect to data sharing and the reduction of data fragmentation.

ATCI's area of focus remained in two basic areas: a) overall coordination of the market given the likelihood of data fragmentation and b) drafting regulations.

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

ATCI continues to interface on a regular basis with FNBCH and other interested parties, including foreign credit bureau operators. Major highlights and accomplishments over the past quarter follow.

Continued assistance to FNBCH and Creditinfo

In the 4th quarter 2006, both FNBCH and Creditinfo/IBCH continued to request ATCI assistance for a) educating market participants, and b) providing support to the credit bureau regulatory authorities with respect to draft regulations, the meaning of data exchange and the need to find a balance between privacy and data flows. ATCI supported our counterparts in the following areas:

- Work at the legal and regulatory levels
- Work with banks and other financial institutions.
- Work with non-financial institutions to secure their participation in data sharing.

Ministry of Justice of Ukraine Adopts Licensing Requirements for Credit Bureaus

As indicated in previous quarterly reports, the Cabinet of Ministers of Ukraine issued a Resolution assigning the Ministry of Justice of Ukraine to serve as the authorized body responsible for licensing and regulation of credit bureau operations. Pursuant to the Ukrainian Credit Bureau Law, the authorized body was mandated to draft the regulations governing licensing requirements and other rules for credit bureau operations in Ukraine.

ATCI, FNBCH, IBCH/Creditinfo, MOJ, and State Committee for Entrepreneurship jointly drafted and agreed on a draft licensing regulation. On December 27, 2006, the Ministry of Justice approved and registered the Regulation on Licensing Requirements for Ukrainian credit bureaus. However, this Regulation differed from jointly agreed draft and included the provision mandating credit bureaus to have a comprehensive data protection system envisaged by the Law of Ukraine "On Protection of Information in Information and Telecommunication Systems". Except for this specific provision, licensing requirements are considered by market participants to be very business friendly. But the provision regarding comprehensive data protection system poses a serious danger for Ukrainian credit bureaus. Credit bureaus can obtain a license simply based on the submission of documents stipulated by the law (document confirming the paid-up charter capital, credit bureau bylaws, etc.). However, following the receipt of a license, they must comply with licensing requirements and having a comprehensive data protection system is the integral part of licensing requirements. Currently, none of credit bureaus have this comprehensive system, and according to experts, it might take up to three years to fully develop such a system. Therefore, any complaint from any interested party regarding inadequate data protection could potentially lead to withdrawal of a license.

ATCI and market participants fully recognize this danger and have "pressed" the Ministry of Justice to address this issue and find a reasonable compromise. Resolution of this issue is expected in January 2007 since according to the law by January 27, 2007 Ukrainian credit bureaus must have received a license. After that date, any data processing operations without a license will be illegal.

Seminar on Mortgage Bonds and Credit Bureau Issues for Specialists from Central and Regional Offices of SSMSC.

On November 16, 2006, ATCI organized and conducted a seminar for specialists from the central and regional offices of the SSMSC. Part of this seminar was dedicated to describing how credit bureaus function as an important mechanism for reducing credit risk and facilitating mortgage lending. Credit bureau issues turned out to be of great interest for SSMSC specialists, especially in light of continuing significant growth of mortgage lending transactions and the expected licensing of existing Ukrainian credit bureaus.

IBCH/CreditInfo Conducts a Test Sale of the First Credit Report

Preparing for the start up of actual operations, on November 7, 2007, IBCH/CreditInfo conducted a test sale of the first credit report with press in attendance. The test sale was designed to show the market the credit bureaus are moving forward towards commercial operation.

Credit Rating

ATCI Credit Rating component is aimed at promoting the development of competitive, fair, and effective credit rating industry in Ukraine.

Ukraine faces great challenges in fostering further development of capital markets that enable efficient mobilization of domestic and foreign capital to support sustainable economic growth. Credit ratings offer significant benefits for investors. It is true that ratings do not constitute investment or financial advice. Ratings are not recommendations to purchase, sell, or hold particular securities. However, ratings do serve as an important tool for the adoption of sound and informed investment decisions.

Ratings represent additional information content and quality framework for the market. They facilitate investor comparison and selection of investment alternatives. A rating agency, with its fundamental approach and access to information, provides ratings that validly compare and contrast the strengths of different organizations and represent opinions regarding relative future creditworthiness of entities or instruments.

Being at a nascent stage, Ukrainian rating industry has a long way to go, and ATCI objective is to make sure that it goes the right way. To achieve this objective and in active cooperation with market participants and government agencies ATCI focuses its efforts on establishing policy dialogue aimed at both the development of fair and effective regulatory framework and implementation of best international practice on operational level.

IV. SIGNIFICANT EVENTS

- SSMSC ADOPTS RESOLUTION #1040 "ON APPROVING THE REGULATION ON TENDER FOR SELECTION OF AUTHORIZED RATING AGENCIES"
- WHITE PAPER IS COMPLETED AND DISTRIBUTED

Brief Historic Note

The mandatory rating requirement came into existence in late 2004. This required those companies wanting to issue ratings in Ukraine to be selected by tender conducted by the SSMSC. One key requirement was that the rating company be a Ukrainian legal entity. This rationed participants to only a few and kept the internationally recognized rating agencies out all together. Only Credit Rating received authority from the SSMSC to offer ratings to Ukrainian issuers. Effectively, any company or municipality who wanted to issue securities had to use them. The mandatory requirement remains in effect to this day and accounts for the exceptional growth of CR.

The Current Situation

Adoption of the Law of Ukraine # 3201 dated Dec. 15, 2005 expands and legislates mandatory ratings. This Law specifies the issuers and types of securities[1] subject to mandatory rating. In response to Law #3201, the SSMSC developed and adopted the resolution that allows Ukrainian companies to use Fitch, Moody`s and Standard & Poor's ratings for the domestic market. In other words, these three international rating agencies are allowed by the law to assign ratings (still mandatory) to Ukrainian issuers and their securities.

Pursuant to the Law # 3201 mandatory ratings can be assigned by:

Authorized Ukrainian rating agencies certified by the SSMSC;
International rating agencies recognized by the SSMSC

Additionally,

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[1] All types of issuable securities (which are not allocated among the founders or among the preliminary determined persons) are subject to mandatory rating, except the following types of securities: *government securities, shares, securities of non-diversified joint investment institutions, securities issued by State Mortgage Institution*

The National scale approved by the Cabinet of Ministers must be used only by authorized Ukrainian rating agencies;
International rating agencies can use their own scales.

Consequently, under legal provisions of the law #3201 Ukrainian companies, banks and municipalities are free to choose between international rating agencies and Ukrainian authorized rating agencies. However, in practice this can be problematic. In certain cases (specifically with regard to securities that can be purchased by insurance companies and pension funds, and with regard to banks in which they can deposit their funds) the law says that the assigned ratings must match the investment level under the national scale approved by the Cabinet of Ministers of Ukraine. At the same time it is unclear from the law how the ratings assigned by international rating agencies or the national scale for Ukraine developed by international rating agencies can be matched to the national scale approved by the Cabinet of Ministers of Ukraine. Therefore, although the law #3201 does not include direct prohibitions[2] for international rating agencies, practical value of their ratings in the above mentioned cases may lead to disputes.

On October 19, 2006, the SSMSC adopted the Resolution #1040 "On Approving the Regulation on Tender for Selection of Authorized Rating Agencies" (registered by the Ministry of Justice as of November 245, 2006). Pursuant to the above regulation the applying company must meet the following requirements (below is an extract from the Regulation related to eligibility requirements):

"**Section IV". Procedure and Conditions for Participation in Tender**

1. .To be eligible to take part in the tender, a bidder shall confirm its intention to participate in the tender in writing, submit tender documents and meet the following criteria:

- Is a Ukrainian Resident.

- Provides professional services and directly assigns credit ratings or provides information and analytical services related to the assignment of ratings;

- Uses the National Scale when assigning mandatory ratings;

- Has an official web-page with free access for users;

- Has at least 1 year operational experience on the assignment of ratings and the list of ratings assigned to domestic businesses and duly publicized;

- Has charter capital totaling at least 2 500 minimal wages. At least 50% of charter capital must be paid in cash;

- Does not have among the associated persons (in the meaning specified in clause 5 of the Procedure for Provision by Authorized Rating Agencies of Information to the SSMSC, approved

[2] The only directly discriminative provision of the law is related to the purchase of securities by pension funds. Pension funds can buy securities only if both the securities and the issuer of such securities have been rated. Based on the wording of the law, in this case securities can be rated by either Authorized Rating Agency or international rating agency, but the issuer must be rated only by the Authorized Rating Agency.

by Resolution of the SSMSC dated September 19, 2006, N 855 and registered in the Ministry of Justice as of October 13, 2006, N 1112/12986) the persons associated with financial market participants and does not assign ratings to such associated persons".

The tender for selection of authorized rating agencies was scheduled to take place on Jan. 22 through Feb. 2, 2007.

The above mentioned Regulation softened all previously proposed eligibility requirements. Nevertheless, it is still severely criticized by the market (mostly with respect to the provisions on charter capital requirements and associated persons).

Draft Law of Ukraine "On Rating System"

The SSMSC developed the Draft Law of Ukraine "On Rating System". Originally SSMSC drafting efforts provoked a lot of criticism on the part of the market and later market participants were included into the task force group responsible for the development of this Draft Law. As viewed by the market participants, the final wording of the Draft Law is "more or less acceptable". It opens certain opportunities for competition and specifies "softer" elegibility requirements for Authorized Rating Agencies (at this stage eligibility requirements in the Draft Law differ from those specified in SSMSC Draft Regulation #236). However, this Draft Law does not invalidate mandatory ratings. Clause 1.3. of Article 4 (Principles of Rating System) of the Draft Law stipulates that "Ratings are voluntary unless otherwise directly stipulated by the law" and Article 11 of the Draft Law spells out the cases for mandatory rating assessment. At this stage, the market is interested in this Draft Law but the SSMCS is not pushing for its adoption focusing, instead, its efforts on regulations that support currently acting legislation. During the period, neither the SSMSC nor Cabinet of Ministers made any effort to push for the adoption of the above Draft Law.

ATCI Efforts Aimed at Improving the Status of Credit Rating Industry

To promote the development of an effective credit rating industry in Ukraine, ATCI engaged Michael McMullen, international credit ratings expert, to prepare a White Paper on the status of rating industry in Ukraine, as well as recommendations aimed at improving market situation. Mr. McMullent spent twenty years with MOODY'S INVESTORS SERVICE and participated in a wide range of assignments and projects for banks, financial institutions, and NGOs, such as USAID, World Bank, Thomson BankWatch. After a series of meetings with market participants, regulators and other interested parties, as well as with assistance of local ATCI advisors, Mr. McMullen finalized the final version of the White Paper and submitted it to ATCI. The paper was distributed to all interested parties (SSMSC, market participants, donor funded projects, etc.) at the end of November 2006. The White Paper recommends abandoning the practice of mandatory rating and the national scale approved by the Government. Other key recommendations include the following:

- Regulation of markets does not mean control of markets. That is, laws and regulations must ensure market participants have access to adequate and accurate information, providing penalties where this fails.
- The most important rating is that assigned by the investor in his decision process.
- Mandatory ratings of uncertain quality are of limited use to the investor.
- Mandatory ratings force issuers to seek financing alternatives that may be less efficient and ultimately more costly.

- The market - investors and issuers - should determine who gets to do rating business.
- It requires time and education for a rating agency to become effective. If its capacity is sufficient, it will get the investors' business and demand-pull creation will ensue
- In accordance with best practice, ratings should be voluntary, and entry to the business open.

Conclusion: Mandated ratings, whether monopoly or not, and prescribed requirements for quality that do not incorporate the process and standards of international best practice will not protect savers and investors. *(See attachment 8).*

V. ADMINISTRATIVE MATTERS

NONE

VI. DESCRIPTION AND STATUS OF TASKS

Defined Activity	PROGRESS MADE DURING QUARTER/PROPOSED FUTURE ACTIONS
• **Develop and establish linkages with primary international credit bureau operators**	• COMPLETED - CREDITINFO WINS FNBCH TENDER
• **Secure buy-in of local data providers and users**	• MARKET REMAINS SPLIT – DATA FRAGMENTATION CONTINUES AS FOUR CREDIT BUREAUS HAVE BEEN ESTABLISHED IN UKRAINE.
• **Sponsor visits to potential foreign CB partners**	• COMPLETED - FINANCIAL ASSISTANCE HAS NOT BEEN REQUESTED AND IS NO LONGER REQUIRED.
• **Determine and review CIC development strategy with government and counterparts**	• FNBCH REQUESTS FURTHER ATCI ASSISTANCE • CONTINUED DISCUSSIONS WITH AUB AND OTHER CIC REPRESENTATIVES FURTHER IMPLEMENTATION STRATEGY FOR THE DEVELOPMENT OF CB.
• **Market best approach for structuring, establishing and operating CIC**	• PUBLIC RELATIONS STRATEGY CONTINUED AND INCLUDED VISITS TO INDIVIDUAL MARKET PARTICIPANTS. • FNBCH AND ICB CONTINUE NEGOTIATIONS ON CONCLUSION OF AGREEMENTS WITH TELECOMMUNICATIONS AND INSURANCE SECTOR. • IBCH CONDUCTS A TEST SALE OF CREDIT REPORT
• **Analyse and Coordinate passage of law**	• MARKET PARTICIPANTS RECOGNIZE THE NEED FOR

	AMENDMENTS TO THE CREDIT BUREAU LAW. HOWEVER, GIVEN THE STATE OF MARKET DEVELOPMENT, IMMEDIATE AMENDMENTS ARE DEEMED PREMATURE.
• **Define Business and Operations Plan**	• COMPLETED
• **Outline Package of Technical Requirements**	• COMPLETED
• **Discussions with Government Data Providers**	• DIFFICULTY IN FINDING THE "PERSON" IN CHARGE OF PUBLIC REGISTRIES STILL CONTINUES

• **Secure Buy-in of Foreign Investors and Banks**	• CREDITINFO (ICELAND) IS NOW OPERATES A COMMON PLATFORM FOR THE TWO LARGEST BUREAUS.
• **Develop and Deliver Package of Training Programs (banks, leasing, credit unions)**	• AUB REQUESTS ATCI TO CARRY OUT A SERIES OF PRESENTATIONS FOR REGIONAL BANKS. THIS JOINT ACTIVITY, TO HAVE BEEN ORGANIZED BY AUB AND UNDERTAKEN JOINTLY WITH AUB, HAS BEEN POSTPONED UNTIL 2007.
• **Assist the Ministry of Justice in drafting regulations governing CB operations**	• THE MINISTRY OF JUSTICE REQUESTED ATCI ASSISTANCE IN DRAFTING REGULATIONS GOVERNING CREDIT BUREAU OPERATIONS. • TASK FORCE (ATCI, ICB, FNBCH, MINISTRY OF JUSTICE) FINALISES THE REGULATION ON LICENSING REQUIREMENTS.AND MINISTRY OF JUSTICE OF UKRAINE ADOPTS LICENSING REGULATION FOR CREDIT BUREAUS. • TASK FORCE AGREES TO DRAFT TWO MORE REGULATIONS: ON UNIFIED REGISTRY OF CREDIT BUREAUS, AND ON INSPECTION OF CREDIT BUREAUS.
• **Deliver educational workshops for the specialists of the Ministry of Justice**	• COMPLETED - ATCI HOLDS 2 MINI WORK SHOPS FOR THE SPECIALISTS FROM THE MINISTRY OF JUSTICE • MINISTRY OF JUSTICE EXPRESSED INTEREST IN FURTHER SEMINARS. ATCI WILL ASSESS JUSTICE RESPONSIVENESS TO DRAFT REGULATIONS PRIOR TO COMMITMENT
• **Discuss participation in international credit bureau conference to be held in Kyiv/Ukraine**	• COMPLETED - ATCI CO-SPONSORED AND PARTICIPATED IN INTERNATIONAL CREDIT BUREAU CONFERENCE.
• **Participation in international Conference "Payment Card – 2006"**	• COMPLETED - ATCI ATTENDED THIS CONFERENCE BUT DID NOT CO-SPONSOR IT OR MAKE ANY PRESENTATIONS.

CREDIT RATING COMPONENT	
• **Assist in the development of competitive and fair ratings industry**	• COMPLETED. ATCI ENGAGED INTERNATIONAL CREDIT RATINGS EXPERT TO PREPARE THE WHITE PAPER ON THE STATUS OF AND RECOMMENDATIONS FOR UKRAINIAN RATING INDUSTRY. • INTERNATIONAL CREDIT RATINGS EXPERT PREPARED A WHITE PAPER ON THE DEVELOPMENT OF A COMPETITIVE DOMESTIC RATINGS INDUSTRY IN UKRAINE AND RECOMMENDATIONS FOR THE UKRAINIAN RATING INDUSTRY. ATCI DISSEMINATED THE WHITE PAPER TO MARKET PARTICIPANTS, THE SECURITIES COMMISSION AND OTHER INTERESTED PARTIES..
• **Analyze existing Regulatory framework**	• ATCI CONTINUES TO ANALYSE AND MONITOR EXISTING LEGISLATION AND REGULATORY FRAMEWORK. • EXSITING LAWS AND REGULATIONS CONTAIN A NUMBER OF PROVISIONS, WHICH ARE DETRIMENTAL FOR FURTHER DEVELOPMENT OF FAIR AND COMPETITIVE RATINGS INDUSTRY • SSMSC ADOPTED THE RESOLUTION #1040 "ON APPROVING THE REGULATION ON TENDER FOR SELECTION OF AUTHORIZED RATING AGENCIES" (REGISTERED BY THE MINISTRY OF JUSTICE NOVEMBER 24, 2006). • TENDER FOR SELECTION OF AUTHORIZED RATING AGENCIES IS SCHEDULED TO TAKE PLACE ON JANUARY 27 THROUGH FEBRUARY 2, 2007. • SSMSC ADOPTED THE RESOLUTION "ON APPROVING THE PROCEDURE FOR KEEPING THE STATE REGISTRY OF AUTHORIZED RATING AGENCIES AND ISSUING THE CERTIFICATE ON INCLUSION TO THE STATE REGISTRY OF AUTHORIZED RATING AGENCIES". • "CREDIT RATING" IS INCLUDED INTO THE STATE REGISTRY OF AUTHORIZED RATING AGENCIES WITHOUT A TENDER. • SSMSC ADOPTED THE RESOLUTION "ON APPROVING THE PROCEDURE FOR SUBMISSION OF INFORMATION TO SSMSC BY AUTHORIZED RATING AGENCIES". • SSMSC ISSUED DRAFT RESOLUTION "ON APPROVING THE RULES FOR ASSIGNING RATINGS UNDER THE NATIONAL SCALE BY THE AUTHORIZED RATING AGENCIES". • SSMSC AND MARKET PARTICIPANTS DEVELOPED THE DRAFT LAW "ON RATING SYSTEM". THERE HAS BEEN NO PROGRESS SINCE ITS DEVELOPMENT.

LIST OF ATTACHMENTS

ATTACHMENT 8 White Paper "Ratings in Ukraine"

G. GENDER

I. COMPONENT DESCRIPTION

This report details events and activities relating to Gender of the USAID Access to Credit Initiative, implemented by the Pragma Corporation, during the period from July 1 through September 30, 2006.

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

ATCI management recognizes the importance of carrying out gender sensitivity training for the staff in order to have a solid basis for the monitoring work.

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

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

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

II. SIGNIFICANT EVENTS AND ACHIEVEMENTS

- EIGHTEEN CANDIDATES (EIGHT WOMEN) BECOME CML CERTIFIED

III. EXECUTIVE SUMMARY

All ATCI tasks present opportunities to identify and address gender bias, and to actively promote gender equality in Ukraine's financial sector. For example, ATCI is working closely with the

Ukrainian National Mortgage Association, the Association of Ukrainian Banks, the Commercial Law Center and other organizations that understand the importance of gender sensitivity with respect to product and services development. These issues have not only been discussed but plans are underway to draft material and articles which point out important opportunities in this area.

During the quarter, ATCI delivered seminars, workshops, and conferences involving two of its four components. In Mortgage, a total of eight women candidates received CML accreditation. Nearly half of the SSMSC regional staff that ATCI made presentations on covered bonds to were women. In Leasing, a number of participants in CLS training included women. The number of CLS Accreditations who are female will be known during the tenth quarter.

All ATCI training and professional development strives for gender balance during the invitation process as well as in delivery of content. Post - event analysis is conducted to understand the reasons for underweighting when it occurs.

The Project staff of ATCI project includes 12 women out of 27 some of whom have professional and technical skills in finance and law.

IV. ADMINISTRATIVE ISSUES

NONE

V. DESCRIPTION AND STATUS OF TASKS

Defined Activity	Progress Made During Quarter/Proposed Future Actions
• **Partner with Woman – run organizations (CLC & UAB)**	• ATCI IS WORKING CLOSELY WITH THE ASSOCIATION OF UKRAINIAN BANKS, THE COMMERCIAL LAW CENTER AND OTHER ORGANIZATIONS WHICH UNDERSTAND THE IMPORTANCE OF GENDER SENSITIVITY RELATED TO PRODUCT AND THE DEVELOPMENT OF SERVICES.
• **Increasing the role of women in the financial sector through training and /or other initiatives**	• THE STAFF OF ATCI INCLUDES WOMEN AND MEN WITH PROFESSIONAL AND TECHNICAL SKILLS IN FINANCE AND LAW. • ALL PROJECT TRAINING STRIVES FOR AN EVEN BALANCE OF MEN AND WOMEN. RECENT TRAINING IN SEVASTOPOL ACHIEVED THIS BALANCE
• **Gender and cultural sensitization training**	• GENDER SENSITIVITY IS PRACTICED DAILY BY ALL ATCI STAFF AND HIGHLIGHTED AT THE ANNUAL STAFF RETREAT

MOLDOVA

(FIRST QUARTERLY REPORT)

A. PROJECT OVERVIEW

I. PROJECT DESCRIPTION

ATCI/Moldova is a project established under the supervision of ATCI/Kyiv, with a separate Country Director reporting to the COP in Kyiv. The scope of ATCI/Moldova is similar to that of the ATCI/Kyiv project, yet narrower and more focused regarding the major components and tasks.

The three (3) major components of the ATCI/Moldova project are:

- Mortgage Lending Component;
- Financial Leasing Component; and
- Fixed Income Component.

The objective of the Mortgage Lending Component is to establish a viable, effective and efficient mortgage lending sector in Moldova. This shall be accomplished by providing technical, advisory, and training assistance to the National Bank of Moldova and to commercial banks and other financial institutions. A Certified Mortgage Lender (CML) Program shall be established and presented in order build the capacity of commercial banks to undertake mortgage lending using standardized, transparent procedures for both borrowers and other lenders. Additionally, technical assistance shall be provided to commercial banks to lower the risks associated with mortgage lending and improve the transparency of mortgage lending practices. Other tasks and sub-tasks are described in the "Mortgage Lending" section of this Report, under "Description and Status of Tasks".

The objective of the Financial Leasing Component is to create a supportive environment for modern financial leasing. This shall be achieved by building the capacity of leasing companies through training and consulting; provision of training for potential lessees, farmers, regulators, and other interested parties, such as vendors, banks; consulting potential foreign investors in the sector; and conducting public awareness efforts. A Certified Leasing Professional (CLP) Program shall be established and presented to leasing professionals, potential leasing professionals, and to training providers for their subsequent delivery of the CLP training program in Moldova.

The objective of the Fixed Income Component is to expand the availability of capital to legal entity borrowers as an alternative to bank financing through the issuance of corporate bonds. To date, in Moldova, there have been only a few corporate bond issuances since the first in 2002. A total of 10 companies have issued 11 bonds (one company conducted 2 bond issuances) for a total of 36 million Lei, or about $3 million at current exchange rates. The project shall work with the CNVM (i.e., National Securities Commission) to ease the legislative and regulatory burdens for bond issuance. At the same time, the project shall help build the capacity of and provide action plans for the CNVM in its upcoming role as Mega Regulator for the Non-Bank Financial Institutions, starting in April 2007. Issues such as transparency and disclosures of issuers shall be the main focuses for bond development while the capacity building elements shall focus on the regulatory and enforcement activities.

Priorities during this first period of ATCI/Moldova activities have been to set up the office, staff the office, and to meet some of the major players in the Government and the regulatory community as well as the professional participants of the mortgage, financial leasing, and capital markets areas.

II. SIGNIGICANT EVENTS AND ACHIEVEMENTS

- CTO RICK GURLEY AND COP DAVID LUCTERHAND ACCOMPANY COUNTRY DIRECTOR RICK DVORIN ON INTRODUCTORY MEETINGS WITH USAID/MOLDOVA PROJECT MANAGER AND OTHER LOCAL USAID COUNTERPARTS, AND EBRD, CNVM, AND BANK/MORTGAGE TOP MANAGEMENT OFFICIALS
- COUNTRY DIRECTOR CONDUCTS MEETINGS WITH MINISTER OF ECONOMY AND TRADE, DEPUTY GOVERNOR OF THE NBM, STAFF OF EBRD AND WORLD BANK, CHAIRMAN OF THE BANKERS ASSOCIATION, CHAIRMAN AND STAFF OF THE CNVM, PRESIDENT OF THE MOLDOVA STOCK EXCHANGE, AND VARIOUS HEADS AND STAFF OF MORTGAGE AND LEASING COMPANIES
- PROJECT CML TRAINING EXPERTS ASSESS MOLDOVAN ENVIRONMENT OF MORTGAGE ACTIVITIES AND NEEDS IN PREPARATION OF UPCOMING MOLDOVA-SPECIFIC TRAINING COURSES; FIRST TRAINING COURSE TO BE INITIATED DURING FIRST HALF OF NEXT PERIOD
- PROJECT CLP TRAINING EXPERT ALONG WITH ATCI/MOLDOVA LEASING ADVISOR ASSESS MOLDOVAN ENVIRONMENT OF LEASING ACTIVITIES AND NEEDS IN PREPARATION OF UPCOMING MOLDOVA-SPECIFIC LEASING TRAINING COURSES
- ATCI/MOLDOVA TARGETS POTENTIAL TRAINING PROVIDERS FOR LEASING TRAINING
- COUNTRY DIRECTOR PLANS WITH CNVM OFFICIALS TO INITIATE CAPACITY BUILDING AND DEVELOPMENTAL ACTIVITIES OF MEGA REGULATOR; SHORT TERM EXPERT TO WORK WITH ATCI/MOLDOVA FOR DEVELOPMENT OF MEGA REGULATOR IN FIRST MONTH OF NEXT PERIOD
- ATCI/MOLDOVA ADVISORS MEET WITH 2 LEASING COMPANIES FOR DISCUSSIONS ON AND ASSISTANCE WITH ISSUANCE OF CORPORATE BONDS
- ATCI/MOLDOVA ADVISORS INITIATE TARGETING OF COMPANIES FOR ISSUANCE OF CORPORATE BONDS
- COUNTRY DIRECTOR MEETS WITH OFFICIALS OF DONOR AGENCIES AND DIRECTORS OF OTHER USAID PROJECT TO COORDINATE ACITIVIES RELATING TO PROJECT'S TASKS

III. PROJECT EXECUTIVE SUMMARY

This Report provides details on the events and activities summarized below, as well as other events and activities regarding the USAID Access to Credit Initiative/Moldova, as implemented by consultants for The Pragma Corporation (the Project), for the period from November 1, 2006 through December 31, 2006. The report is comprised of three components: Mortgage Lending, Financial Leasing and Fixed Income. Each component section of the report will have a summary with specific activity tasks identified and the status of each task with appropriate commentary, relevant attachments, and reference to administrative issues, if any.

IT MUST BE NOTED HERE THAT THE PROJECT'S WORK PLAN HAS NOT BEEN FULLY DEVELOPED TO DATE. TAKING INTO CONSIDERATION THE RECOMMENDATION OF USAID'S MOLDOVAN PROJECT MANAGER, ALONG WITH THE CONSENT OF PRAGMA'S CHIEF OF PARTY, THE COUNTRY DIRECTOR HAS WAITED UNTIL THE FULL COMPLIMENT OF LOCAL PROFESSIONAL STAFF HAVE BEEN HIRED. THE COUNTRY DIRECTOR SHALL DEVELOP THE

WORK PLAN DURING THE EARLY PART OF THE NEXT PERIOD WITH THE ASSISTANCE FROM THE LOCAL ADVISORS, INDICATING TASKS FOR EACH COMPONENT ALONG WITH CONTEMPLATED DELIVERY DATES AND DESIGNATED STAFF RESPONSIBILITY. THE WORK PLAN FOR ATCI/MOLDOVA SHALL GENERALLY FOLLOW THE WORK PLAN OF THE ATCI/KYIV PROJECT IN ITS SAME PERIODS OF DEVELOPMENT AND IMPLEMENTATION.

Mortgage Lending

ATCI/Moldova initiated its work in the development of the primary mortgage market by through the short term Certified Mortgage Lenders (CML) Program trainers, Alexandre Kopeikin and Natalia Rogozhina, meetings with the institutions and major players conducting residential mortgage activities in Moldova. These meeting took place during the first month of the Project's inception. Meetings were held with 9 mortgage institutions, the National Bank of Moldova, the EBRD, and the CNVM.

Brief highlights of the information gathered on the mortgage activities in Moldova include:

- Volume of residential mortgages in Moldova estimated at $30 million;
- Need to develop longer term mortgages;
- Need to adopt Mortgage Law, containing provisions relating to issuance of mortgage bonds;
- Major problem of residents making loans to construction companies, taking on risks that banks should absorb; and
- Insufficient insurance related to mortgages.

Accordingly, the CML trainers are adapting their training courses to be presented in Moldova (anticipated) during the first week of February 2007.

The Draft Mortgage Law has been submitted to the Minister of Economy and Trade, for his review and subsequently for presentation to the Parliament for adoption. This is the 4th draft developed by the EBRD, and deals with the development of the primary mortgage market, without concern for the secondary market development which would include provisions for mortgage securities. This Law, or another, will have to be amended or another Law developed concerning Mortgage Securities, and this Project shall be accomplishing this in the coming period(s).

Financial Leasing

ATCI/Moldova focused on establishing the Certified Leasing Professional (CLP) Program. ATCI/Moldova's Senior Financial Leasing Advisor Vlad Railean assessed the Financial Leasing activity for the short term expert Robert Homans prior to Mr. Homans' visit to Moldova, in order to become familiar with the activities as well as the major players conducting financial leasing activities. Mssrs. Homans and Railean met with eight (8) Leasing Companies, an equipment vendor, an insurance company, and the USAID CEED project, to gather information on the needs and desires of the leasing professionals and activities of the financial leasing market. The purposes of these information gathering meetings are to develop a Certified Leasing Professional training program in Moldova, adapting training courses from presentations in other countries as well as to focus on the specific needs of the leasing market in Moldova. Brief highlights of the information gathered include:

- Most leasing activity in Moldova is centered on the leasing of private vehicles;

- Approximately 80-90% of the total leasing activity is handled by the 3 top leasing companies;
- Total leasing activity in Moldova is estimated at $42 million;
- Leasing companies need capital to finance their activities; and
- Training is highly desired by all leasing (and potential leasing) professionals, particularly in the areas of marketing, credit, and risk management.

One of ATCI/Moldova's primary objectives in establishing the CLP program is to establish local training capacity in the market that will be able to provide commercial training for lessors and industry professionals both within and outside the CLP Program. The ATCI/Moldova Financial Leasing Advisor has identified several potential Leasing Training Providers and is currently contacting them for interest in becoming the CLP training provider(s) for Moldova. Potential Leasing Training Providers will be invited to attend the CLP Program which is scheduled to be initiated in Moldova during the early part of the second quarter in 2007.

The meetings with the leasing companies proved to be fruitful in the area of ATCI/Moldova assisting companies in the issuance of corporate bonds (related to the other major component of the Project), thus increasing their capital for the expansion and funding of their leasing businesses. MAIB Leasing has already issued a corporate bond in 2005, to mature in February 2007. They shall be issuing a second corporate bond later in 2007, and asked for assistance from ATCI/Moldova. Additionally, IMC Leasing is considering a bond issuance for 2007 and has asked for ATCI/Moldova's assistance. Staff of the Project has since met with both companies to further these desired activities.

Fixed Income

ATCI/Moldova focused on creating a good working relationship with the CNVM, which includes their understanding of the Project, our activities regarding the three (3) major components, and our resources in relation to working with the CNVM and development of the bond market and corporate bond issuances.

In this regard, the staff of the Project conducted several meetings with staff and Chairman of the CNVM, ensuring their understanding of the Project's priorities as well as gaining an understanding of what the CNVM's activities have been regarding development of the capital and non-banking financial markets. It should be noted that there is a great need for TA at the CNVM in the form of a Capital Markets project, yet this ATCI/Moldova project has a narrow focus in its scope regarding activities in the capital markets of Moldova. The CNVM has also delivered its 5 year (2006-2010) market development strategy to the Project for reference to other areas for non-bank financial development.

The first priority is for the CNVM to transform into the Mega Regulator (the Non-Bank Financial Institutions and Markets Regulator) by 1 April 2007, as targeted in the Draft Law on the National Commission of the Financial Markets, scheduled to be adopted early in the first quarter of 2007. Minister of Economy and Trade Dodon has also voiced his opinion to the Project regarding the importance and the priority issue of the Mega Regulator development. Although consultants from the World Bank have in the past provided some TA, there was not a definitive plan in place for subsequent TA for the development of the Mega Regulator. In this regard, USAID and ATCI/Moldova has taken the lead in arranging a short-term expert on the development of Mega Regulators, Dr. Oonagh McDonald, to come to Moldova during January 2007 to work with the CNVM and the other relevant regulators.

Regarding corporate bond issuance development, the Project has initiated, through its Financial Analyst Mihail Gherghircic, the targeting of creditworthy companies for the issuance of debt securities in the coming year. Corporate Bonds have been issued in Moldova since 2002, with 10 companies issuing 11 bonds. The Project has met with executives of two (2) leasing companies scheduling corporate bond issuances in 2007 and who have requested the Project's assistance.

Some progress has already been made regarding the easing of financial burdens on issuers and on bond buyers. Effective 1 January 2007, issuers of debt securities shall pay to the CNVM a reduced fee of 0.1% of the issuance rather than a fee of 0.5% for the issuance of equity securities. Additionally, on the same effective date, individual persons (rather than legal persons) shall pay no tax on the interest derived from their investments in corporate bonds.

The Project shall continue its review of the legislative and regulatory aspects of bond issuances, including the issuance of mortgage bonds, and make recommendations for easing the constraints as well as continuing to work with companies in the issuance of debt securities.

IV. PROJECT STAFFING

The Country Director Rick Dvorin arrived in Moldova on 1 November 2006 needing to staff the Project's office with 9 full-time staff. The following team members of ATCI/Moldova have been hired during this period:

- Vlad Railean, Senior Financial Leasing Advisor
- Mihail Gherghircic, Financial Analyst
- Viorel Rusu, Senior Attorney (started first day of next period)
- Mariana Botezatu, Mortgage Advisor (started first day of next period)
- Alina Birsan, Junior Attorney (started second week of next period)
- Olga Captilova, Office Manager/Financial Controller
- Tamara Burca, Translator/Interpreter
- Alisa Savva, Assistant Office Manager/Receptionist/Data Base Development Expert
- Alex Levit, Driver
- The following short-term experts worked with the Project during the period in order to find information relating to their areas of expertise:
- Alexandre Kopeikin, CML Training
- Natalia Rogozhina, CML Training
- Robert Homans, Financial Leasing and Training

V. ADMINISTRATIVE ISSUES

The Country Director needed to find office space, furnish the office, and obtain documentation for qualifying for zero-rate VAT. The Country Director, along with the Office Manager initially found a turn-key office for short-term lease, housing the initial 5 staff members of the project. The long-term, permanent office was leased a month after the Country Director landed in Moldova, needing to be equipped with computers and systems as well as furnishings. While the equipment and furnishings were being installed in the permanent office space, the Project utilized the short-term office facility for conducting project-related business activities. By the middle of December 2006, the ATCI/Moldova Project staff permanently moved into the long-term office facility, borrowing furniture and utilizing personal computers, while installing internet and telephone connections. The zero-rate VAT qualification was received during the middle of December, with the Project appearing on the List of Projects during the first week of the following period. The Project has been successful in locally buying the major furnishings and equipment at the zero-rate VAT.

The permanent office shall be fully furnished, including a Training Center for up to 30, and equipped by the end of the first month in the coming period.

B. MORTGAGE LENDING

I. Component Description

This Report provides details on the events and activities relating to the Mortgage Component of the USAID Access to Credit Initiative/Moldova, as implemented by The Pragma Corporation, during the period from November 1, 2006 through December 31, 2006.

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

A secondary goal of the Project related to Mortgage development is assisting in the development of a Credit Information Company. The Project shall participate in this endeavor only after a CIC Law that is acceptable to USAID is passed. To date, this law is still pending.

II. Significant Events

- PROJECT CML TRAINING EXPERTS GATHER INFORMATION REGARDING THE MOLDOVAN ENVIRONMENT OF MORTGAGE ACTIVITIES AND NEEDS IN PREPARATION OF UPCOMING MOLDOVA-SPECIFIC TRAINING COURSES, TO BE IMPLEMENTED FIRST PART OF NEXT PERIOD
- DRAFT MORTGAGE LAW (4^{TH} VERSION), AS PREPARED BY THE EBRD, IS SUBMITTED TO MINISTER OF ECONOMY AND TRADE; GIVEN CURSORY REVIEW BY ATCI
- MINISTER OF ECONOMY AND TRADE DODON AND NBM DEPUTY GOVERNOR MOLOSHAG VOCALIZE SUPPORT FOR ATCI/MOLDOVA PROJECT AND MORTGAGE DEVELOPMENT

III. Executive Summary

In this period, ATCI/Moldova initiated its development of the primary mortgage market by through the short term Certified Mortgage Lenders (CML) Program trainers, Alexandre Kopeikin and Natalia Rogozhina, meetings with the institutions and major players conducting residential mortgage activities in Moldova. These meeting took place during the first month of the Project's inception. Meetings were held with 9 mortgage institutions, the National Bank of Moldova, the EBRD, and the CNVM. Notes of these meetings, highlighting the findings and areas for adaptation of training course material are attached at the end of this report, as

Attachment 1. Brief highlights of the information gathered on the mortgage activities in Moldova include:

- Volume of residential mortgages in Moldova estimated at $30 million;
- Need to develop longer term mortgages;
- Need to adopt Mortgage Law, containing provisions relating to issuance of mortgage bonds;
- Major problem of residents making loans to construction companies, taking on risks that banks should absorb; and
- Insufficient insurance related to mortgages.

Accordingly, the CML trainers are adapting their training courses to be presented in Moldova (anticipated) during the first week of February 2007. **Attachment 2** summarizes the CML trainers' targeted areas for adaptation for the Moldovan mortgage training as well as providing possible solutions to the problems that were uncovered.

The Draft Mortgage Law has been submitted to the Minister of Economy and Trade, for his review and subsequently for presentation to the Parliament for adoption. This is the 4th draft developed by the EBRD, and deals with the development of the primary mortgage market, without concern for the secondary market development which would include provisions for mortgage securities. This Law, or another, will have to be amended or another Law developed concerning Mortgage Securities, and this Project shall be accomplishing this in the coming period(s).

Given the fact that during meetings with Minister (of Economy and Trade) Dodon and Deputy Governor (of the NBM) Moloshag, they both voiced fervent interest with the Project and the development of mortgage activities in Moldova, it can be expected that this Mortgage Law will be passed on soon to Parliament for adoption. The Project shall make a determination if the timing is right either before of soon thereafter from the adoption of the Mortgage Law to introduce provisions securing the rights of bond holders along with the assurance of the transferability of bonds and underlying assets for the issuance of mortgage (backed) bonds.

IV. Administrative Issues

As noted, the Project occupied its permanent office space in mid-December 2006. Among other reasons for choosing the office space, it has a large room that is to be functioning as both a conference room and training center. Based on the dimensions of the training center, it should be able to hold at least 30 for training. The CML trainers have indicated that 20, with possibly 24, the optimum number of trainees to attend their courses.

As of the end of December, the office is yet to be furnished with conference/training tables and chairs. However, it is planned that the training tables along with the chairs will be installed for the inception of the training. The Project has already procured a multimedia presentation device and shall rent computers as necessary for the CML training.

During this initial period (1 November through 31 December 2006), the Project hired a Mortgage advisor, but she did not start until the beginning of the next period. Therefore, activities relating to the Mortgage Lending component were not as dynamic as desired.

V. Description and Status of Tasks

Tasks are listed in the Statement of Work for the Project, according to the three (3) components of Mortgage Lending; Financial Leasing; and Fixed Income. These Tasks shall be identified and detailed as to "activities" and "progress made" in the upcoming development of the Work Plan for the Project.

As stated in the SOW, major tasks include:

- Implement CML Program: Project initiated review of Moldova mortgage activity for adapting training course; candidates for training as well as for training providers to attend these courses are in the process of being selected;
- Assist Banks in Undertaking Mortgage Lending: N/A (No Activity this period);
- Develop Mortgage Related Life Insurance Products: N/A;
- Build the Capacity of the Real Estate Appraisal and Brokers' Associations: N/A;
- Develop a Mortgage Securities Facility: Project staff have initiated meetings with the CNVM to secure their backing and support in this area;
- Facilitate the Establishment of a Commercial Credit Information Company, as appropriate: Moldova needs to adopt an appropriate CIC Law; meanwhile, it is learned that the World Bank is facilitating this where the Project may assist in its facilitation;
- Capacity Building of Participating Banks to Maximize Benefits of CIC: N/A; and
- Develop a Business Plan for CIC: N/A.

List of Attachments

Attachment 1: CML Trainers' Notes of Meetings

Attachment 2: CML Trainers' Anticipated Adaptations for Training Course for Moldova

C. FINANCIAL LEASING

I. Component Description

This report details events and activities relating to the Financial Leasing Component of the USAID Access to Credit Initiative/Moldova, implemented by the Pragma Corporation, during the period from November 1 through December 31, 2006.

The primary purpose of the Financial Leasing Component is to create a supportive environment for modern financial leasing. As well, the Project shall provide specific technical, advisory, and training assistance in order to increase access to credit throughout Moldova, whereas Financial Leasing is an efficient alternative to bank financing.

ATCI/Moldova aims to strengthen existing leasing companies. Capacity building consists of training and consulting for lessors, lessees, farmers, regulators, and other interested parties, such as vendors and banks. In addition, ATCI/Moldova shall be seeking potential foreign and local investors as well as conducting public awareness efforts.

Moreover, the Financial Leasing Component shall be building the capacity of leasing professionals by introducing the Certified Leasing Professional (CLP) Program, a designation for market participants so that they may attain world standards of practice.

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

II. Significant Events

- PROJECT CLP TRAINING EXPERT ALONG WITH ATCI/MOLDOVA LEASING ADVISOR ASSESS AND GATHER INFORMATION REGARGING MOLDOVAN ENVIRONMENT OF LEASING ACTIVITIES AND NEEDS IN PREPARATION OF UPCOMING MOLDOVA-SPECIFIC LEASING TRAINING COURSES
- ATCI/MOLDOVA TARGETS POTENTIAL TRAINING PROVIDERS FOR CLP PROGRAM LEASING TRAINING
- ATCI/MOLDOVA STAFF MEET WITH 2 LEASING COMPANIES FOR DISCUSSIONS ON AND ASSISTANCE WITH ISSUANCE OF CORPORATE BONDS

III. Executive Summary

In this period, ATCI/Moldova focused on establishing the Certified Leasing Professional (CLP) Program. ATCI/Moldova's Senior Financial Leasing Advisor Vlad Railean assessed the Financial Leasing activity for the short term expert Robert Homans prior to Mr. Homans' visit to Moldova, in order to become familiar with the activities as well as the major players conducting financial leasing activities. A full appointment schedule was developed with Mssrs. Homans and Railean meeting with eight (8) Leasing Companies, an equipment vendor, an insurance company, and the USAID CEED project, to gather information on the needs and desires of the leasing professionals and activities of the financial leasing market. (Note: the CEED project along with the USAID Agribusiness Development Project is surveying the needs of the lessees, while the ATCI/Moldova project is working to develop the lessors; the results of the survey should direct the lessors into areas of leasing needs while the leasing activities of the lessors shall (hope to) fill those needs of the lessees.) The purposes of these information gathering meetings are to develop a Certified Leasing Professional training program in Moldova, adapting training courses from presentations in other countries as well as to focus on the specific needs of the leasing market in Moldova. The summary report of the ATCI/Moldova leasing professionals are attached at the end of this report as **Attachment 3** and **Attachment 4**. Brief highlights of the information gathered include:

- Most leasing activity in Moldova is centered on the leasing of private vehicles;
- Approximately 80-90% of the total leasing activity is handled by the 3 top leasing companies;
- Total leasing activity in Moldova is estimated at $42 million;
- Leasing companies need capital to finance their activities; and
- Training is highly desired by all leasing (and potential leasing) professionals, particularly in the areas of marketing, credit, and risk management.

One of ATCI/Moldova's primary objectives in establishing the CLP program is to establish local training capacity in the market that will be able to provide commercial training for lessors and industry professionals both within and outside the CLP Program. The local ATCI/Moldova Financial Leasing Advisor has identified several potential Leasing Training Providers and is currently contacting them for interest in becoming the CLP training provider(s) for Moldova. Potential Leasing Training Providers will be invited to attend the CLP Program which is scheduled to be initiated in Moldova during the early part of the second quarter in 2007.

The meetings with the leasing companies proved to be fruitful in the area of ATCI/Moldova assisting companies in the issuance of corporate bonds (related to the other major component of the Project), thus increasing their capital for the expansion and funding of their leasing businesses. MAIB Leasing has already issued a corporate bond in 2005, to mature in February 2007. They shall be issuing a second corporate bond later in 2007, and asked for assistance from ATCI/Moldova. Additionally, IMC Leasing is considering a bond issuance for 2007 and has asked for ATCI/Moldova's assistance. Staff of the Project has since met with both companies to further these desired activities.

IV. Administrative Issues

None

V. Description and Status of Tasks

Tasks are listed in the Statement of Work for the Project, according to the three (3) components of Mortgage Lending; Financial Leasing; and Fixed Income. These Tasks shall be identified and detailed as to "activities" and "progress made" in the upcoming development of the Work Plan for the Project.

As stated in the SOW, major tasks include:

- Build the Capacity of Market Participants: ATCI/Moldova Leasing advisors met with major leasing companies to gain the status of their leasing activities, their leasing desires and needs. Forthcoming CLP Program training courses shall address these activities, desires, and needs, as well as review the legislation and regulatory environment. Needs are focused on financing, diversification, risk management, marketing, and credit policies;
- Implement Outreach/Information Network: N/A;
- Facilitate Import Capital and Know-How to Leasing Industry: N/A;
- Provide Consulting Services to Market Participants: This was initiated through the meetings held by the ATCI/Moldova leasing advisors and shall be integrated into the CLP Program; additional company-specific leasing advice shall be provided throughout the life of the Project by the ATCI/Moldova leasing advisors.

List of Attachments

Attachment 3: Leasing Companies Meetings Report (by short term expert)

Attachment 4: Report of Meetings with Leasing Companies (by ATCI/Moldova leasing advisor)

D. FIXED INCOME

I. Component Description

This report provides details on events and activities relating to the Fixed Income component of the USAID Access to Credit Initiative/Moldova, as implemented by the Pragma Corporation, during the period from November 1 through December 31, 2006.

The objective of this activity is to expand the availability of capital to borrowers as an alternative to bank financing, through the issuance of corporate bonds. Additionally, this component includes the goals for the development of the CNVM as not only a regulator of the capital markets but a Mega Regulator, i.e., regulator of the Non-Bank Financial Institutions. The CNVM shall become the Mega Regulator on 1 April 2007. Tasks are shall be focused on disclosure and transparency issues and systems related to the bond-related regulations and enforcement capabilities of the CNVM.

II. Significant Events

- COUNTRY DIRECTOR MEETS WITH WORLD BANK TO COORDINATE TA FOR THE CNVM, TAKING THE LEAD IN MEGA REGULATOR DEVELOPMENT; ATCI/MOLDOVA COMMITS TA TO CNVM IN THEIR DEVELOPMENT AS MEGA REGULATOR, CONFORMING TO MINISTER OF ECONOMY AND TRADE DODON'S TOP PRIORITY
- ATCI/MOLDOVA MEET WITH 2 LEASING COMPANIES PLANNING TO ISSUE CORPORATE BONDS IN 2007 WITH PROJECT'S ASSISTANCE
- ATCI/MOLDOVA ADVISORS INITIATE TARGETING OF COMPANIES FOR ISSUANCE OF CORPORATE BONDS

III. Executive Summary

In this period, ATCI/Moldova focused on creating a good working relationship with the CNVM, which includes their understanding of the Project, our activities regarding the three (3) major components, and our resources in relation to working with the CNVM and development of the bond market and corporate bond issuances.

In this regard, the staff of the Project conducted several meetings with staff and Chairman of the CNVM, ensuring their understanding of the Project's priorities as well as gaining an understanding of what the CNVM's activities have been regarding development of the capital and non-banking financial markets. **Attachment 5** presents the TA requests of the CNVM, most of which are beyond the scope of work for the Project. It should be noted that there is a great need for TA at the CNVM in the form of a Capital Markets project, yet this ATCI/Moldova project has a narrow focus in its scope regarding activities in the capital markets of Moldova. The CNVM has also delivered its 5 year (2006-2010) market development strategy to the Project for reference to other areas for non-bank financial development.

The first priority is for the CNVM to transform into the Mega Regulator (the Non-Bank Financial Institutions and Markets Regulator) by 1 April 2007, as targeted in the Draft Law on the National Commission of the Financial Markets, scheduled to be adopted early in the first quarter of 2007. In this regard, ATCI/Moldova has arranged for a short-term expert on the development of Mega Regulators, Dr. Oonagh McDonald, to come to Moldova during January 2007 to work with the CNVM and the other relevant regulators.

Regarding corporate bond issuance development, the Project has initiated the targeting of creditworthy companies for the issuance of debt securities in the coming year. Corporate Bonds have been issued in Moldova since 2002, with 10 companies issuing 11 bonds (see **Attachment 6** and **Attachment 7** for details of these issuances). The Project has met with executives of two (2) leasing companies scheduling corporate bond issuances in 2007 and who have requested the Project's assistance.

Some progress has already been made regarding the easing of financial burdens on issuers and on bond buyers. Effective 1 January 2007, issuers of debt securities shall pay to the CNVM a reduced fee of 0.1% of the issuance rather than a fee of 0.5% for the issuance of equity securities. Additionally, on the same effective date, individual persons (rather than legal persons) shall pay no tax on the interest derived from their investments in corporate bonds.

The Project shall continue its review of the legislative and regulatory aspects of bond issuances, including the issuance of mortgage bonds, and make recommendations for easing the constraints as well as continuing to work with companies in the issuance of debt securities. Specific areas of TA which will be provided by ATCI/Moldova in accordance with the Project's SOW related to the CNVM's TA requests and its 5 year development plan are:

- Development of the Mega Regulator;
- Assisting in the analysis of Mega Regulator conformity to EU and IOSCO standards and principles;
- Development and installation of an automated Disclosure System for use by issuers (of equity and debt securities);
- Drafting and amending Corporate Debt legislation and regulations;
- Assisting in the development of a longer-term yield curve and GOM bond trading on the secondary market.

IV. Administrative Issues

None.

V. Description and Status of Tasks

Tasks are listed in the Statement of Work for the Project, according to the three (3) components of Mortgage Lending; Financial Leasing; and Fixed Income. These Tasks shall be identified and detailed as to "activities" and "progress made" in the upcoming development of the Work Plan for the Project.

As stated in the SOW, major tasks include:

- Assess and Implement Regulatory Reform: ATCI/Moldova committed TA for the development of the CNVM as Mega Regulator by bringing in a short-term expert in the following period, during January 2007. Project staff has had several meetings with the CNVM identifying their priorities for assistance in this area. CNVM Chairman Ursu delivered a list of 11 requests for TA, of which one was the development and installation of a Disclosure System for Issuers, very much part of the tasks for ATCI/Moldova. Country Director met with staff of CNVM guiding them to make a self-assessment of the IOSCO 30 Principles for Capital Market Regulation.

- Develop Corporate Bond Issuances: ATCI/Moldova met with two (2) leasing companies, MAIB Leasing and IMC Leasing, who need funds to finance their equipment purchases for leasing and shall be issuing corporate bonds in 2007, requesting the Project's assistance. Project staff initiated process of targeting creditworthy companies needing investment capital and having the capabilities for successful bond issuance.

- Assist the GOM and NBM in Constructing a Long-Term Government Yield Curve: N/A

UKRAINE ATTACHMENTS

ATTACHMENT 1


22 12 2006


22 12 2006

ATTACHMENT 2

Housing Mortgage Lending in Ukraine

2006 Analytical Review

УНІА
Українська національна іпотечна асоціація

Kyiv 2007

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Disclaimer

This analytical report (hereinafter - the "Analytical Report") is based on current information received by UNIA specialists from banks, government institutions, mass media and other sources of information that we believe to be reliable but assume no responsibility for their accuracy and fairness.

This analytical report has been prepared with the sole purpose to provide information. The analytical report is not a credit rating or a recommendation to take or to make loans.

This analytical report is not provision of consultancy services on any specific issues. Any specific issues that the users of the materials may have must be resolved based on consultations with relevant specialists.

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Macroeconomic Situation

GDP

2006 is the 7th year of economic growth in Ukraine with growth of real GDP on the level of 7.1%. Despite pessimistic forecasts of Ukrainian and international experts regarding development of the national economy under the conditions of political instability, growth of prices for energy carriers, Ukraine has again confirmed its image of a country capable of demonstrating positive growth.

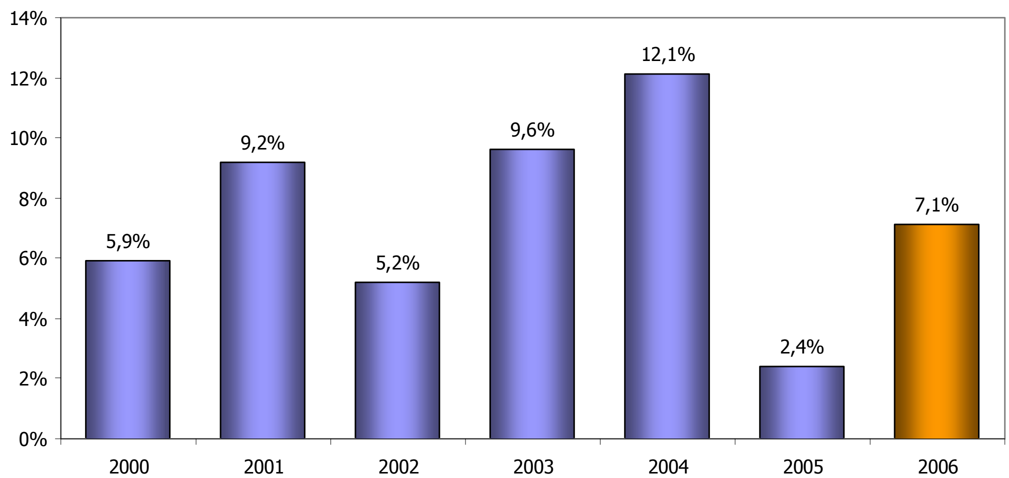

Chart 1. *GDP growth in 2000-2006, %*

Source: State Committee on Statistics

According to an approximate estimate, nominal GDP in January-November 2006 was UAH 452.9 billion. GDP growth in January-November last year took place mainly due to increase of gross value added on practically all types of economic activities, except agricultural production: in extraction industry – by 5.8%, in production and distribution of energy, gas and water – by 7.1%, in construction – by 8.4%. Increase of the volumes of industrial production on the background of increased real personal income has lead to growth of demand for the services of neighboring industries. As a result, wholesale and retail trading grew 15.6%, transport – 10%.

Preservation of positive dynamics of the macroeconomic indicators has caused improvement by the rating agencies of sovereign rating projections. On October 25, 2006, **Fitch** rating agency improved its projection on long-term ratings of debt liabilities in the country (in foreign and national currency) from "Stable" to "**Positive**". The ratings themselves were confirmed on the existing level ("BB-"). Moreover, the agency confirmed "the limit" for Ukraine ("ceiling for country ratings") on the level "BB-", and short-term rating – on the level "B". This rating decision reflects the agency's opinion on possible improvement of Ukraine's ratings in case of continued economic growth and preservation of political stability for a longer period.

On October 10, 2006, **Moody's** agency improved its projection for medium- and long-term liabilities of Ukraine in the national and foreign currency, with the rating "B1", having changed it from "Stable" to "**Positive**". According to analysts of the agency, this took place due to strengthening of political stability in Ukraine which increased likelihood of cautious and consistent economic policy.

Unlike their colleagues, **S&P** agency left its projections on Ukraine's sovereign ratings unchanged – "**Stable**". On 30 August 2006, S&P confirmed long-term credit ratings of Ukraine on the level of "BB-" on liabilities in foreign currency, "BB" – on liabilities in national currency, as well as short-term ratings on the level of "B" – taking into account that economy of the country is developing faster than it was expected, and political situation has become stable.

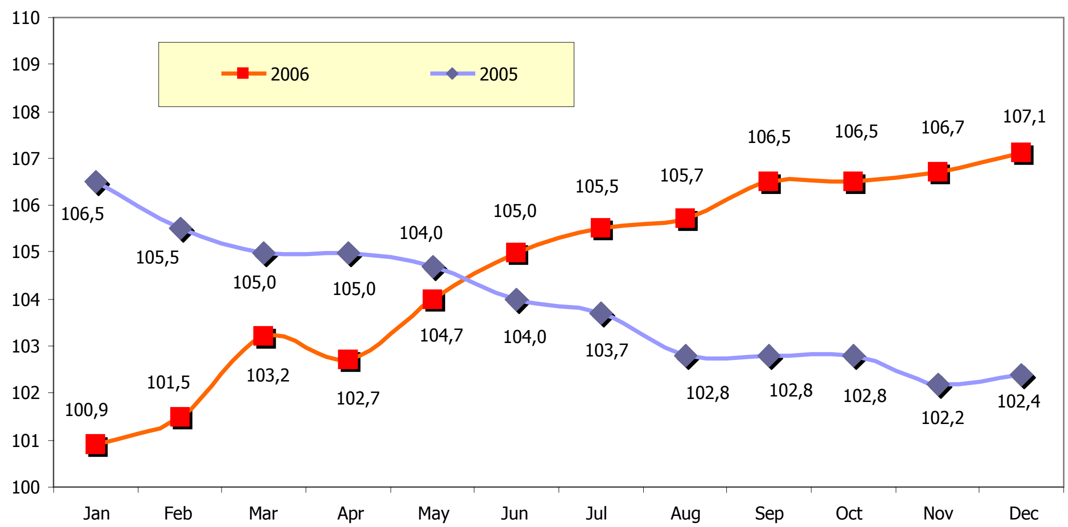

Chart 2. *Changes of real GDP, % of the relevant period of the previous year*

Source: State Committee on Statistics

There were significant differences in 2006 in the views of economists regarding development of the Ukrainian economy, and this is demonstrated by significant deviations in quantity assessments of the Ministry of Economy forecasts which were published on different dates. For example, consensus forecast as of June 2006 was expecting growth of real GDP to be on the level of 2.6%, while in October this macroeconomic indicator was optimistically reviewed towards significant increase – growth of real GDP was expected on the level of 5.9%.

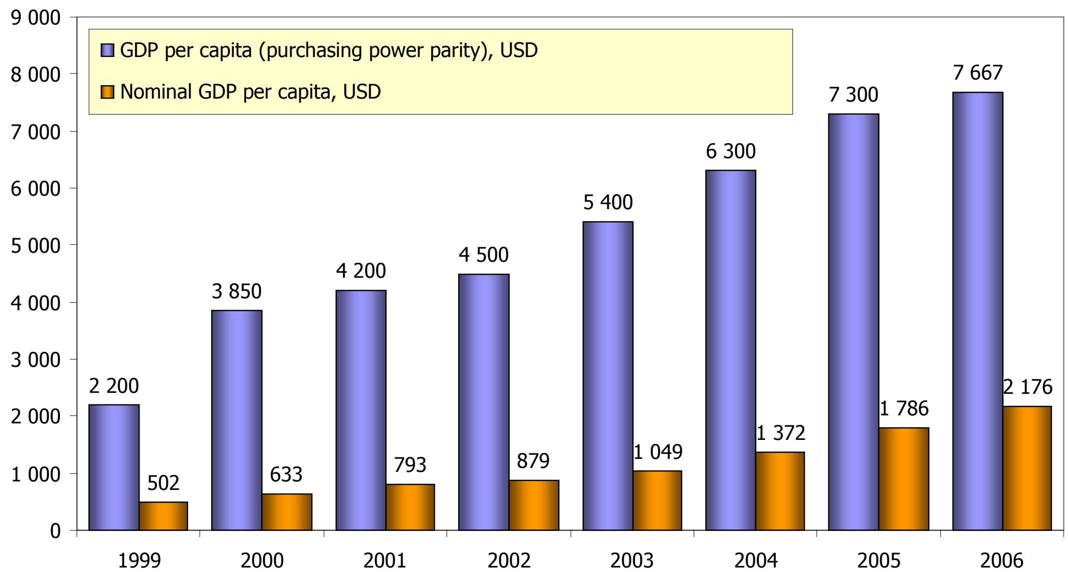

Chart 3. *GDP dynamics per capita*

Source: UNIA

Consensus forecast of the Ministry of Economy of Ukraine envisages preservation of the rate of economic growth in 2007-2011 on the level of 5.6% in 2007-2008, and 6.2% in 2009-2011. In Key Foundations of Monetary and Credit Policy, consumer price index (inflation level) is forecasted as 7.5% in 2007.

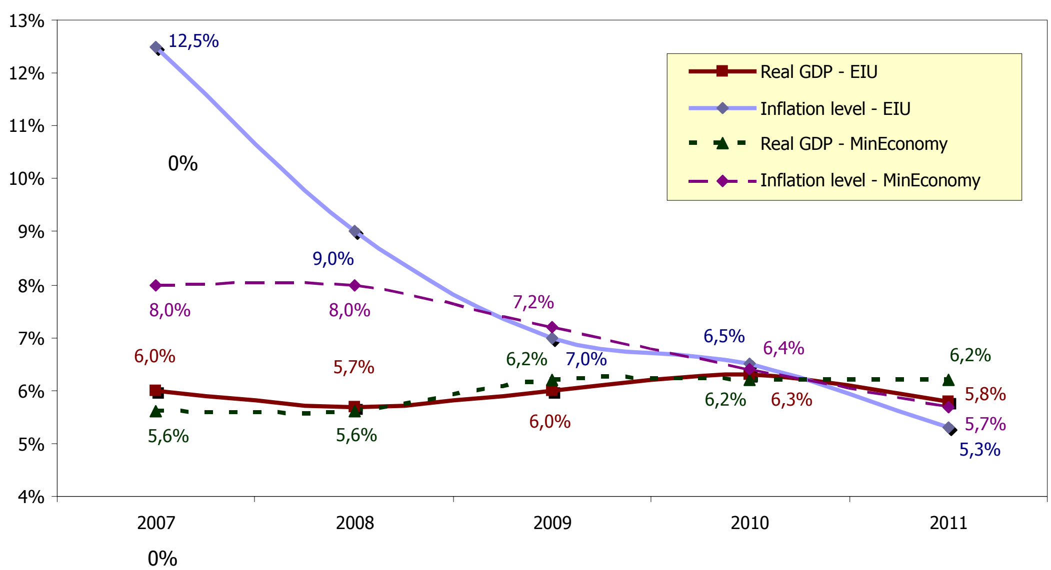

Chart 4. *Forecast for growth of GDP and inflation level, %*

Source: Ministry of Economy, EIU – Economist Intelligence Unit

General Price Level

Growth of consumer prices (inflation index) was **11.6**% in 2006 (10.3% in 2005). Increased growth rate of consumer prices in comparison with the previous year is not a demonstration of strengthening of the general inflation trends in the consumer market. Significant correction of dynamics of consumer price index which was within the acceptable limits during the first eight months of 2006 and demonstrated the trend to gradual lowering of inflation pressure, introduced administrative increase of tariffs for housing and communal services which took place in the second half of 2006.

Tariffs for paid services increased in 2006 by 49.4% (in 2005 – only by 15.8%). But dynamics of prices for food and non-food products was slower than in the previous year – prices for food products grew by only 3.5% in 2006, while in 2005 – by 10.7%. Insignificant rate of price growth (even subject to significant price growth for imported energy carriers) was registered also for the group of non-food products, the value of which increased in 2006 only by 2% (4% in 2005).

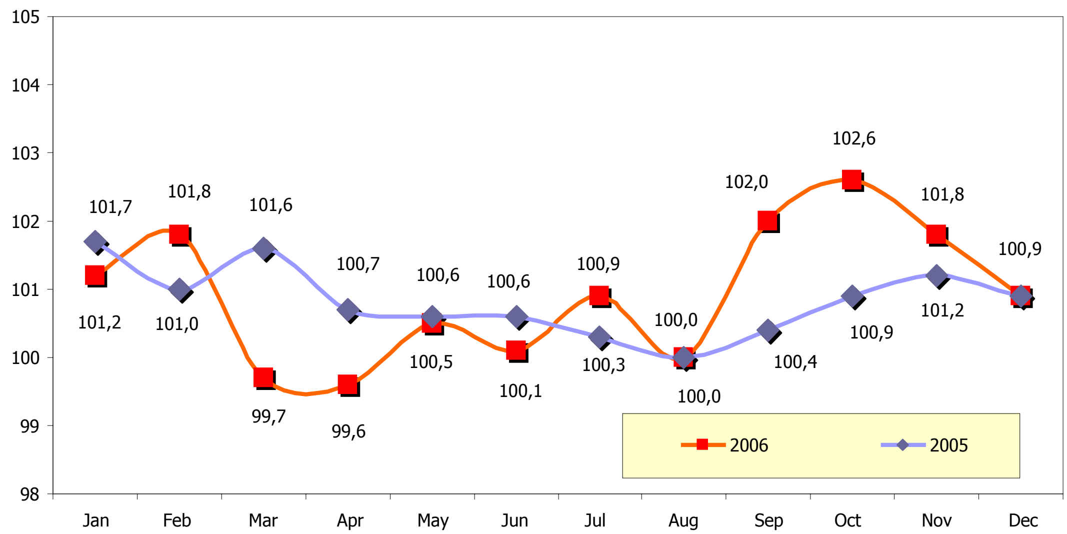

Chart 5. *Consumer price index in 2005-2006, % of the previous month*

Source: State Committee on Statistics

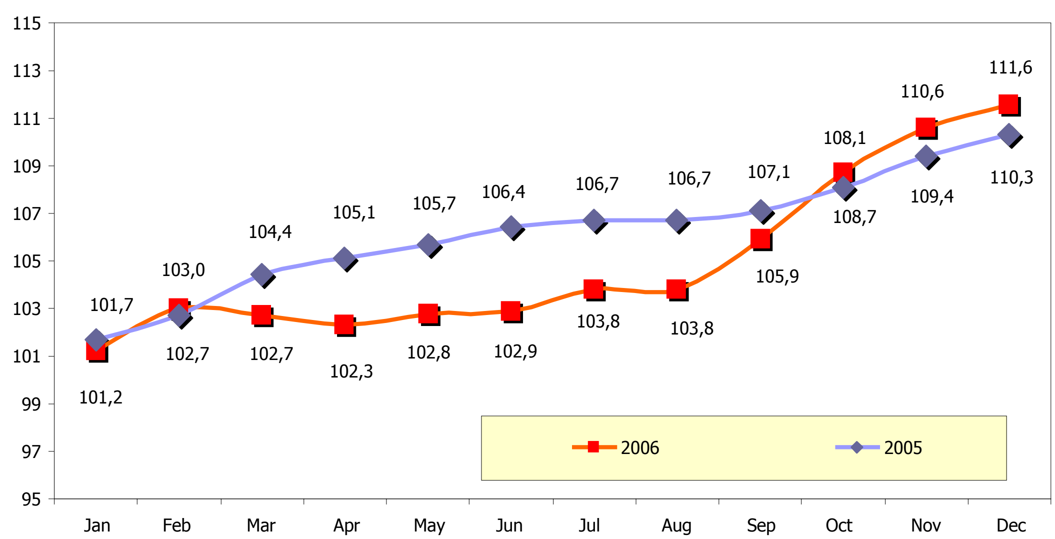

Chart 6. *Consumer price index in 2005-2006, % December yoy*

Source: State Committee on Statistics

Consensus forecast of the Ministry of Economy of Ukraine for the next years contains expectations of inflation level during the next 2007-2008 years on the level of 8%, with gradual lowering of inflation factor to 5.7% in 2009-2011.

Personal Income

Preservation of the rate of economic growth had positive impact on supporting of high level of private consumption, and this was fostered by growth of real personal income by 16.1%, with lowering of the level of registered unemployment from 3.1 to 2.7% in 2006.

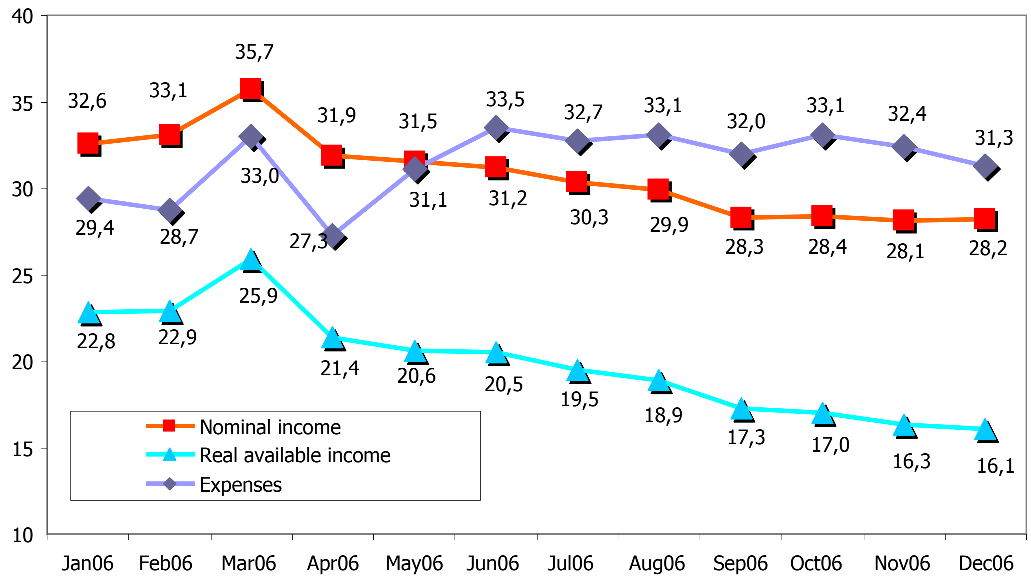

***Chart 7.** Growth of income and expenses of the Ukrainian citizens in January-June 2006, progressive total in % of the relevant period of the previous year*

Source: State Committee on Statistics

In January-December 2006, nominal personal income increased by 28.2% compared to the relevant period of the previous year. Available income which can be used by the citizens for purchase of goods and services increased by 26.6%, and real available income which incorporates the price factor – by 16.1%. Available income per capita in December 2006 was UAH 852.3.

Expenses of the citizens in January-December of the previous year increased by 31.3% compared to the similar period of 2005. Growth of savings was UAH 50.5 billion.

In the structure of personal income in January-December 2006, 43.2% is salary, 15% - profit and mixed income, 2.6% - income from property, and more than one third of personal income is received from social assistance and transfers from the state – 39.2%.

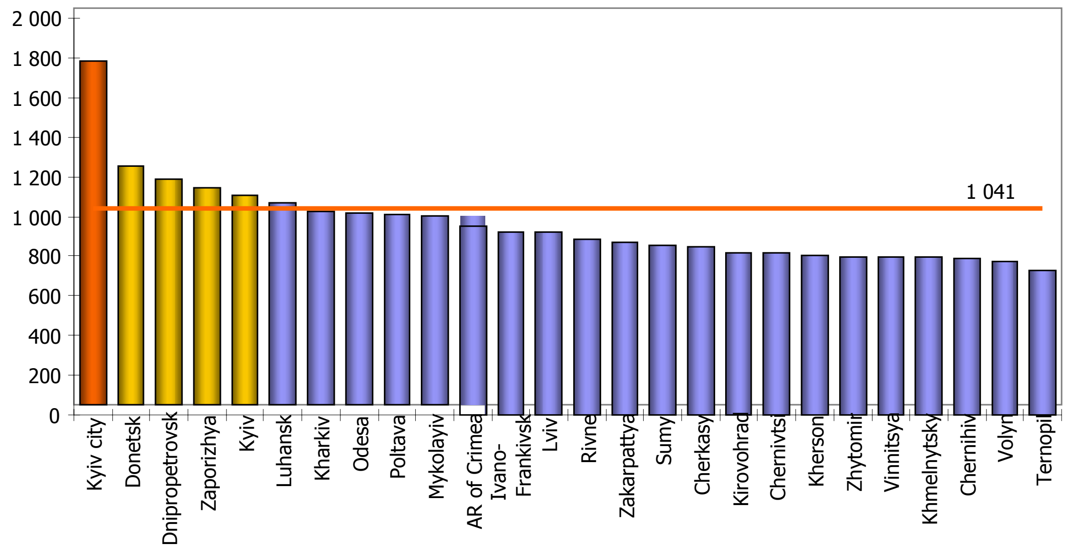

Chart 8. *Nominal average monthly salary in Ukraine in 2006, UAH*

Source: State Committee on Statistics

Average real salary in total in 2006 increased by **18.3**% compared to the previous year. As of December 2006, average monthly salary in Ukraine was UAH 1,041. Differentiation in amount of salary remains significant: between Kyiv city and Ternopil oblast it is 2.5 times. Only in the capital and in 4 regions (Donetsk, Dnipropetrovsk, Zaporizhya and Kyiv oblasts), the level of average nominal salary is higher than average number for Ukraine which is explained by significant concentration in these regions of the industrial and production capacities and financial capital.

Significant gap between the amount of nominal salary in certain regions and in average in Ukraine is caused by development of private, small and medium business (therefore, higher level of shadow income), as well as high level of the Ukrainian citizens who receive unofficial income in EU countries.

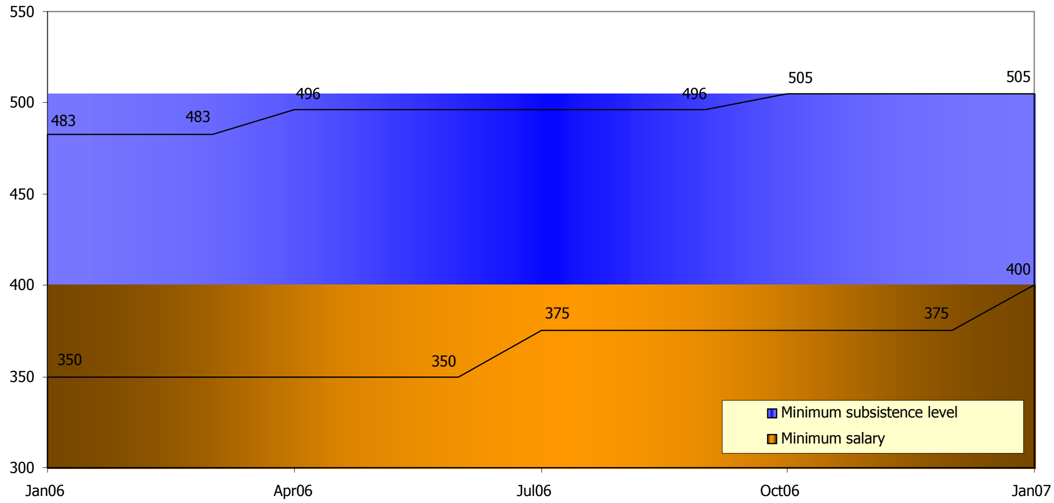

Chart 9. *Minimum subsistence level and minimum salary in Ukraine in 2006, UAH*

Source: State Committee on Statistics

Money and Credit Market

In 2006, development of the money-and-credit market was significantly influenced by changes in indicators of the balance of payments and relevant fluctuations in demand and supply in the currency segment of the market. Through the use of monetary instruments and mechanisms, the National Bank has ensured the level of money supply adequate to the growing demand, thus strengthening positive trends both in the monetary sphere and in the real sector of economy.

Negative balance of the foreign trade balance caused, first of all, by growth of prices for energy carriers, has led to a misbalance between the commodity flows and quantity of money in circulation. In the conditions of monetary base growth by 17.5% and money stock growth by 34.5% with slower rate than in the previous year (53.9% and 49.3%, accordingly), the NBU was actively using the following instruments to ensure proper level of bank liquidity:

- mechanism of mandatory reserves due to which over UAH 10 billion was released.
- refinancing – total volume of refinancing transactions in 2006 році was UAH 8.33 billion. Adequately to the situation with the banking system liquidity, weighted average actual rate on all refinancing instruments in 2006 was constantly decreasing – in January it was 13%, and in December – 9.5%.
- NBU bank rate - from June 10, 2006, the NBU decreased the level of the bank rate from 9.5% to 8.5%.

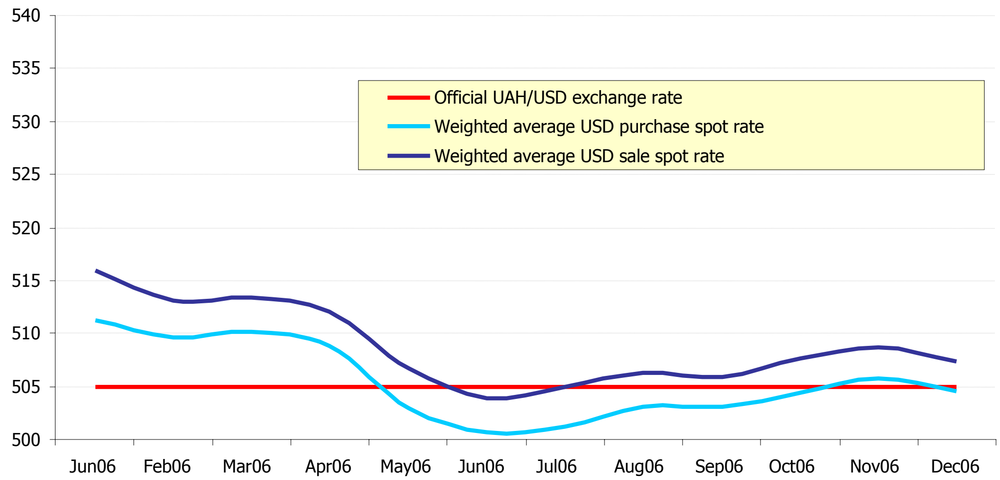

Chart 10. *Dynamics of UAH/USD exchange rate in 2006, in UAH for USD 100*

Source: NBU, UIBCE

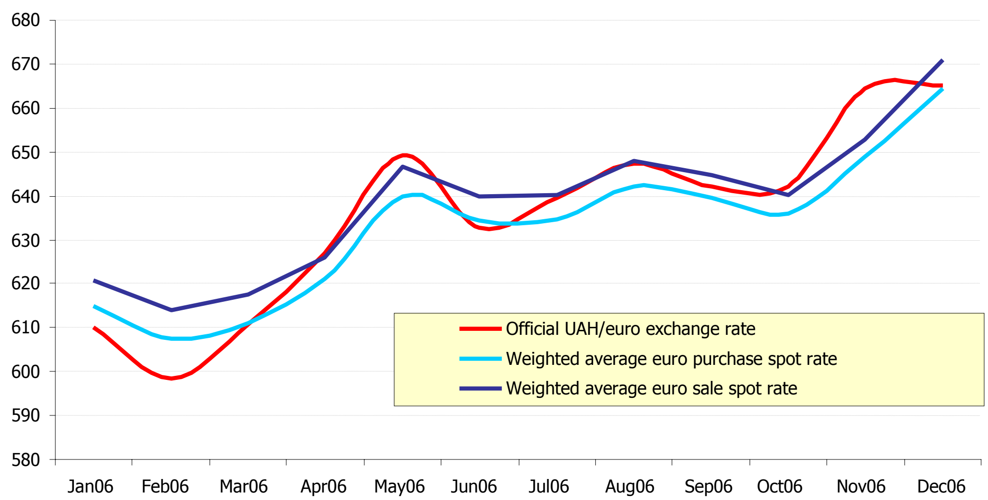

Chart 11. *Dynamics of UAH/euro exchange rate in 2006, in UAH for euro 100*

Source: NBU, UIBCE

Important results of the NBU money-and-credit policy in 2006 in the currency segment were ensuring stable UAH exchange rate to the exchange rate forming currency – USD, and growth of international reserves due to timely repayment of foreign sovereign debt. Official UAH/USD exchange rate remained unchanged during the year and was UAH 505/USD 100. But Hryvnia has weakened its positions in respect to euro: official UAH/euro exchange rate increased by 9% and as of January 1, 2007 was UAH 665.08 /euro 100. The main reason of this was depreciation of USD compared to the world currencies which reflected the international markets environment. Volumes of international reserves in 2006 increased by USD 2.9 billion and reached almost USD 22.3 billion.

In future, the National Bank looks at the necessity of gradual transition to the monetary regime based on price stability and free fluctuation of exchange rates. Final transfer to use of inflation benchmark as key target of the money-and-credit policy should be preceded by a certain transitory period during which the National Bank aims its efforts at support of both external stability of the national currency through regulation of exchange rate, and internal price stability. Priority in the money-and-credit policy is gradually shifted towards ensuring of price stability, with subordination to it of the policy of currency exchange rate formation which will become more flexible. In general, the policy of currency exchange rate formation will be aimed at provision of forecasted dynamics of exchange rate depending on the status of balance of payments and non-admission of its significant fluctuations. In order to raise the role of monetary factors in the consumption price dynamics, measures to lower inflation should be taken. Calculation of basic inflation will be introduced, and it will be determined by the monetary factors. It will be used for analytical purposes to assess influence of the monetary measures on inflation.

In general, "Key Foundations of NBU Money-and-Credit Policy for 2007" envisage that main objective of the central bank is to ensure stability of the national currency unit. Taking into account the trends of macroeconomic development in 2006, the following indicators are projected for the monetary sphere in 2007: growth rate of money stock - 28-33%, UAH/USD exchange rate (average in the period) – UAH 4.95-5.25 for USD 1.

Positive macroeconomic trends and growth of personal income has positive impact on formation of the bank resource base, which was reflected in rapid pace of deposit growth. In the 1st quarter of 2006, total volume of deposits increased by 2.2%, in the 2nd quarter – by 9.6%, in the 3rd quarter – by 10.7%, in the 4th quarter – by 11.9%. In total, bank deposits increased in 2006 by 38.8% and reached UAH 184.4 billion. At that, funds from the natural persons were growing much faster than funds from the legal entities – 45.8% versus 30.1%.

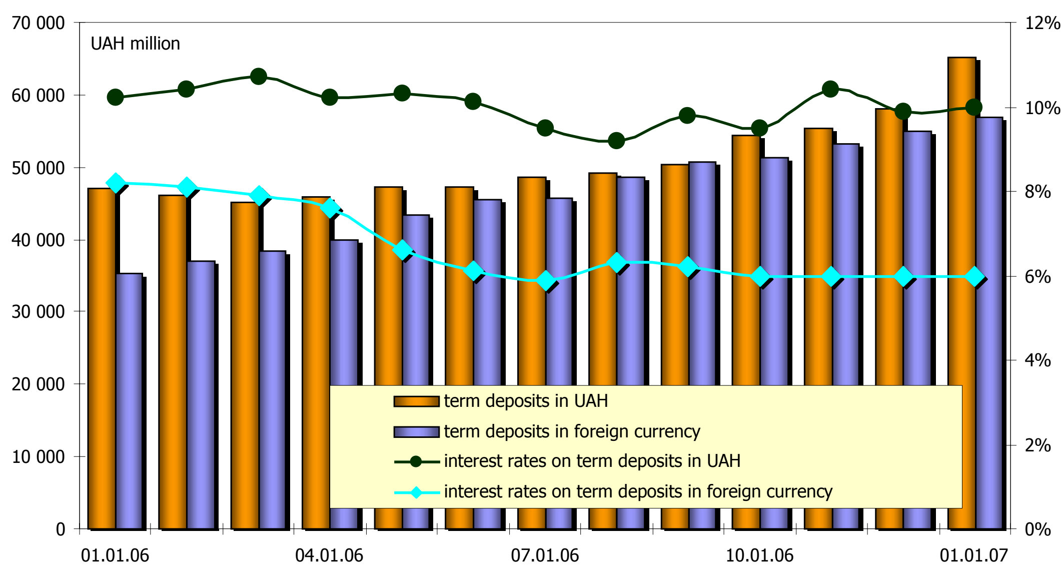

Chart 12. *Volumes of term deposits, UAH million. Interest rates on term deposits in 2005-2006*

Source: NBU

Portion of term deposits in total volume of raised funds was constantly growing during the year from 61% at the year beginning to 66.1% at the year end (UAH 121,943 million).

Beginning from the 2nd quarter, there appeared a trend of accelerated rate of term funds growth. In the 1st quarter, term deposits grew by 4.1%, in the 2nd quarter – by 9.8%, in the 3rd quarter – by 12.0%, in the 4th quarter – by 15.4%.

In the currency structure of term deposits, we can see an interesting trend: at the beginning of 2006, correlation between UAH and currency deposits was 57% versus 43%, but in August-September currency deposits were growing faster and this lead to the current correlation on the level of 50% versus 50%, which was caused by the relevant interest rate policy of the banks in respect of raising funds in the national currency. At the end of 2006, the trend of increased portion of term deposits in the national currency was resumed – the correlation is set on the level of 53% versus 47%.

Weighted average interest rate on term deposits in the national currency decreased insignificantly – only by 0.2% and was 10% as of January 1, 2007.

Actual bank interest rates on term deposits for 1 year as of the beginning of 2007 were 15% for deposits in UAH, 10.5% for deposits in USD and 8.5% for deposits in euro.

The trend to gradual animation of economic growth rate, along with positive dynamics of social indicators, fostered increased demand for money by both legal entities and natural persons, which was reflected in record growth of capital investments in the last years.

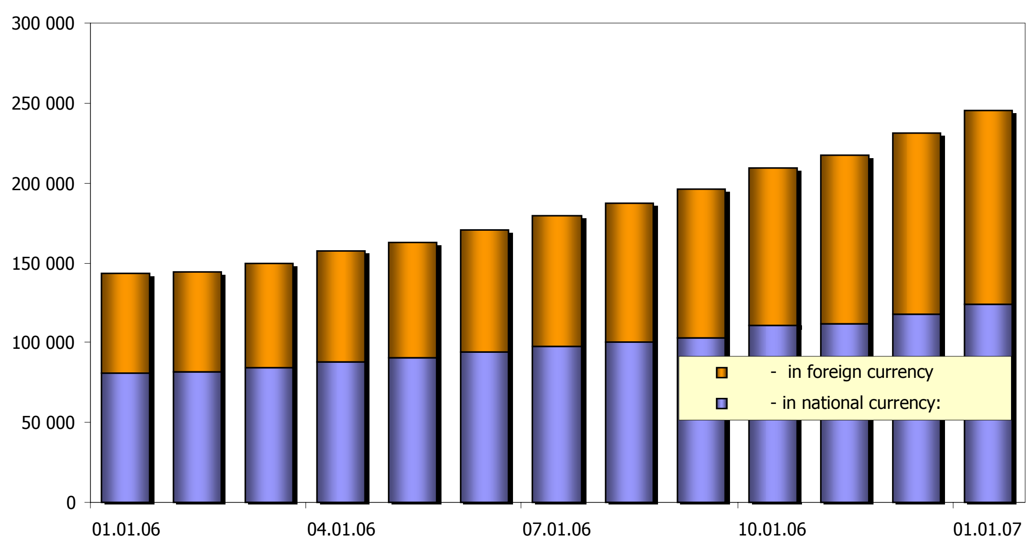

Chart 13. *Volumes of all loans in economy by currency in 2005-2006, UAH thousand*

Source: NBU

Credit investments in economy were growing faster than deposits. As of January 1, 2007, total volume of debt on loans reached UAH 245.3 billion, i.e. from the year beginning it increased by 71% (in 2005 – by 61.9%). At that, the highest credit activity is registered exactly in the 3rd and 4th quarters during which growth of credit investments was 16.7% and 16.9%, respectively, while in the 1st and 2nd quarters – 10.1% and 13.9%.

In 2006, loans in foreign currency were growing faster (by 95.8%) than loans in national currency (by 52.5%) which is explained by changes in the balance of payments (activation of importers who form demand for foreign currency), rapid increase by the banks of their resource base in foreign currency (through currency deposits and fund raising in the international markets) and more attractive interest rates on loans in foreign currency compared to UAH loans. Weighted average interest rate on loans in national currency decrease from 16.4% in January 2006 to 15.1% in January 2007.

Volumes of loans to natural persons increased in 2006 by 2.3 times up to UAH 78.5 billion, and portion of such loans in total loan portfolio of the banks is 32% as of January 1, 2007 compared to 23.4% at the year beginning.

Traditionally, loans in foreign currency are most popular with the individuals, and this is explained by lower cost of such loans and their connection to income level and UAH/USD exchange rate. Currency loans increased by 157.3%, UAH loans – by 106%.

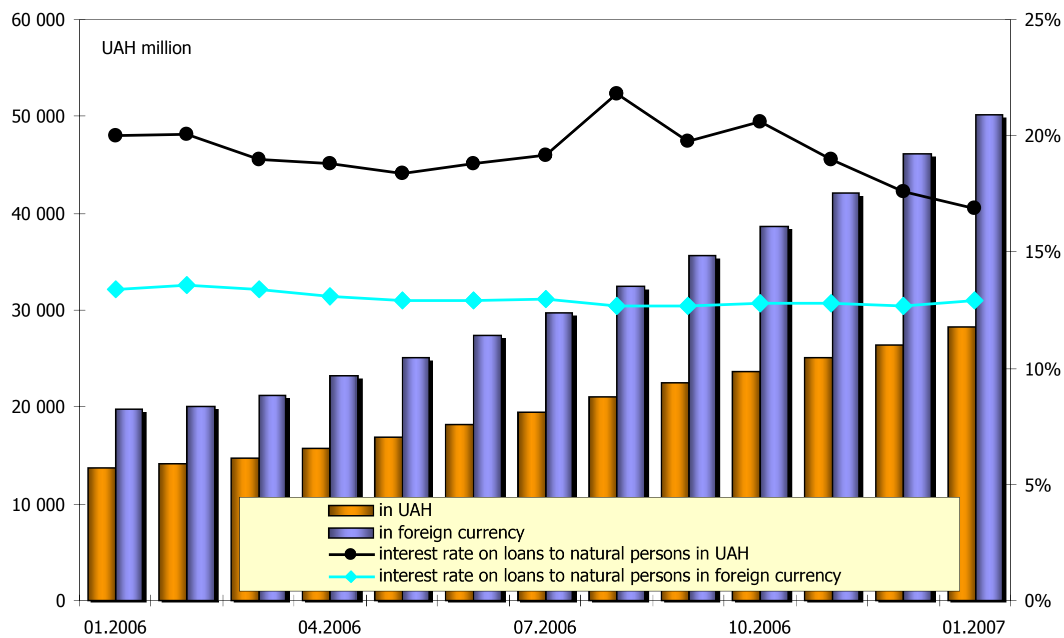

Chart 14. *Bank loans to natural persons in 2005-2006*

Source: NBU

As of January 1, 2007, interest rate on loans to natural persons in national currency remains higher compared to price of hard currency loans – 16.9% versus 12.9%. But analysis of dynamics of changes in weighted average interest rates during the year shows that a significant achievement is decrease of the interest rate on UAH loans by 3.1% (from 20% to 16.9%) which is explained by cycles of changes in cost of UAH loans – decrease of the interest rates falls on the spring and summer months and gets back to indicators of the year beginning in fall, i.e. declining trend occurs in the periods of the lowest demand for loans, while for hard currency loans there is a slow but steady decrease of loan cost – from the year beginning, the interest rate decreased by 0.5%.

Real Estate Market – Kyiv

2006 was marked in the history of Kyiv real estate market development as the period of rapid growth of prices for housing, and confirmed again the thesis that this sector in Ukraine is the most risky and unpredictable sphere of business. Taking into account stagnation of prices in January-February, expectation of market drop and political uncertainty of the country's economic policy, according to analysts' forecasts, price growth as of the year end was expected to be not more than 25-30%. But price of housing in the secondary market increased in 2006 by 66% having exceeded mercantile expectations of the sellers and crossed out the hopes of an average Kyiv resident to buy own housing.

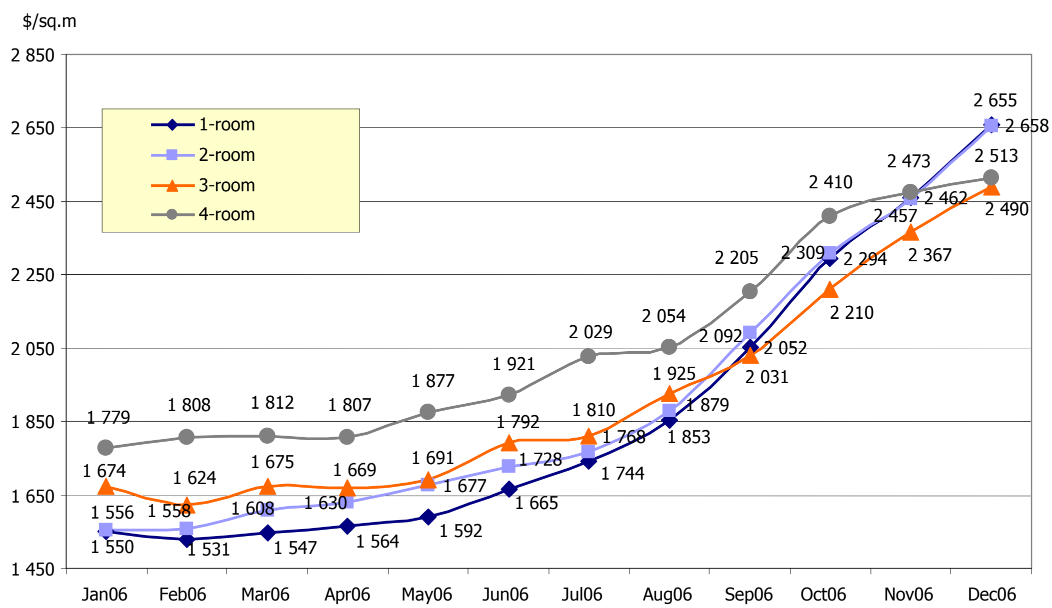

Chart 15. *Average dynamics of price for 1 sq.m. of housing in the Kyiv secondary market, USD per sq.m.*

Source: Planeta Obolon real estate agency

In the ***1st quarter*** of 2006, there was insignificant fluctuation of prices – decrease in value of low-quality housing, and insignificant increase of business class housing in the districts adjacent to downtown. In February, a shock occurred in the Kyiv primary real estate market as a result of investment fraud "Elita-Center" but this event did not have significant impact on price of a square meter, it only shattered confidence to small companies-developers and stimulated initiatives to regulate the system of parcellation of land plots for construction and improvement of mechanisms for financing of housing construction by individual investors. In total, in the 1st quarter of 2006, average price of 1 sq.m. of housing in the secondary market increased by not more than 1.2%.

Spring was marked with activation of the real estate market. The ungrounded winter forecasts for a fall in the Kyiv real estate market and expectations in the conditions of unclear political situation lead to formation of deferred demand for housing, and potential buyers decided to exercise it in spring. In the ***2nd quarter*** of 2006, prices for housing real estate were steadily growing by 1.5-2.0% a month both in the primary and secondary markets, except certain categories of expensive housing where increase-decrease of prices was 3-6% in certain months.

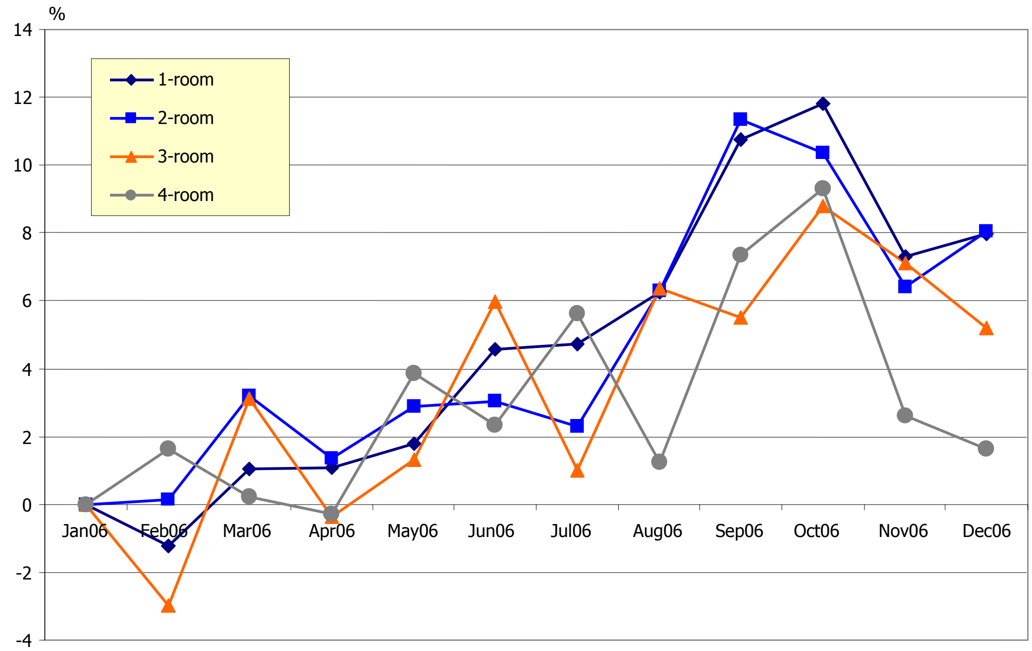

Chart 16. *Increase-decrease of price of 1 sq.m. of housing in the Kyiv secondary market, % of the previous month*

Source: Planeta Obolon Real Estate Agency

The beginning of summer was characterized by narrowing by the banks of their mortgage lending programs and increased level of interest rates in connection with the liquidity problem and issues of mortgage financing. Seasonal lowering of business activity also did not provide grounds for the real estate market specialists to forecast rapid growth of prices for housing which was expected only in fall. But the decisive role was played by the political factor – formation of the Parliamentary coalition and expectation of arrival to the capital of financial funds from the regions.

The market was heating up. According to real estate agencies, 25% of apartments were temporarily removed from sale by the sellers who were willing to hold their real estate till fall, in expectation of the seasonal price growth. The rest of the sellers raised the value of objects for sale in advance, thus providing profitability on the level of future fall prices. As a result, in July 2006, prices in the primary housing market increased by 1.9%, in the secondary market – by 3.1%. In August, the market was activated due to deferred demand of the buyers who were willing to buy housing today, before coming of the fall galloping prices, - the number of applications to buy housing significantly increased, just like the number of visitors viewing real estate objects and number of transactions, but still it was happening on the background of rapid price growth in all segments of Kyiv real estate. Just in one month, housing both in the primary and in the secondary market increased in price by 4.8%. With the beginning of fall, the situation became even more acute. In September, price growth was 8.6%.

As a result of ***the 3rd quarter*** of 2006, price of housing in the primary market increased by 11.9%, in the secondary market – by 17.9% in comparison with the previous quarter.

In the ***4th quarter*** 2006, Kyiv real estate prices experienced the same high growth rate as in the previous months: in October – 10.1%, November – 5.8%, December – 5.7%.

Overall, in 2006, secondary market housing prices increased by 66.3%, in the primary market – by 55.8%. As of January 1, 2007, the price of one square meter in one-room secondary market apartments was USD 2658, two-room – USD 2655, three-room – USD 2490, four-room and larger – USD 2513.

Table 1. *Prices of one square meter of housing by Kyiv districts*

District	*Secondary market*			*Primary market*		
	USD/sq.m.		*Growth, %*	*USD/sq.m.*		*Growth, %*
	1.1.2006	*1.1.2007*		*1.1.2006*	*1.1.2007*	
Holosiyivsky	1747	3073	75,9	1263	2108	66,9
Darnytsky	1413	2258	59,8	1045	1466	40,3
Desniansky	1308	2161	65,2	880	1743	98,1
Dniprovsky	1416	2321	63,9	1201	1760	46,5
Obolonsky	1566	2561	63,5	1520	1360	-10,5
Pechersky	2561	4042	57,8	1855	3187	71,8
Podilsky	1652	2670	61,6	1967	4888	148,5
Sviatoshynsky	1369	2283	66,7	1026	1532	49,3
Solomiansky	1531	2562	67,3	1145	1822	59,1
Shevchenkivsky	2006	3207	59,8	2185	2094	-4,2

Source: Real estate agency "Planeta Obolon", Portal "Nerukhomist"

The traditional specifics of Kyiv real estate prices are a significant differentiation by district. The most prestigious and expensive are Pechersky, Shevchenkivsky, Holosiyivsky and Podilsky – USD 2600-4000 per one square meter, the cheapest – Desniansky, Darnytsky and Sviatoshynsky – USD 2150-2280 per one square meter.

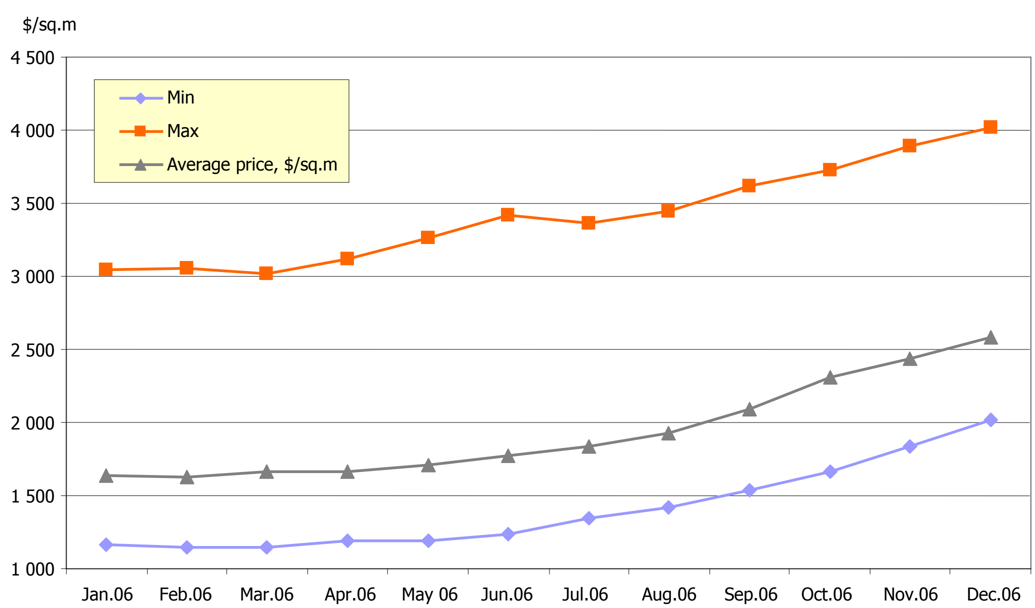

Chart 17. *Maximum and minimum prices of one square meter of housing in the Kyiv secondary market, USD per one sq.m.*

Source: Real estate agency "Planeta Obolon", Portal "Nerukhomist"

However, while the spread between maximum and minimum prices of housing in the most expensive (Pechersky) and the cheapest (Desniansky) districts of Kyiv was 2.6 times as of the beginning of the year, by the end of 2006 it decreased to 2 times, because middle-class housing was appreciating much quicker than expensive housing.

A high degree of housing prices differentiation depending on the location of the apartment is not in line with quality of such housing, since location of the apartment is not the only factor impacting on the price. As part of solving the problem of transparency in Kyiv real estate pricing, a forward-looking step in 2006 was the completion of developing the Ukrainian housing classification scale under the auspices of the Ukrainian Construction Association. The new classification breaks down housing into five categories: social class, economy class, business class, premium and de-lux.

Classification of a piece of housing real estate is determined based on 7 groups of parameters, including location of the building in the city, construction and technical specifications of the building, the level of development of the surrounding territory, the level of the external infrastructure, materials and equipment used during construction, technical equipment of the building and its system of exploitation.

The main purpose of adopting a unified classification is to distribute different formats of housing real estate offered in the market in the mind of the consumer, which would allow an objective assessment and pricing of real estate.

As regards transparent pricing in the primary housing market, the picture is somewhat different. Since October 1, 2006, the normative price of 1 sq. meter of Kyiv housing established by the Ministry of Construction that includes actual construction costs and the planned profit of 7% is UAH 3356 (USD 665), while the primary market prices have reached USD 1800-2100. In other words, construction companies' profits on each square meter of housing, on average, are at least USD 1135.

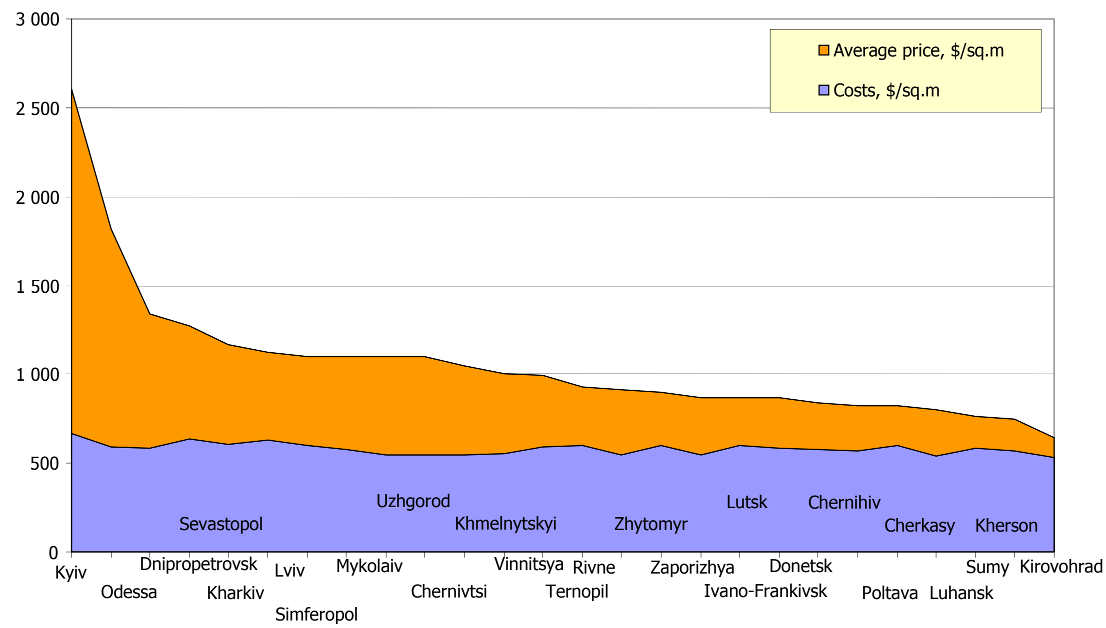

Chart 18. Relation between indirect and actual housing prices by regions, USD per one sq. m.

Source: UNIA

Comparing between the average secondary market housing price and indirect prices by regions, the margin becomes obvious showing the scale of overstating real estate prices, in Kyiv – 3.9 times, in Odessa – 3 times, in Dnipropetrovsk – 2.3 times.

The main reason of exorbitant real estate prices is that supply of new housing is in deficit. In Kyiv, each year they construct approximately 1 million of square meters of housing, while the real demand is at least 2 million square meters (or 20 thousand apartments). This misbalance between demand and supply causes price growth supported by profiteering – approximately 30-50% of apartments in the primary market are purchased with the view to their further reselling and receiving profiteering income.

Summing up the above, we may specify the main factors impacting on the development of the Kyiv real estate market in 2006:

1. The dynamic development of mortgage lending directly determining the level of affordability of housing – approximately 50-60% of Kyiv apartments are bought with housing mortgage loans.
2. The growth in population's incomes – the growth in actual incomes in 2006 was 16.1%.
3. Increased prices of construction materials and energy sources by 20% and 56.1% respectively.
4. Migration of the population including migration to Kyiv by representatives of regions holding significant capitals.
5. Psychological factors – deferred demand and expectations of a market collapse
6. Profiteers' demand for real estate – 30-50% in Kyiv, 20-30% - in regions.

2007 began with new regulation of relations between real estate market participants that would impact on its further development.

Kyiv housing prices in 2007 may experience an impact resulting from attempts of the current City State Administration to increase the proportion of housing that the construction companies must provide to the city free of charge or at cost. There is a high probability that the costs related to providing housing space to the government needs are compensated for by construction companies through price increases in the primary market to preserve the level of profitability at the same level.

Forecasts

Most real estate professionals believe that in 2007 Kyiv real estate prices will continue to grow, although at a slightly lower rate than in 2006. The price growth in the secondary market is expected to be 25-30%.

One of scenarios in the Kyiv real estate market in 2007 is the possibility that the overall level of housing prices will drop by 20-30%. Formulating such a hypothesis, analysts base their opinion on a business activity slump that occurred in entering into real estate purchase and sale transactions. For example, in 2006, the number of agreements was reduced by 15% as compared to 2005. Today, potential demand in the Kyiv market amounts to 500 thousand apartments, while the actual solvent demand is only 25 thousand apartments.

Real Estate Market – Kyiv Satellite Towns

The critical housing prices situation in Kyiv directed interests of potential buyers to towns located in the 30-kilometer area around Kyiv, which conditioned an accelerated price growth in the satellite towns. According to real estate agencies data, if in Kyiv in 2006 real estate prices increased by 66.3%, in surrounding towns they increased by 50%. The average price of one square meter in the primary market is USD 922, while in Kyiv it is USD 1576.

Table 2. *Average price of 1 square meter of housing in the primary market of Kyiv satellite towns*

Settlement	Average price of newly constructed housing, USD/sq.m	Date of commissioning the building
Boryspil	777-867	III Q 2007
	741	IV Q 2007
Boyarka	787-876	II Q 2007
Brovary	867	II Q 2007
	797-1036	III Q 2007
	966-996	IV Q 2007
Bucha	870	IV Q 2007
Vasylkiv	719-749	II Q 2007
Byshneve	1195-1265	IV Q 2007
Vyshgorod	1255	IV Q 2007
Gostomel	777-797	I Q 2007
Irpin	916	I Q 2007
Kotsiubynske	926	I Q 2007
Obukhiv	518-769	I Q 2007
Chaiky	996	II Q 2007
Yuriyivka	837	II Q 2007

Source: UNIA

The most popular in the satellite towns are small apartments: 50% of demand is for one-room apartments up to 45 square meters, 25% - two-room up to 70 square meters, 10% of buyers wish to buy three-room apartments up to 100 square meters.

The real estate market of the Kyiv satellite towns is considered the most attractive segment of activities by small and medium-sized construction companies, given the availability of solvent demand, development of infrastructure and possible inclusion of satellites in the Kyiv territory. Today, the price of local square meters is USD 300-600 lower than in Kyiv depending on the class of housing and its location. Experts forecast that in 2007 prices in the Kyiv suburban area will increase by 20-25%.

Real Estate Market – Regions

Dnipropetrovsk

Prices of Dnipropetrovsk real estate experienced an abrupt growth in all market segments. Housing in the primary market went up by 61.4% (from USD 700 to USD 1130 per one sq. m). In the downtown area, the price increase has been even more pronounced – at the level of 97.6% (from USD 1025 to USD 2025 per one sq. m), in districts close to the center – by 78.8% (from USD 660 to USD 1180 per one sq. m), uptown – by 34.4% (from USD 586 to USD 787 per one sq. m). By the end of 2006, housing prices in the secondary market ranged between USD 1293-1357 per one sq. m. During 2006, one-room apartments went up by 59.6%, two-room by 55.8%, three-room – by 53.5%. Demand remains unmet, there is an acute deficit of housing in all segments; over the past six month, only one new building was constructed in the market, scheduled to be commissioned in late 2008.

Donetsk

Over the period January-December 2006, Donetsk secondary market prices rose by 22%, which is almost twice less than the last year. On average, prices of one-room apartments in the city increased by 14%, two-room – by 18.3%, and three-room – by 20.2%. Prices of primary market housing increased by 30%. There is a noticeable trend of reduced profitability of real estate investments. Experts believe that, in the nearest future, the secondary market will cease to be part of the investment market, since in this region there are industrial investment alternatives. In 2007, it is forecasted that housing would appreciate no more than by 11-17%.

Kharkiv

Appreciation of housing in the primary market of Kharkiv in 2006 was 17-22%, in the secondary market – 35-38%. The price breakdown is as follows: economy class – USD 640/960 per one sq. m., business class – USD 740/1000 per one sq. m., business class+ - USD 1000/- per one sq. m., premium class – USD 1460/1400 per one sq. m. in the primary/secondary market respectively.

Sevastopol

There is an acute deficit of housing in the real estate market. While the real need of the city is 1 million sq. m., only up to 60-70 thousand sq. meters of housing are commissioned each year. Solvent demand is formed, mostly, by Moscow and St. Petersburg residents as well as residents of the Southern Shore of Crimea migrating to Sevastopol. In 2006, one-room apartments appreciated by 37.2%, two-room – 38.7%, three-room – 43.1%, four-room – 48.8%. The average price of one square meter is USD 800 in the secondary market and USD 700 in the primary market. Overall, real estate appreciated by 35.6% in 2006.

Yalta

The main demand in the primary market is formed by well-off residents of other regions considering high-quality housing in the Southern Shore of Crimea as a good investment. Demand in the secondary market is formed by the local population whishing to improve their living conditions. Downtown, the average price of one square meter in newly-constructed buildings is USD 2000-3500, uptown Yalta – USD 600-1500 per one sq. m. Secondary market housing is much cheaper – USD 1000-1500 downtown and USD 500-600 per one sq. m. uptown.

Luhansk

For the past two years, it has been the leader among regions by the rate of housing price increases. In 2006 alone, prices went up by 68.4%. Local realtors believe that the main reasons for such quick price growth is migration processes via Luhansk from Kazakhstan and Russia, a complete lack of a primary market in the region and active transformation of apartments into business premises in a situation where there is a lack of commercial real estate. By late 2006, the price of one sq. meter downtown reached USD 1150-1290, uptown – USD 660-820.

Lviv

Lviv real estate market in 2006 was characterized by rising prices of all types of housing: one-room apartments appreciated by 31.2% (from USD 800 to USD 1050 per one sq.m.), two-room apartments appreciated only by 19% (from USD 840 to USD 1000 per one sq. m.), three-room apartments appreciated by 26.3% (from USD 760 to USD 960 per one sq. m.).

The secondary market had a smooth price dynamics, in particular, one-room apartments appreciated by 11.9%, two-room – by 21.4%, three-room – by 22.9%. On average, the price of one square meter in the secondary market ranged between USD 1020-1100. The average space of apartments put up for sale in 2006 was 58.1 sq. m. For Lviv, same as for other Western Ukrainian cities, characteristic is the activity in the real estate market by migrant workers working abroad and using earned money to buy real estate at home. According to realtors, there is a deficit in the region of high-quality economy-class housing, however, on the other hand, Lviv has always been the place for elite construction, therefore, in the nearest future, the city may become the leader by the amount of high-quality club-type housing.

Uzhgorod

In 2006 in Uzhgorod, one- and two-room primary market apartments appreciated by 23% (from USD 650 to USD 800 per one sq. m.). Some apartments were sold at USD 1350 per one sq. m. depending on location. Mostly local construction companies are active in the primary market, even though one Kyiv construction company – "Komfort-Invest" – is active there. In the local secondary market, one square meter in one- and two-room apartments has the same price. Downtown prices rose by 53.7% (from USD 846 to USD 1300 per one sq. m.), uptown prices rose only by 6.3% (from USD 846 to USD 900 per one sq. m.). Three-room apartments appreciated on average in the city by 36% (from USD 946 to USD 1300 per one sq. m.). Dynamic housing appreciation in this region is, obviously, the result of the city being close to the state border.

Ivano-Frankivsk

The primary market of Ivano-Frankivsk has oversupply of newly-constructed housing - there are approximately 220 construction companies active in the region, and only 30-40% of apartments are sold in newly-constructed buildings. Despite this, in 2006 realtors recorded a price increase in the primary market of one- and two-room apartments – by 15.2% downtown (from USD 660 to USD 760 per one sq. m.) and by

26.1% uptown (from USD 560 to USD 700 per one sq. m.), two-room by 16.1% downtown (from USD 620 to USD 720 per one sq. m.) and by 28.3% uptown (from USD 480 to USD 616 per one sq. m.).

In the secondary market, prices of one- and two-room downtown apartments rose by 12.5% (from USD 800 to USD 900 per one sq. m.) and by 13.3% uptown (from USD 750 to USD 850 per one sq. m.). Three-room apartments appreciated by 12.5% (from USD 650 to USD 800 per one sq. m.) downtown and by 30.8% uptown (from USD 650 to USD 850 per one sq. m.).

Ternopil

In 2006, prices rose in all segments of the real estate market of Ternopil. Primary market apartments appreciated on average by 31.6% (from USD 575 to USD 757 per one sq. m.). Secondary market one-room apartments appreciated by 16.6% downtown and by 13.6% uptown, two-room by 12.3% and 11.9% respectively, three room by 11.3% and 8.75%. By late October 2006, the average price of one square meter was USD 980-1050 downtown and USD 870-1000 uptown.

Rivne

According to local real estate agencies, primary market housing prices rose in 2006 by 66%, which is explained by insufficient volume of housing construction in the region. Today Kyiv ("Sit-Invest") and Lviv ("InterGalBud", "AvantiBud") construction companies entered the Rivne market. Hopes of renewing the city's housing are laid on those. Presently, 60% of apartments there are in Khruschov 5-storey apartment blocks.

The highest demand in the secondary market is for one-room apartments, where one square meter appreciated by 25% downtown and by 30.4% uptown. Two- and three-room apartments appreciated by 28.7% and 44.3% downtown and by 31.1% and 14.3% uptown respectively. The main factors causing the positive price dynamics are weak development of the primary housing market, expansion of mortgage lending programs and income of migrant workers.

Overall, housing prices in the regions appreciated, on average, by 38.4%. Joint features for regional real estate markets are the high dependency of demand for housing and, consequently, prices on availability of housing mortgage loans, given the low level of population's incomes as well as the deficit of high-quality new housing, that is, a virtual lack of a competitive primary market.

Table 3. *Secondary market price dynamics in regions*

Oblast center	*Rating position as of January 1, 2007*	*Average price USD/ sq.m.*			*Price growth, %*	
		1.1.2005	1.1.2006	1.1.2007	2005-6	2006
Kyiv	1	940	1 550	2 600	176.6	67.7
Odesa	2	830	1 100	1 820	119.3	65.5
Dnipropetrovsk	3	650	880	1 340	106.2	52.3
Sevastopol	4	590	940	1 275	116.1	35.6
Kharkiv	5	690	900	1 170	69.6	30.0
Simferopol	6	520	880	1 120	115.4	27.3
Lviv	7-10	650	890	1 100	69.2	23.6
Mykolaiv	7-10	-	740	1 100		48.6
Uzhgorod	7-10	-	860	1 100		27.9
Chernivtsi	7-10	500	870	1 100	120.0	26.4
Khmelnytsky	11	400	700	1 050	162.5	50.0
Vinnitsya	12	450	660	1 000	122.2	51.5
Ternopil	13	450	850	995	121.1	17.1
Rivne	14	450	700	925	105.6	32.1
Zhytomyr	15	350	640	910	160.0	42.2
Zaporizhya	16	360	650	900	150.0	38.5
Ivano-Frankivsk	17-18	350	750	870	149.0	16.0
Lutsk	17-18	-	660	870		31.8
Donetsk	19	570	720	865	51.8	20.1
Chernihiv	20	350	580	840	140.0	44.8
Poltava	21	-	570	820		43.9
Cherkasy	22	330	625	820	148.5	31.2
Luhansk	23	270	475	800	196.3	68.4
Sumy	24	320	600	760	137.5	26.7
Kherson	25	-	490	750		55.1
Kirovohrad	26	-	520	645		24.0

Source: Association of Realtors of Ukraine

Residential Mortgage Lending

Note
The information in this Section was provided by 42 banks in the course of a survey administered in February 2007.

Overall Market Situation

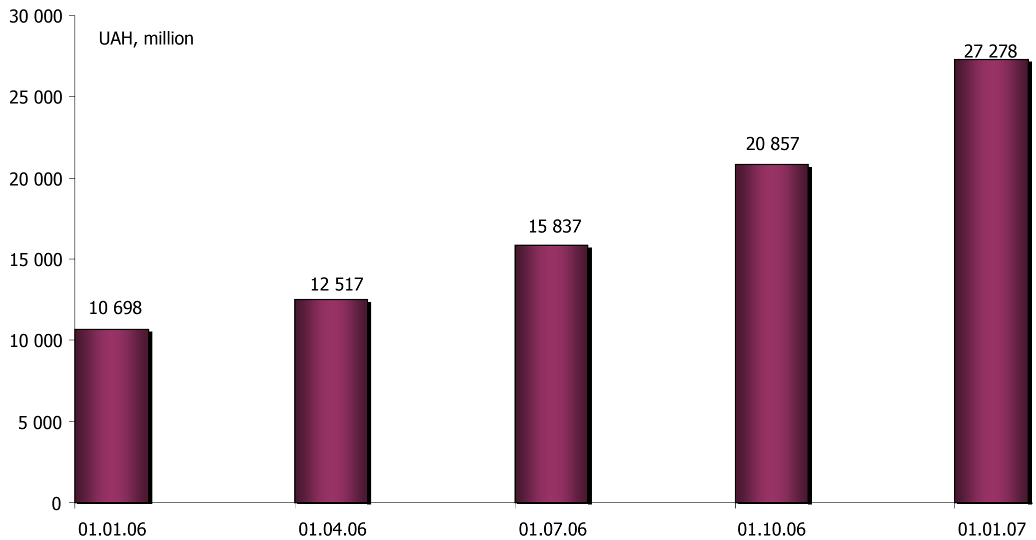

Chart 19. *Volumes of outstanding mortgage loans in 2006, million UAH*

Source: UNIA

During the entire term, commercial banks worked actively trying to achieve record indicators of the past 2005 year. As usual, the year has a slow start in the first quarter, but the highest rate was achieved at the end of the year, in the fourth quarter, when, on average, during one month they wrote mortgage loans for over UAH 2 billion! For the year, the average rate of outstanding mortgage loan increase was UAH 1.3 billion per month.

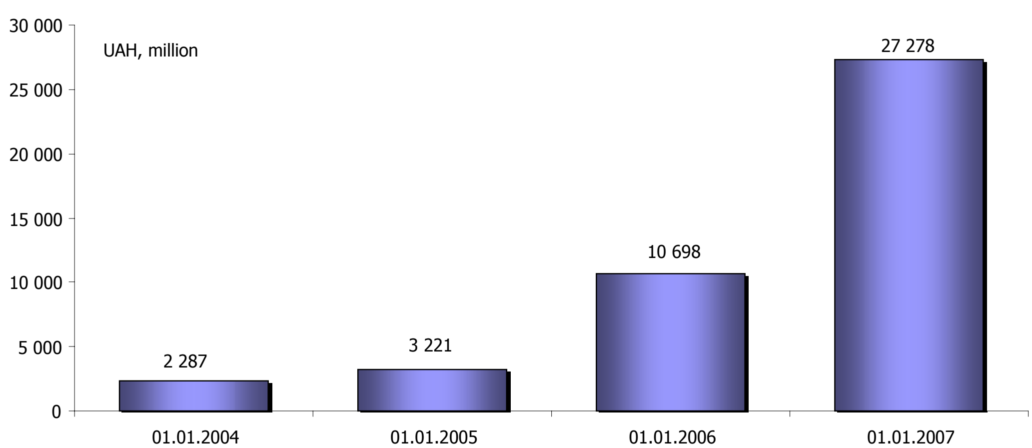

Chart 20. *Amounts of outstanding mortgage loans in 2004-2006, UAH million*

Source: UNIA

Over the past years banks demonstrate really striking indicators of writing mortgage loans. After the 200% rate of growth in 2005, the last year banks reached 155% growth. In the beginning 2006, we made a forecast for 2006 – 90-95% growth during the year. However, banks reached this level already during the first nine months, and in the last quarter they increased the outstanding mortgages to UAH 27.2 billion. Schedules of indebtedness for mortgage loans remind us of Soviet posters with one essential difference – the former represent real facts and, indirectly, show the growth of population's trust in their promising future.

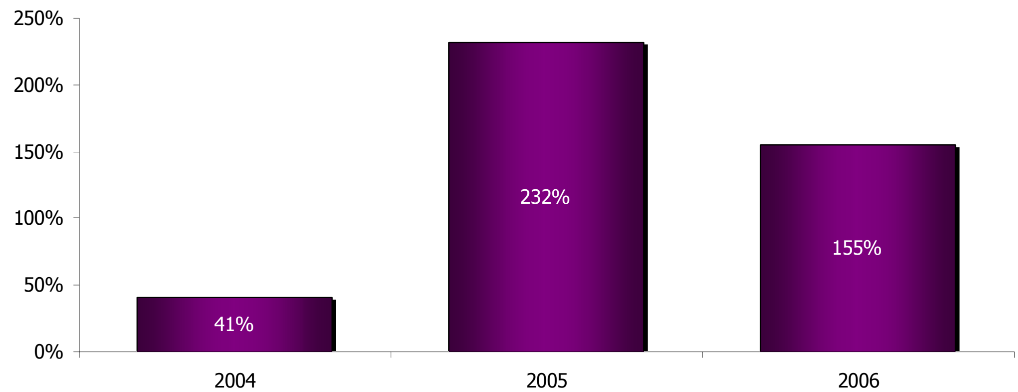

Chart 21. *Rates of growth of outstanding mortgage loans in 2004-2006, % of the prior year.*

Source: UNIA

The proportion of mortgages is increasing both in the general loan portfolio and in the portfolio of loans to individuals. In the beginning of the year, the proportion of mortgage loans in the general loan portfolio was 7.5%; it reached 11.1% over the year. The proportion of mortgages in loans to individuals exceeds one-third – 34.7%.

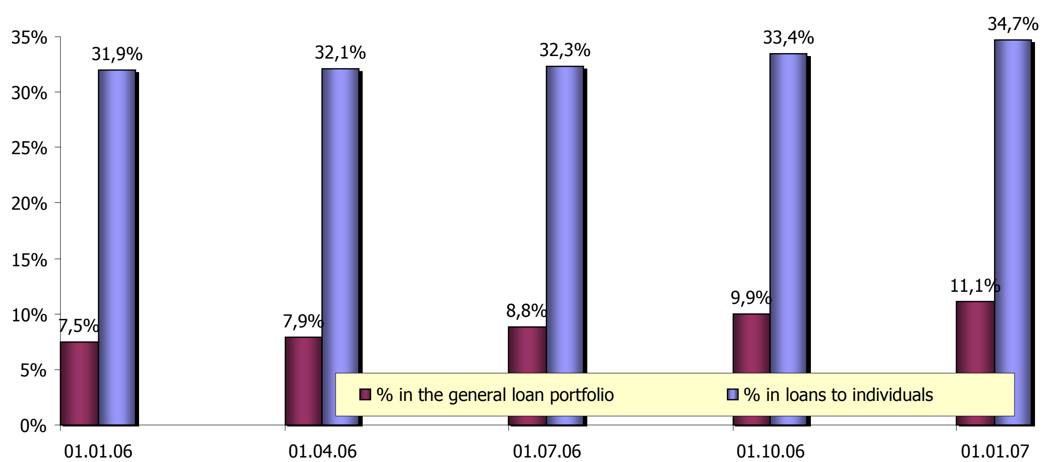

Chart 22. *Proportion of mortgage loans in the loan portfolio of commercial banks in 2006, %*

Source: UNIA

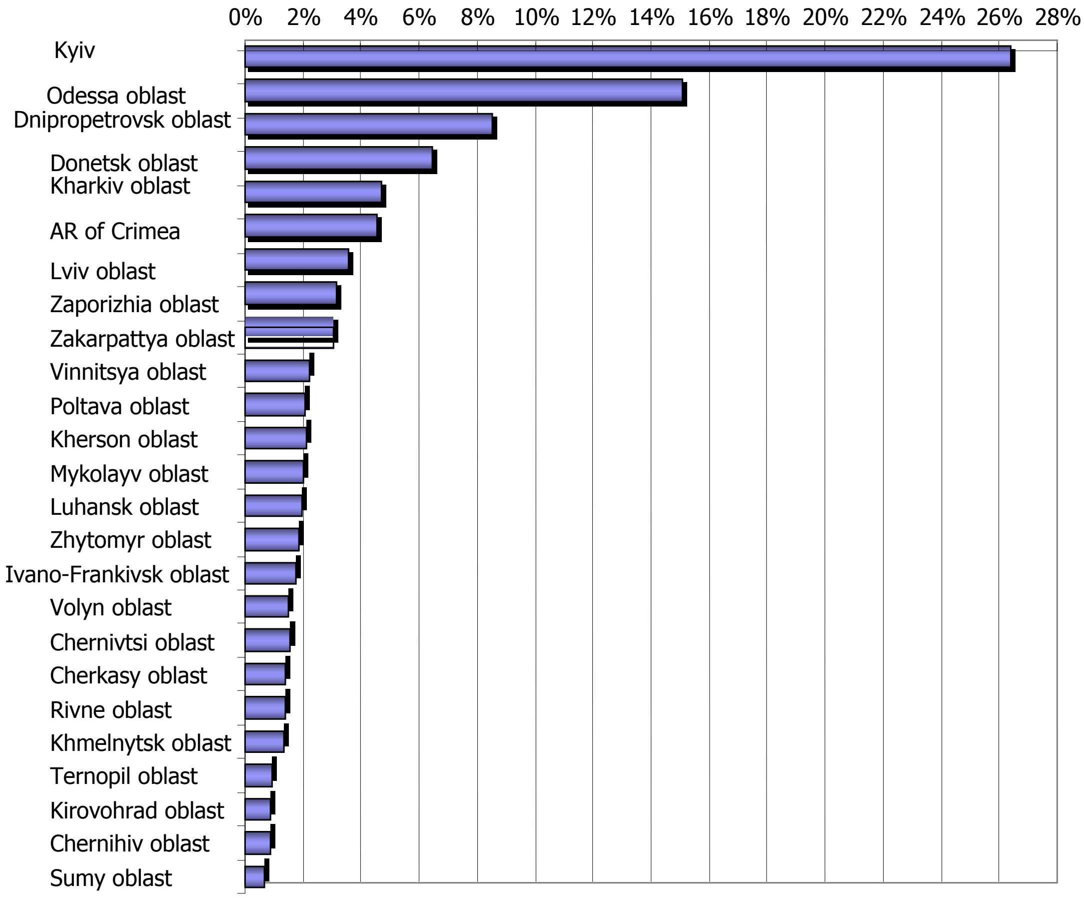

Chart 23. *Regional structure of mortgage loans as of January 1, 2007, % of total amount*

Source: UNIA

At the end of the year, we collected information on the regional structure of mortgage lending. This first position is occupied, as expected, by Kyiv and the oblast – 27% (the oblast accounts for no more than 1.5%). The second position is occupied by the Odessa oblast. However, it is not much surprising that Odessa is in the second place, but rather the fact that it accounts for approximately 16%, twice as much as Dnipropetrovsk that occupies the third position with slightly over 8%. Overall, the mortgage structure of Ukraine represents the situation in the housing market of the country and its regional demand for housing. Besides, we should take into consideration the population of oblast centers and cities. For example, Luhansk and Zhytomyr are close and have almost the same share. However, if we remember that the population of Luhansk is times more than the population of Zhytomyr, it becomes clear that Zhytomyr has a higher volume of mortgage lending per capita. If we calculate this indicator for other cities, it is Odessa, not Kyiv that comes to the first place.

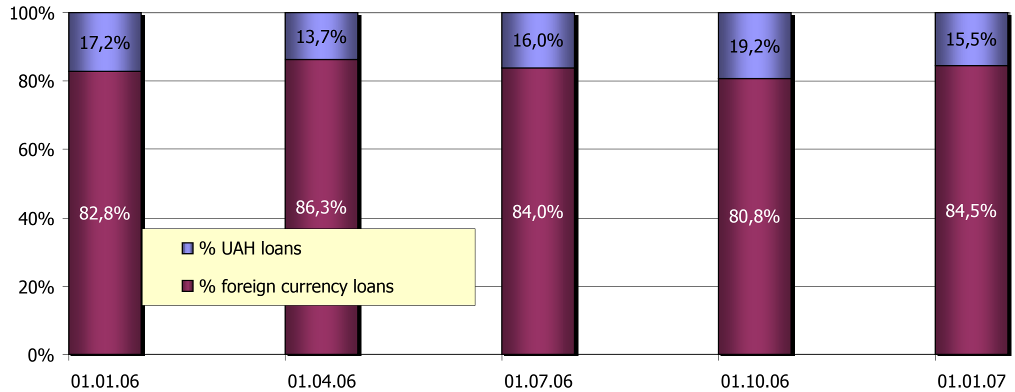

Chart 24. *Structure of mortgage loans in foreign currency in 2006, % of total amount*

Source: UNIA

Despite regulator's attempts to have an impact on the currency of loans, Ukrainians prefer foreign currency when obtaining mortgage loans. It is the mortgage loans that have the highest proportion of foreign currency loans – almost 84.5%, while in the overall loan portfolio foreign currency loans account for 49.5% and in loans to individuals – 63.9%. In our opinion, loan prices as well as long-term expectations regarding the hryvna stability have an impact on the choice of a foreign currency as a priority currency.

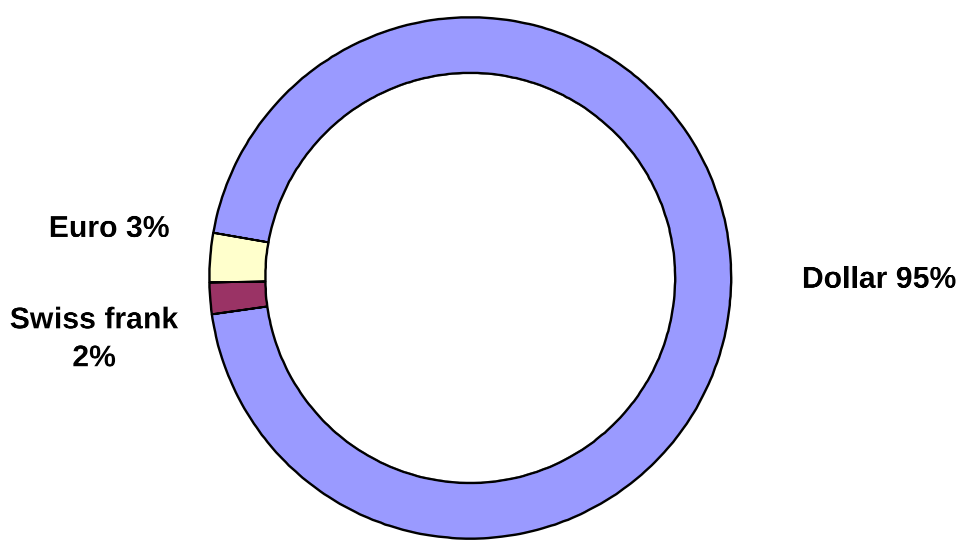

Chart 25. *Structure of foreign currency mortgage loans as of January 1, 2007, % of the total amount*

Source: UNIA

The foreign currency composition of mortgage loans is as follows: USD accounts for 95%, the other two currencies, euro and Swiss frank, both account for 5%. Swiss frank loans appeared in the market of Ukraine little more than one year ago. However, over such a short period, due to the efforts by three banks, the popularity of Swiss frank loans is catching up on euro. We may expect that in the nearest future, given more favorable lending terms, Swiss frank loans will become more popular with loan amount exceeding that of euro.

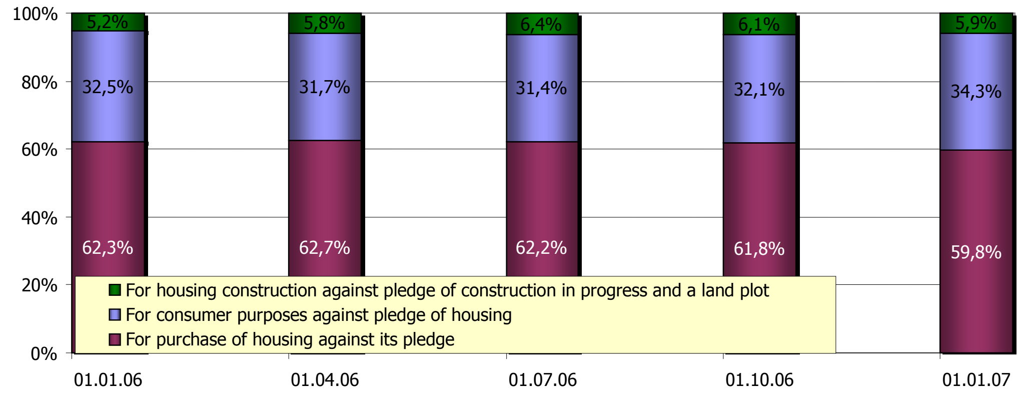

Chart 26. *Structure of mortgage loans in 2006 by fields of lending, % of* ***total amounts***

Source: UNIA

The structure of mortgage loans by fields of lending has remaned virtually the same over the past two years. The priority field is loans to purchase housing against its pledge – 59.8% as of the end 2006. Loans for constructing private housing have been increasing but at the same rate as the entire market.

The average amount of outstanding mortgage loans increased at the expected rate, the reasons for such growth being:

- Growth of housing prices and related growth of average loan amounts
- Extension of mortgage loan terms.

The average amount of outstanding loans to purchase housing as of late 2006 was UAH 122 thousand, or 36% more than in the beginning of the year. A more abrupt growth was registered for loans to construct private homes, over six months they increased by 81%, the average amount being UAH 182 thousand.

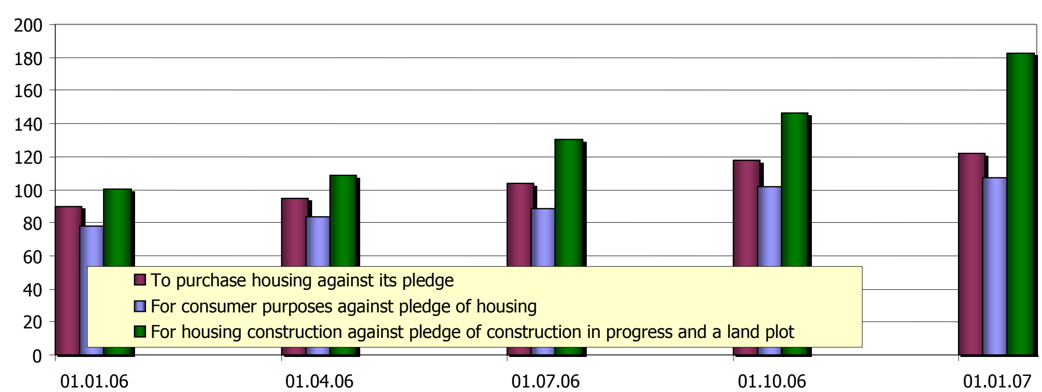

Chart 27. *Average amount of outstanding mortgage loans in 2006, UAH thousand*

Source: UNIA

The proportion of loans in the primary market continues to grow – if at the beginning of the year 6.3% of housing loans were written to purchase housing in the primary market, in nine months this figure increased to reach 15.7%. Such growth occurs against the background of an insignificant growth in the number of banks that write loans to the primary market. The top five mortgage lender banks are active creditors in the primary housing market.

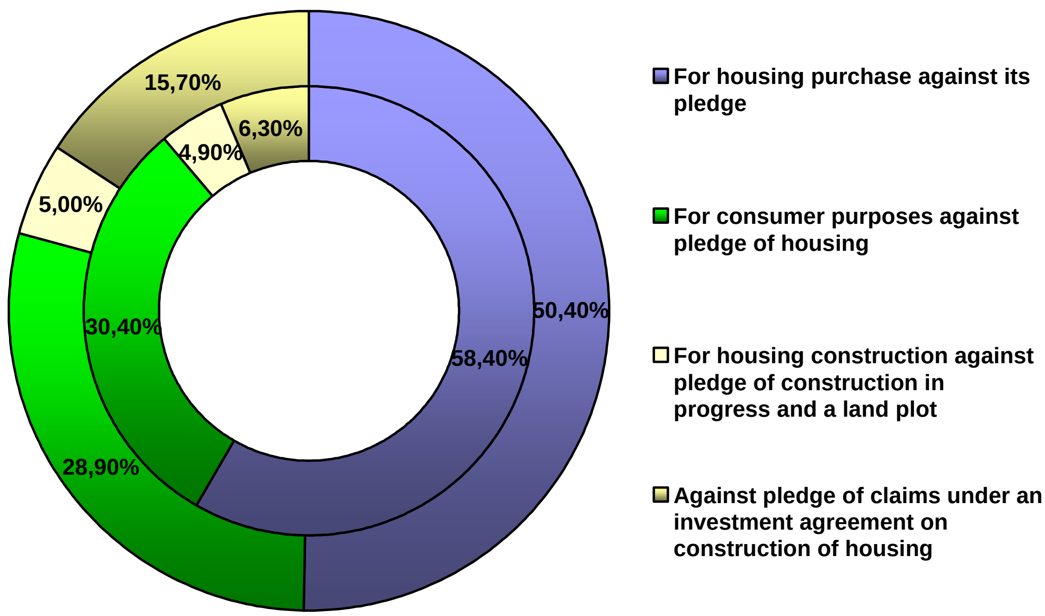

Chart 28. *Structure of housing loans as of January 1, 2007, % of total amount*

Source: UNIA

Bank Performance Indicators

The market remains highly concentrated. The situation on the market is determined by first 20 banks which account for more than 95% of the real estate market. The portfolio of only 19 of them exceeds UAH 100 million.

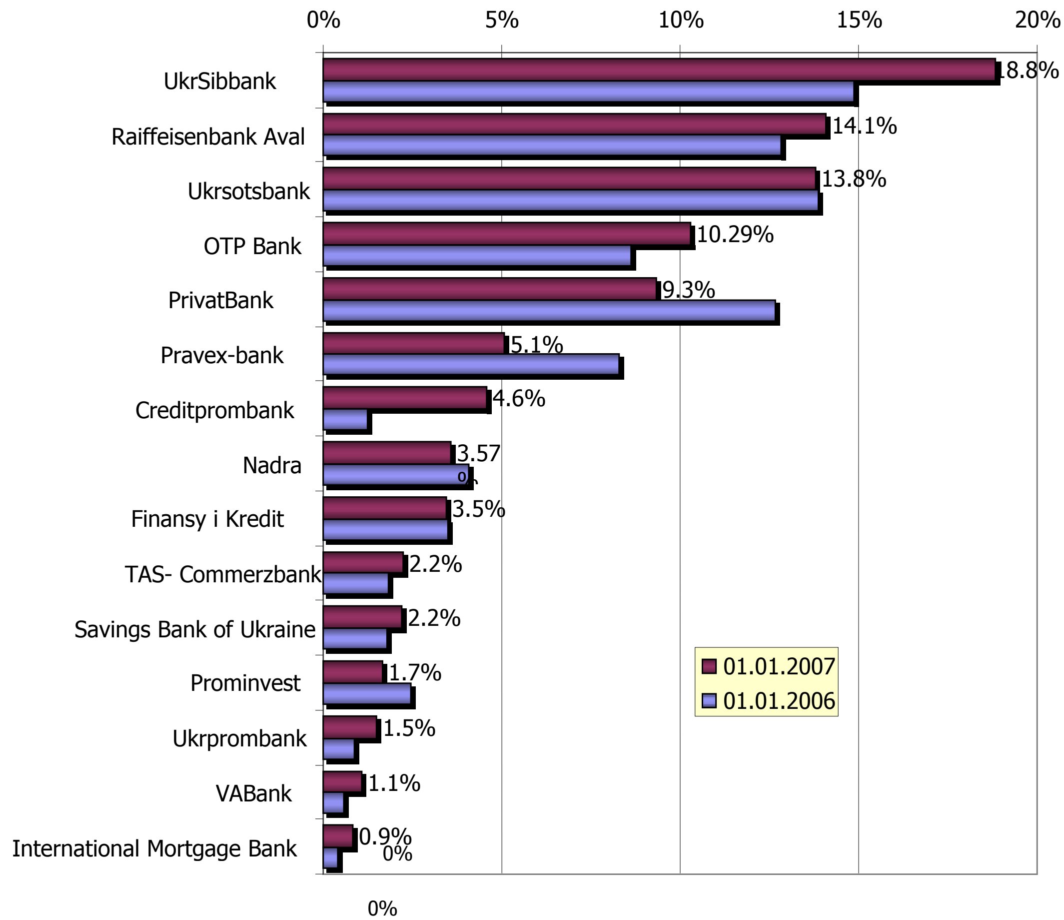

Chart 29. *Market share of 15 biggest banks in the mortgage lending market as of January 1, 2007, %*

Source: UNIA

The mortgage market leader has been changing all the time in the course of the year. After every successful quarter the positions of a bank on a mortgage Olympus seemed to be steady, however several months of active loan-making resulted in a change of the leader. UkrSibbank began the year at the top and is still there. Raiffeisenbank Aval and Ukrsotsbank rated second and third respectively though they have managed to be at the top of the mortgage market during the year. OTP Bank rated fourth, Privat Bank fifth.

There were changes in the top ten of the banks during the year: Arkada and Prominvestbank were replaced by Creditprombank and TAS- Commerzbank.

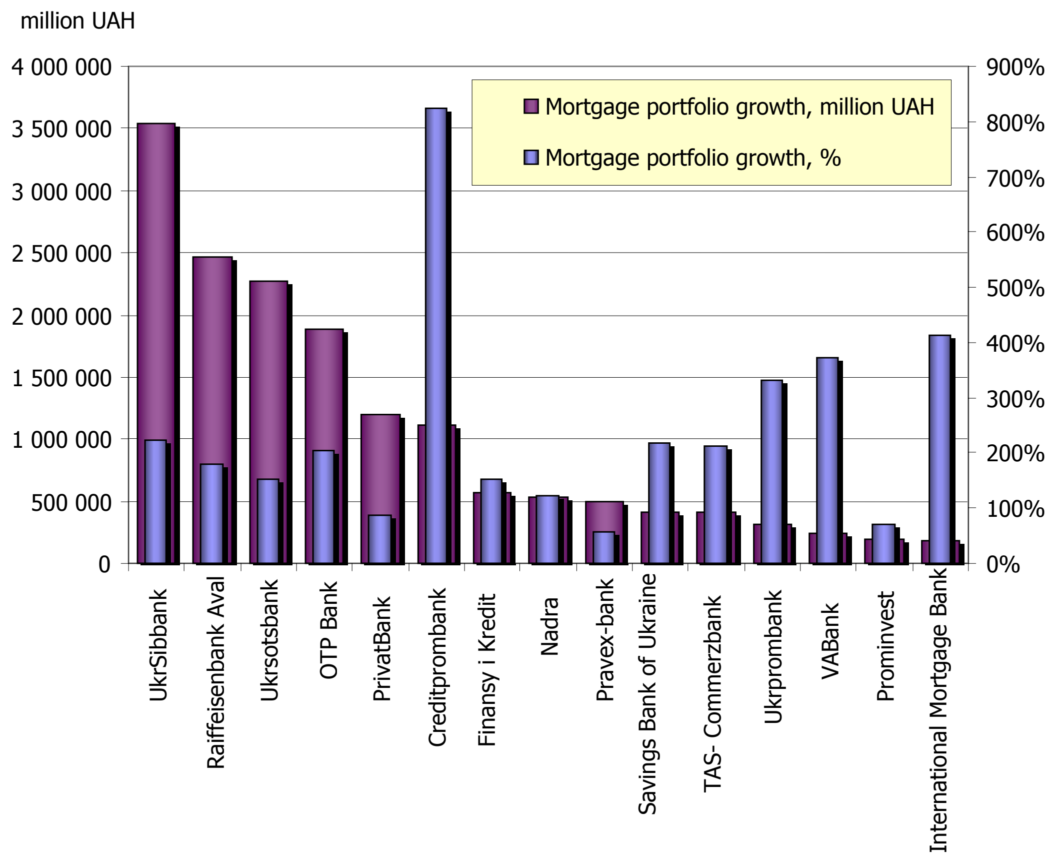

Chart 30. *Mortgage portfolio dynamics of the first 15 banks in 2006*

Source: UNIA

First five banks increased their mortgage portfolio on average by UAH 190 million per month in 2006. UkrSibbank was the most successful with an increase of more than UAH 3.5 billion in its mortgage portfolio.

Creditprombank is the leader of growth rates among banks having a mortgage portfolio in excess of UAH 100 million. Over the year the bank has increased its mortgage portfolio 8 times.

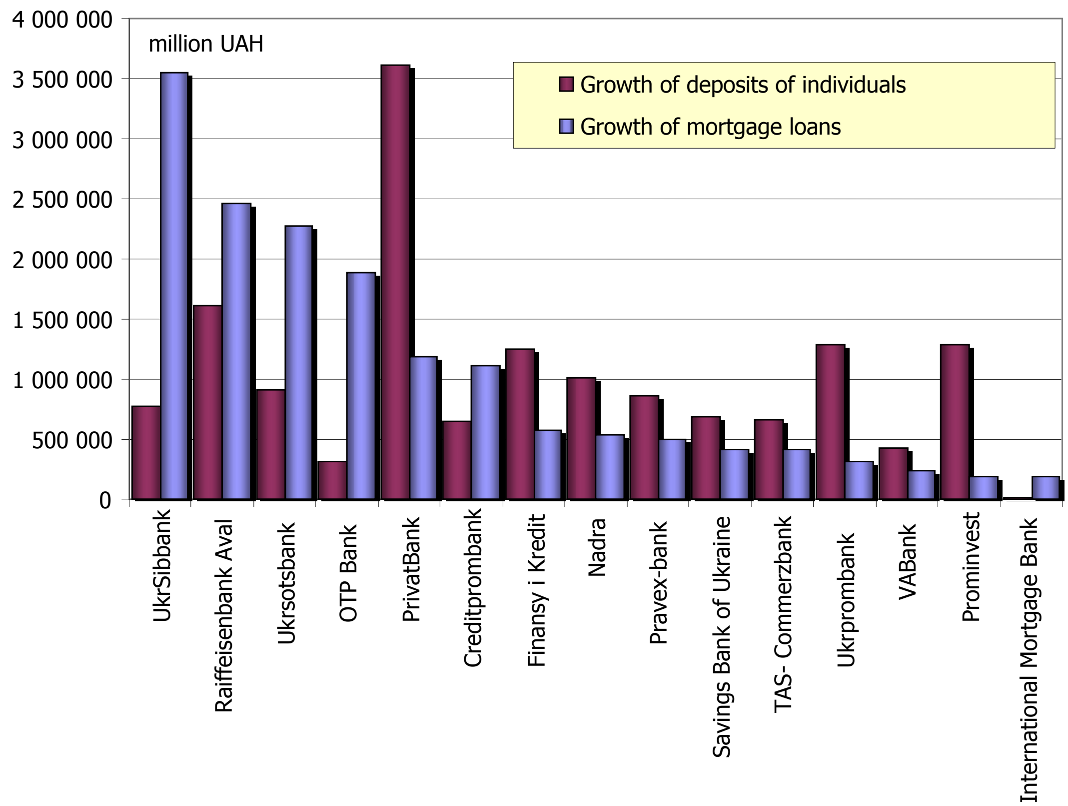

Chart 31. *Growth of mortgage loans and term deposits of individuals of the first 15 banks in 2006, in millions UAH*

Source: UNIA

In the last year, leading mortgage lenders have managed to resolve the issue of financing their credit portfolios to secure their rapid growth. Foreign banks practically do not view deposits of individuals as the main source for mortgage loan financing. As shown on the chart, deposits of individuals were growing faster than mortgage loans only in Ukrainian banks.

Terms of Residential Mortgage Lending

In the second half of January 2007, UNIA specialists conducted a survey of basic lending terms in the residential mortgage market. Te survey has been administered to the ten banks that are the largest mortgage lenders. The survey was conducted over the telephone. The information about mortgage lending posted on the banks' official websites was checked for fairness and accuracy.

The 10 banks that are the largest mortgage lenders: Raiffeisenbank Aval, UkrSibbank, Ukrsotsbank, OTP Bank, Privatbank, Creditprombank, Aval, Nadra, Finansy i Kredit, TAS-Commertzbank.

Interest Rates

2006 is the year of forecasts that have not proven to be true. Not only stable high rates of economic growth in the country turned out to be unexpected for Ukrainian and international experts and the unpredicted increase in prices for residential real estate shocked market participants but further tendencies regarding the trend for interest rates on mortgage loans became a surprise for potential lenders as well as banks lenders.

In 2006, **nominal** interest rates on residential mortgage loans in the national currency increased by 1.75% and decreased by 0.5% in USD and by 0.75% in euro.

Taking into account the monthly commission fees charged by the lenders to adjust the value and yield on mortgage loans, we analyzed the dynamics of interest rates including monthly commission. In 2006, real interest rates on residential mortgage (including monthly commission) denominated in UAH increased 2% and practically remained on the level of the beginning of 2006 for loans in USD and euro (increased 0.1-0.3%).

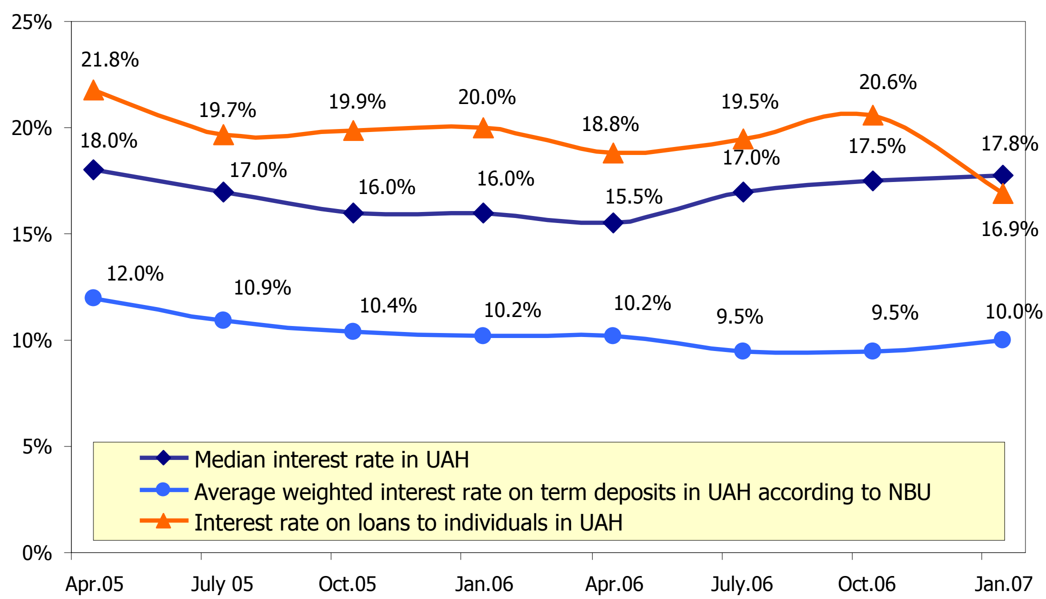

Chart 32. *Median interest rate on residential mortgage loans in the national currency,%*

Source: UNIA

In the **1st quarter** 2006, the main feature of the residential mortgage lending market was liberalization of residential mortgage lending terms. It mainly manifested in the slight decrease in interest rates and loan down payments. Nominal interest rate on residential loans in the national currency decreased by 0.5% and by 0.5-1% for loans in USD and euro. As of April 1, 2006, median interest rates were 15.5% for loans in the national currency, 12.0% - in USD and 10.8% - in euro.

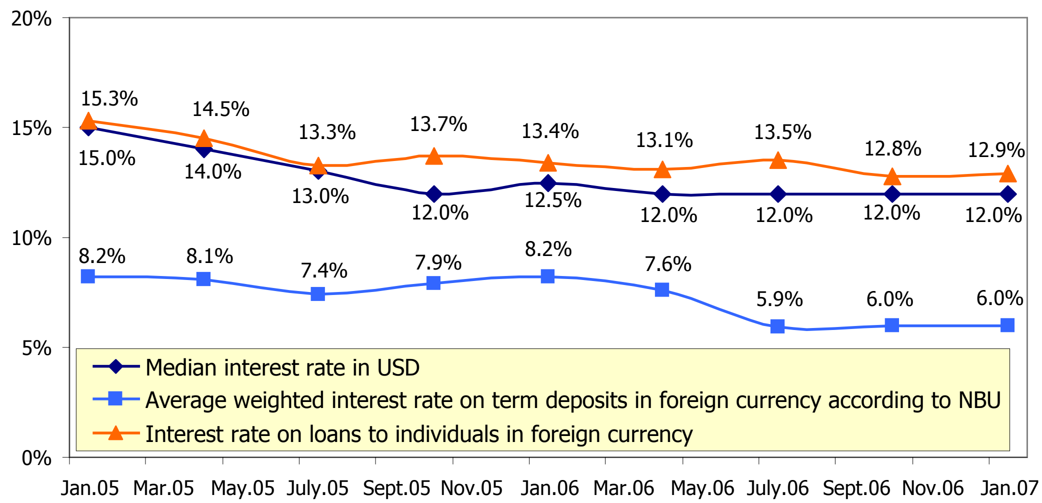

Chart 33. *Median interest rate on residential mortgage loans in USD, %*

Source: UNIA

However, in the beginning of the **2nd quarter** a general increase in mortgage loans interest rates started. Liquidity problems of the banks, unstable political environment as well as an increase in the cost of financial recourses in the international capital markets were the main reasons of the increase in the mortgage cost. As of July 1, the median rate was 17.5% for loans in the national currency, 12% in USD and 11.5% in euro.

Although there was a seasonal increase in business activity and considerable growth of demand for mortgage loans **in the 3rd quarter**, banks failed to initiate reduction of mortgage loans interest rates as the autumn began. Hryvnia loans increased up to 17.5%, dollar loans remained unchanged at 12%, euro loan interest rates decreased by 0.25 to 11.25%. The lack of uniformity among banks in terms of pricing policy (some banks increased interest rates, while others reduced them) was largely due to differences in the access to financial recourses which were attracted by issuing euro and hryvnia bonds as well as making syndicated loans. To some extent, the NBU statement about limiting the amount of loans in foreign currency could become one of the factors which triggered the increase in the cost of hryvnia loans. That is, banks factored in the potential increase in the cost of hryvnia mortgage loans that would have occurred if a corresponding NBU Resolution had taken effect.

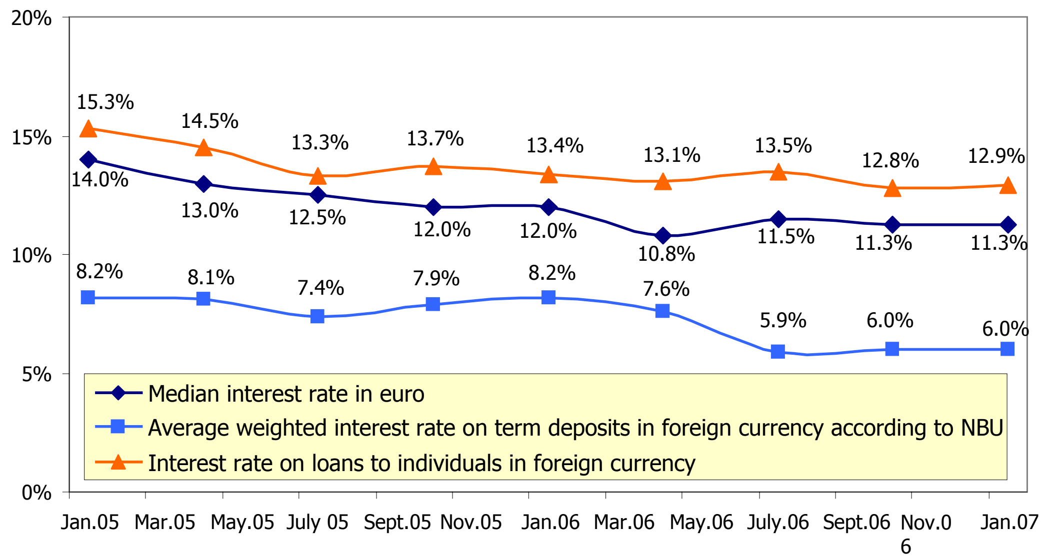

Chart 34. *Median interest rate on residential mortgage loans in euro, %*

Source: UNIA

4th quarter of 2006 did not bring any significant changes in the prices offered by banks – over the last three months the interest rates on loans in national currency have increased by 0.25% while the interest rates for loans in foreign currency remained unchanged.

As of **January 2007,** nominal median interest rates on residential mortgage loans were 17.75% in hryvnia, 12.0% in US dollars and 11.25% in euro.

There are two main factors hindering further decrease in interest rates on residential mortgage loans in Ukraine:

1. *Cost of mortgage financing* – lack of experience in using the mechanisms for drawing funds to the mortgage market by issuing mortgage bonds and doing mortgage portfolio securitization, which could give the banks a systematic access to international capital markets following Europe's example. Residential lending is currently financed from deposits, eurobonds or even equity.
2. *Credit risks* - residential property prices have reached a level that does not the real value of property. Consequently, banks set higher interest rates to partially compensate potential losses in case of default on the loans.

Monthly commission fees

Banks continue charging monthly commission fees on the outstanding debt or the whole loan amount. Among the top 10 banks making mortgage loans, Privatbank charges a monthly commission of 0.2% on the outstanding amount, Finansy i Kredit - 0.19% and Nadra - 0.35%.

When the monthly commission is added, the real annual interest rate paid by the borrower is 2.2 - 4.2% higher than the nominal interest rate.

Maximum interest rates (with the monthly commission included in the annual interest rate) were charged by banks such as Nadra - 19.7% in hryvnia, Raiffeisenbank Aval, Creditprombank, TAS-Commertzbank - 14% in USD, Raiffeisenbank Aval - 14% in euro.

Cheapest loans were offered by the Savings Bank of Ukraine - 15% in hryvnia and 11.7% in USD, and UkrSibbank - 9.5% in euro.

Loans denominated in Swiss franks are competitively low. Only two banks offered this product in the market - UkrSibbank at 7.99% and Ukrsotsbank at 10.7%.

One-time commission fees

One-time commission fees are increasingly often charged by banks not only to cover the actual cost of mortgage loan preparation, but also as a component of the pricing policy which makes it possible to compensate to some extent the decrease in the nominal interest rate. This indicator varies between 1-2% or is set as a fixed amount of money.

Down payment

Borrower's down payment varies between 10% and 30% depending on the market for the property used as a collateral for the loan (primary/secondary market). When making loans for purchasing property on the secondary market, banks most often require the borrower to make a down payment of 15% of the property value.

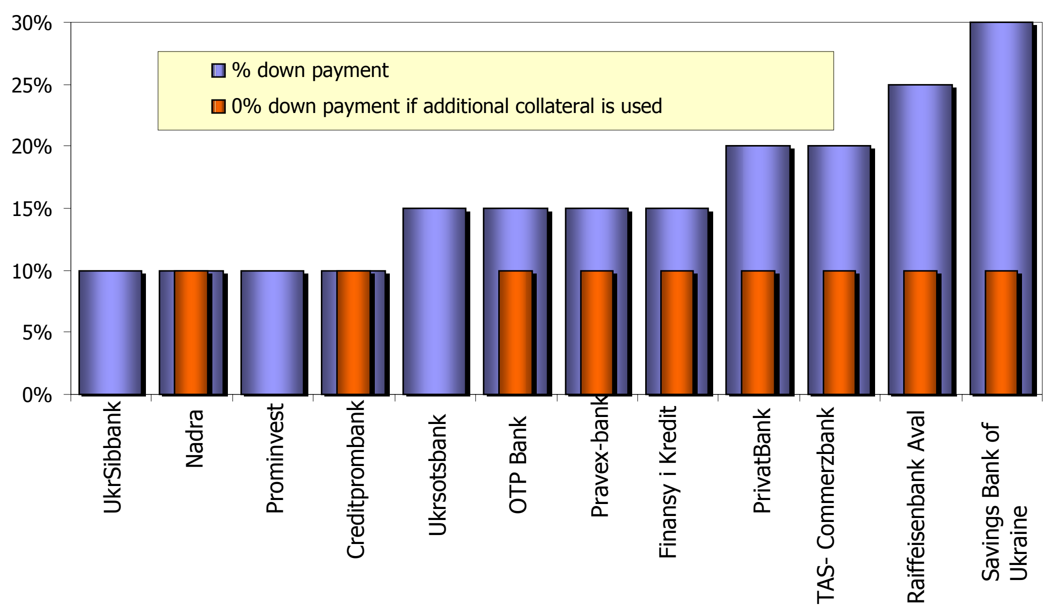

***Chart 35.** Minimum down payment for residential mortgage loans, %*

Source: UNIA

Mortgage lending terms offered by some banks (Nadra, OTP Bank, Pravex-bank, Finansy i Kredit, Privatbank, TAS-Commertzbank, Raiffeisenbank Aval, Savings Bank of Ukraine) make it possible to take a loan without the need for the borrower to pay his/her own money (LTV=100%) if an additional collateral is used which may be liquid property or a bank deposit ownership.

When issuing loans for purchasing residential property on the primary market, banks require the borrower to make a contribution of 15-30% from his/her own money.

Lending term

In 2006, banks (Ukrsotsbank, Privatbank, Pravex-bank) increased the term of residential mortgage loans by 5 years. A typical term of residential mortgage loans in Ukraine is 20 years. Some lenders offer their clients maximum terms of up to 21 years (UkrSibbank), up to 25 years (Creditprombank, Ukrsotsbank, OTP Bank, Pravex-bank) and up to 30 years (Arkada, Nadra).

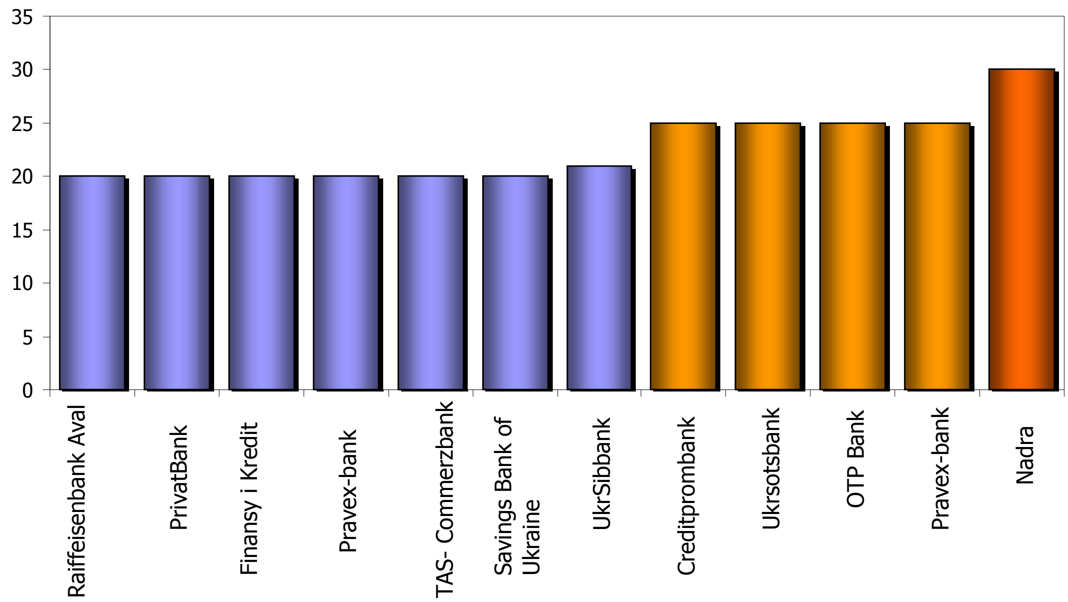

Chart 36. *Terms of residential loans for purchasing property on the secondary market*

Source: UNIA

Similarly to charging different down payments, banks differentiate their maximum lending terms by regions. For example, Creditprombank offers a maximum term of 25 years for loans issued in Kyiv and major regional centers (Kharkiv, Dnipropetrovsk, Odesa, Lviv) and not more than 15 years in other regional centers.

Insurance

When making residential loans mortgage lenders require only 2 types of insurance - that of the mortgaged asset (0.3% of the appraisal value of the property) and the borrower's life insurance or personal insurance (0.3-0.8% of the outstanding debt). It is interesting that although the title insurance was an integral part of loan policy of banks with foreign capital last year, today this type of insurance is required by only two Ukrainian banks – Finansy i Kredit (0.5% of the loan) and Savings Bank of Ukraine.

Table 4. *Insurance tariffs by insurance type in mortgage lending, %*

Banks	*Insurance of the mortgaged asset*	*Borrower's life insurance*	*Title insurance*
Raiffeisenbank Aval	0.3%	0.55%	-
Privatbank	0.4%	0.5%	-

OTP Bank	0.4%	0.3%	-
Creditprombank	0.11%	0.2%	-
Pravex-bank	0.5-1%	-	-
Nadra	0.4%		-
Finansy i Kredit	0.3%	0.48	0.5% of the loan amount
TAS-Commertzbank	0.3%	0.3%	-
Savings Bank of Ukraine	1.0% of the loan amount (cost of the 3 types of insurance)		
			Source: UNIA

In 2006, there were no substantial changes in the banks' policy regarding the insurance of risks in residential mortgage lending.

Possibility of prepayment

Virtually all largest mortgage lenders allow to prepay a loan pursuant to provisions of the Law of Ukraine "On Protection of Consumer's Rights" as well as due to the availability of mortgage products on the market, which allow borrowers to refinance residential loans by way of changing their banks. Only Ukrsotsbank and Nadra charged a commission of 1% and 2% for loan prepayment during the first 2 years of a loan depending on the prepaid amount.

Table 5. *Minimum interest rates on residential mortgage loans charged by 10 largest mortgage lenders including the monthly commission*

Banks	*Minimum interest rates with monthly commission, %*								
	hryvnia			*USD*			*euro*		
	01.01.06	*01.01.07*	*Δ, %*	*01.01.06*	*01.01.07*	*Δ, %*	*01.01.06*	*01.01.07*	*Δ, %*
Raiffeisenbank Aval	17.75	18.00	0.25	12.25	14.00	1.75	12.00	14.00	2.00
UkrSibbank	15.50	16.50	1.0	12.50	11.80	-0.70	11.50	9.30	-2.20
Ukrsotsbank	16.00	18.00	2.00	12.50	12.50	0.00	11.50	12.00	0.50
OTP Bank	15.50	17.50	2.00	11.00	11.99	0.99	10.50	11.49	0.99
Privatbank	19.48	16.44	-3.04	15.48	12.48	-3.00	15.48	11.40	-4.08
Creditprombank		19.00			14.00			13.50	
Pravex-bank	16.00	18.00	2.00	12.00	12.00	0.00	12.00	11.00	-1.00
Nadra		19.70			13.70			12.20	
Finansy i Kredit	14.40	16.28	1.88	11.40	12.78	1.38	10.40	11.78	1.38
TAS-Commertzbank	20.00	19.00	-1.00	15.00	14.00	-1.00	15.00	12.00	-3.00
Median	16.00	18.00	2.00	12.40	12.60	0.30	11.80	11.90	0.10
									Source: UNIA

Table 6. *Mortgage loans terms offered by 10 largest mortgage loan banks as of February 1, 2007*

Bank name	*Maximum amount, USD*	*Term, years*	*% of down payment without additional collateral*	*Possibility of 0% down payment wth additional collateral*	*Market*		*Obligatory insurance*			*Types of commission*		*Possibility of prepayment*	
					Primary	*Secondary*	*Property*	*Life*	*Title*	*One time*	*Monthly*		
UkrSibbank	-	21	10-30%		Yes	Yes	Yes			2% of the loan amount for issuance	no	Yes	
Ukrsotsbank	-	25	15-30%		Yes	Yes	Yes	Yes		0.99% of the loan amount for issuance	no		Moratorium on first 2 years, penalty 1% of the prepaid amount
Raiffeisenbank Aval	200 000	20	25%	Yes	Yes	Yes	Yes	Yes		1% of the loan amount for issuance	no	Yes	
Privatbank	-	20	20%	Yes	Yes	Yes	Yes	Yes		no	0.20%	Yes	
OTP Bank	200 000	25	15-20%	Yes	Yes	Yes	Yes	Yes		UAH 1 500	no	Yes	
Creditprombank	-	25	10%	Yes	Yes	Yes	Yes	Yes		no	no	Yes	
Pravex-bank	200 000	25	0-15%	Yes	Yes	Yes	Yes			0.22-0.45% of the amount for opening the account, 1.5% for RKO; UAH 321-639 for review of the questionnaire and inspection of documents	no	Yes	
Nadra	75 000	30	10%	Yes	Yes	Yes	Yes			1.5% of the loan amount	0.35%		If the loan is prepaid during the first 2 years –a 2% penalty
Finansy i Kredit	-	20	0%	Yes	Yes	Yes	Yes	Yes	Yes	1% of the loan amount for issuance	0.19 of the loan amount	Yes	
TAS-Commertzbank	-	20	20%	Yes	Yes	Yes	Yes	Yes		no	no	Yes	

General Conclusions

The demand for mortgage loans remains high, which allows banks to continue accumulating their loan portfolios very fast. Given the general trends on the market and the macroeconomic prerequisites, a 70% growth, or up to UAH 46 billion, can be expected in 2007 in mortgage lending.

Competition for borrowers between banks did not have any effect on mortgage loan interest rates. Although consumer loan interest rates decreased in the banking system in general, there were no changes in the mortgage loans interest rates charged by leading mortgage lenders. Banks seek to compete by adjusting other loan terms and conditions such as down payment, loan maturity and additional loan servicing payments. As earlier, the additional payments serve as a means to manipulate the real interest rates on mortgage loans. We do not expect any substantial decrease in mortgage loan interest rates in 2007.

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ATTACHMENT 3

USAID Access to Credit

USAID FROM THE AMERICAN PEOPLE

Rural Access to Credit Assessment

Rural Land Mortgages

Capital Equipment Leasing for Rural Ukraine

Rural Access to Credit Assessment
Assessment Findings

- Ukraine Agriculture/Food Sector Producing Quality Food
- Now Ready and Need Capital to Fuel Growth
- Agriculture Real Estate Can Support Needed Debt Capital
- Banks Need Greater Business Activity for Rural Branches

Therefore, Land Moratorium will be Lifted Soon
But Also There are Rising Systemic Risks

Rural Access to Credit Assessment
Assessment Findings

- Leasing
  - Equipment leasing primarily Urban Business
  - Lessors do not have Rural Outlets
  - Rural Bank Branches may offer leasing opportunity
  - Bank loan terms making leasing less attractive
  - Lack of customer understanding

Rural Access to Credit Assessment
Recommendations

- In Order to Avoid Bank Systemic Risk
  - Banks Need Underwriting Standards and Training
- In Order to Expand Leasing to Rural Market
  - Lessors Need Rural Business Strategy and Training

Rural Access to Credit Assessment
Good Economic Conditions

- Strong Ukrainian GDP growth
  9.4% 2003 12% 2004 2.4% 2005 5-7% est. 2006

- Growth in residential real estate values
  30-50% 2005 20-30% 2006

Rural Access to Credit Assessment
Good Economic Conditions

- Accelerating Banking Asset Growth
  20% 2003 34% 2004 59% 2005 36-39% 2006 Estimated
- Foreign Banks investing in Ukrainian banks
  - Bringing Capital, Expertise, Banking Systems
  - Access to Strategic Investors, Debt, and Trading Partners

Rural Access to Credit Assessment
Good Economic Conditions

Banks are attracting strong foreign investment and buy outs.

Representative Recent Acquisitions of Ukrainian Banks			
Name of Bank	**Investor**	**Sum of Deal**	**Announced**
Aval Bank	Raiffeisen International Bank Holding (Austria)	$1.028 B for 93.5%	October 2005
UkrSibbank	BNP Paribas (France)	51% Amount not disclosed	December 2005
Ukrsotsbank	Banca Intesa (Italy)	$1.16 B for 85.42%	February 2006
Index Bank	Credit Agricole (France)	$260 M for 98%	March 2006
Raffeisenbank Ukraine	OTP Bank (Hungary)	650 M Euro For 100%	September2006

Rural Access to Credit Assessment
Rapid Banking Growth

- Urban Residential Housing
- Consumer (Cars, Household Goods, Electronics)
- Debit and Credit Cards
- Branch Network Growth
  - To collect deposits and provide some services
- Corporate Credit Expansion
- Bank Profits = 2.55B UAH for 6th months 2006
  - 2.3 times 2005 rate for the same period

Rural Access to Credit Assessment
Slower Rural Banking Growth

- Rapid Branch Growth for Deposits
- Fewer Rural Housing Consumer Loans
  - Much Lower Collateral Values
  - Much Lower Salaries/Income
- SME Business Loans—6 Ukrainian Banks
  - EBRD Business Model and Training
  - Multiple Collateral Sources or Character Lending
- Limited Agribusiness Lending
    - Mostly Large Farms; Smaller Commercial operations

Rural Access to Credit Assessment
Growing Banking Risk

- Rapid Increase in Foreign Currency Loans
  - Up to 60% of Bank loans
  - Growing Exchange Risk in Banking System
  - Weak Money Supply Control

Rural Access to Credit Assessment
Growing Banking Risk

- Several NBU Calls for Capital Increases
  - 22.5% increase in 7 months of 2006
  - More growth will require even more
- Fitch Watch on Ukraine Banks

Rural Access to Credit Assessment
Growing Banking Risk

- Lending Against Rising Property Values
- Limited Credit Scoring
- Limited Asset/Liability Management
- Poor Loan Workout Planning

Rural Access to Credit Assessment
Growing Banking Risk

- Rapid Asset Growth under Poor Standards
  - Aggressive Housing Consumer Growth
    - Approaching 50% of Bank Loan Portfolios
  - High Interest & Fees on Debit/Credit Cards

Rural Access to Credit Assessment
Rising Economic Concerns

- Rising Political Risk for Foreign Investment ?
  - Announcement of grain export licenses
  - Delayed VAT reimbursement
  - Imposition of commodity export quotas
  - Strategic Reserve issues

Rural Access to Credit Assessment
Slow Rural Leasing Growth

- Most Equipment Leasing Firms Urban
- Rural Leasing Affiliated with Banks
  - Banks Focused on Company Loans
  - Building Rural Branches Gathering Deposits
- Banks Need Greater Volume for Branches
  - Looking to Offer Dual Products
    - Loans and Leasing Options
    - Loan Officer Training
    - Customer Education

Rural Access to Credit Assessment
Leasing Market

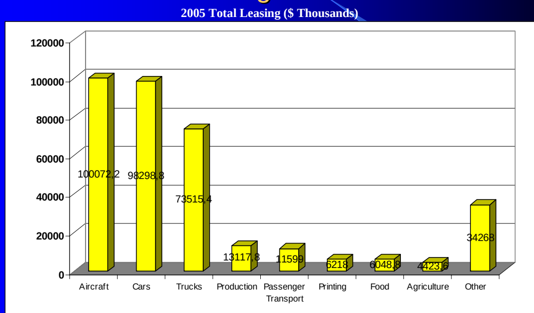
In 2005:

Number of leasing firms grew by 47%.

Leasing portfolio grew by 62.3%

Only 1.8% of leases are five or more years.

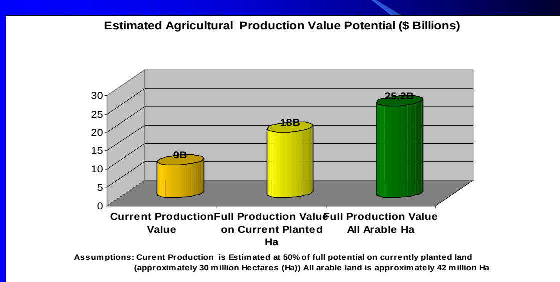
Rural Access to Credit Assessment
Leasing Market



Rural Access to Credit Assessment
Agribusiness Overview

- Growing Land Use Consolidation
  - Grains and Oilseeds
  - About 70% arable land under growing yield/volume production
  - Farm Management Companies, Old Farm Operations, Capital Investors
  - Access to export credit agency lines, traders, investors
  - Large Land Leasing Operations with Guaranteed Purchase Options
  - Lease Roll-Overs in Progress

Rural Access to Credit Assessment
Agribusiness Overview



Rural Access to Credit Assessment
Agribusiness Overview

- Commercial Smallholder—Fruit/Vegetable Concentration
  - Intensive operations—Hothouses, irrigation, quality inputs
  - Contracts with large processors (Volyn, Chumak, etc.)
- Other Smallholders (grain, livestock, dairy) struggling

Rural Access to Credit Assessment Agribusiness Overview

- Strong Food Processing Industry Growth
  - Fruit/Vegetable, Confectionary, and Milk Processing (urban/rural based near distribution or production)
  - Meat processing, sugar beet refineries, oil seed processing (rural near production)

Rural Access to Credit Assessment Agribusiness Overview

- Gradually Reaching EU Standards
  - Better Management
  - Access to Capital, Equipment
  - Focused on Domestic Market with Some Export
  - Establishing National Brands

Rural Access to Credit Assessment Agribusiness Overview

- Food Processors Need Raw Materials
  - Established Own Production Operations
  - Need even Higher Volume to Meet Demand
  - Contract Producers Need Capital Investment

Rural Access to Credit Assessment Agribusiness Overview

- Ukrainian Agribusiness Ready for Investment
  - Production and Yields Generating Cash Flow
  - Major Equipment, Storage, Infrastructure Needs
  - Linkages with International Suppliers
  - Domestic and International Market Connections

Rural Access to Credit Assessment
Agribusiness Overview

- Large Operations Still Growing
  - More land under lease and production
  - Expanding Vertically and Horizontally

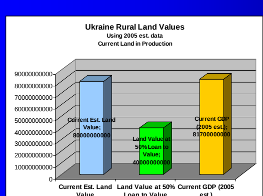
Rural Access to Credit Assessment
Rural Land Mortgage Potential

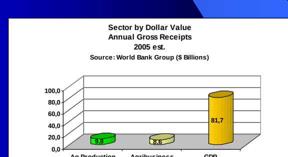
- Agricultural Land Sale Moratorium ends January 2007

  Extension to January 2008 Expected, Likely

- Last Major Untapped Ukrainian Capital

Rural Access to Credit Assessment
Rural Land Mortgage Potential





Rural Access to Credit Assessment
Rural Land Mortgage Potential

- Estimated Bank Loan Value is $40 billion
  - Based on estimated loan value of currently farmed land
  - Banks and Agribusiness Want to Tap Capital
  - Provides Capital Needed for Next Level of Operation

Rural Access to Credit Assessment
Rural Commercial Bank Development

- Banking Industry Wants and Needs Infrastructure
  - Loan Underwriting Standards
  - Land Registry (Important but will go ahead without it)

Rural Access to Credit Assessment
Rural Commercial Bank Development

- Land Productivity Data (Exists but not Easily Accessible)
- More Professionally Trained Officers

Rural Access to Credit Assessment
Rural Land Mortgage Market

- Assist Banking Industry: Establish Rural Mortgage Underwriting Standards
  - Appropriate Economic Based Financing with Strict LTV limits;
  - Improves Bank Loan Portfolio Credit Quality;
  - Reduces Excessive Lending Against Rural Land;

Rural Access to Credit Assessment
Rural Land Mortgage Market

- Secondary Mortgage Market Attractive
  - Avoids Additional NBU Capital Calls
  - $40 Billion of Loans Needs $6 Billion Capital
  - Gains Access to Long Term Funds
  - Volumes as High/Higher than Housing

Rural Access to Credit Assessment
Rural Land Mortgage Market

- Benefits of uniform standards
  - Better bank lending decisions
  - Greater transparency in land sales
  - Lowering land speculation

Rural Access to Credit Assessment
Rural Land Mortgage Market

- Better bank marketing to customers
- Better financing costs
- Secondary Market possible

Rural Access to Credit Assessment
Capital Equipment Rural Leasing Market

- Impediments to the growth of capital equipment leasing.

  Commercial banks are providing export loan pass through lending to best customers;

  VAT issues;

  Accounting issues; and

  Lack of rural customer understanding of the lease product

Rural Access to Credit Assessment
Capital Equipment Rural Leasing Market

Opportunities to grow the leasing market in rural areas:

- Some Banks do not need additional fund sources;
- Banks do have an interest in Technical Assistance;
- Only one identified large bank has targeted rural leasing in their business plan;
- Leasing companies may need additional funding for the capital leasing market.

Rural Access to Credit Assessment
Capital Equipment Rural Leasing Market

- **Strongest options to grow rural leasing market:**
  - **Offer technical assistance to most active banks;**
  - **Develop "rural certified leasing" program;**
  - **Develop credit lines for strongest independent leasing companies for capital equipment.**

Rural Access to Credit Assessment
Rural Leasing and Banking Development

- Rural and Agribusiness Management Training
  - Significant Grounding in Economics of Various Agribusiness and Food Industry Segments
  - Risk Assessment &Asset/Liability Management

Rural Access to Credit Assessment
Rural Leasing and Banking Development

- Rural Certified Leasing Professional
  - Focused on the equipment, revenue, and business needs of rural customers
  - Business Strategy for Rural Market

Rural Access to Credit Assessment
Rural Leasing and Mortgage Market

- Bank Leasing and Lending Moving Rural
  - Need Industry Wide Know How and System
  - Need Rural Trained Leasing Professionals
  - Need Trained Rural/agribusiness Loan Officers
- Time Window: Now Til Moratorium Lifted

Rural Access to Credit Assessment
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The Peoples Group, Ltd.

DRAFT

ACCESS TO CREDIT INITIATIVE:

USAID
FROM THE AMERICAN PEOPLE

RURAL FINANCING ASSESSMENT

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October 28, 2006

ACRONYMS

ATCI	Access to Credit Initiative
COP	Chief of Party
EBRD	European Bank for Reconstruction and Development
EU	European Union
GOU	Government of Ukraine
GDP	Gross Domestic Product
Ha	Hectare
MOA	Ministry of Agriculture
NBU	National Bank of Ukraine
NIS	Newly Independent States
TPG	The Peoples Group Ltd
UAH	Ukrainian hryvnia
US	United States
USAID	United States Agency for International Development
USDA	United States Department of Agriculture
VAT	Value Added Tax
WTO	World Trade Organization

ACKNOWLEDGEMENTS

The Peoples Group Ltd wants to express its appreciation to the Access to Credit Initiative all of whom made our visit in Ukraine both pleasant and productive. We want specially to acknowledge the dedicated efforts of Alla Chernyak to gain appointments with often reluctant bank and business officials. Her relentless pursuit of individuals and information were in no small part responsible for our being able to portray as much about the Ukrainian financial sector for the rural area as we have. We also appreciate the cordial hospitality that the entire ATCI provided throughout our three weeks of working in the ATCI offices. Many were very helpful in facilitating our working and improving our ability to conduct the assessment. This clearly reflects a positive corporate culture set by the Chief of Party. Any error or mistakes made in this report are entirely our own.

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I. Executive Summary

The Ukrainian banking industry has transformed dramatically over the past decade following a pattern that other Eastern European countries experienced moving from state banks to commercial banks regulated by a central bank. The last five years have seen the financial sector become highly dynamic, offering many new products and services to industry and consumer alike. Loan portfolios of most banks are growing 20 to 50 percent per year. Returns are double and triple those of international banks. Growing bank loan portfolios and other credits have provided the economic oil to facilitate growth in both industrial and consumer sectors, primarily residential housing and purchase of consumer goods, especially autos, refrigerators, washers and dryers, and electronics.

A key question is what has been the impact of this banking growth on the rural economy? How much of the Ukrainian bank financial asset growth has occurred from loans to rural businesses and consumers? More than a quarter of the country's annual GDP is produced in the rural areas. A large portion of that is tied to the agricultural sector. How much of the banking industries financing reaches agribusiness and rural businesses? Are mortgage products and other financial services reaching the rural areas for businesses and consumers? What is being financed and how is it being done? What about equipment leasing? How much of the growth in equipment leasing has leased equipment and machinery to agricultural production, processing, and other rural businesses? When will the financial products and services offered in Kyiv trickle down to the rural areas.

These questions are the focus of this rural financing assessment, which is intended to assist the USAID Access to Credit Initiative (ATCI) understand more fully the rural Ukrainian economy and its financing. A key focus of the assessment is what might be done to accelerate competitive financial services becoming readily available to creditworthy rural borrowers and other rural users of financial services?

An experienced ATCI Team has conducted a rural financing assessment and this report presents their findings and recommendations for interventions consistent with the ATCI program. Much of the report uses a combination of general economic data, banking industry financial information from annual reports, NBU reports, other public documents and reports and anecdotal information gleaned from interviews with senior management from banking, agribusiness, government, leasing, and equipment dealers. The mosaic picture developed is a composite of the information synthesized by the Team based on its experience in conducting similar assessments in Eastern Europe. Because financial data is not yet collected and available on debt and equity investments in the agricultural sector and rural businesses, this picture is not precise.

When this information is considered with agricultural economic statistics revealing recent crop and livestock productivity gains and with the large spurt of Ukrainian processed food products, what is clear is that an increasing percentage of bank financing is going into the rural and agricultural sectors. Commercial banks are providing loans directly or indirectly through suppliers, food processors, and leasing firms into the agricultural sector, though precise numbers are not publicly available because banks do not break down their loan portfolio data to this level of detail in their annual reports or in reports to the NBU that are distributed to the public. Having both an understanding of banking industry trends as well as trends in the agricultural sector, experienced observers can spot assistance opportunities. By combining this information with knowledge of bank business strategies learned through interviews with bank officials, the business opportunities that bankers are beginning to see in the rural sector become clearer. This assessment provides sufficient information to use as a guide for developing recommendations on interventions to help facilitate and accelerate the flow of commercial financing to the agricultural and rural sectors.

The report presents information on the banking industry, equipment leasing and the agricultural sector, including the food industry. It provides indicators showing that trends and directions in each area and how they will gradually and increasingly overlap to some degree synergistically fueling growth in all areas.

Growth in the banking industry and the agricultural sectors is now reaching a stage where synergies between them can provide further growth for both. Ukrainian agricultural production and food processing has needed new equipment and machinery for a number of years. Now that production and revenues are increasing due to good management and market development, it is evident that both agricultural production and food processing can use new equipment efficiently to raise production and generate revenues to the next level of production, product development and revenue growth. Revenues are sufficiently stable and growing to be able to service long term debt for these capital expenditures.

Ukrainian banks have been growing not only in loans, deposits, and the wide arrays of financial products and services offered, but also they are rapidly building branch networks across Ukraine. Initially, these branch networks have served to gather deposits for funding residential mortgages, consumer, and corporate loan growth. Now these branches are available and need to offer new products and services to rural customers to pay for their financial infrastructure. The increasing presence of foreign banks owning and managing Ukrainian banks not only means increasing the quality of bank operations but also greater access to international funding, especially long term funding needed for equipment and capital improvements. With access to a wider variety of funding sources for different maturities, banks are better able to finance the agricultural sector more prudently.

Equipment leasing provides a more narrow but very important opportunity. Equipment leasing provides a financing structure that most complies with underlying economics, use, and the useful life that a firm has for the equipment. The structure is off balance sheet so the firm can use its scarce capital to obtain working capital. Leasing firms need debt capital to fuel their equipment leases. This is the opportunity. In developing markets, leasing firms are starved for debt funding. Where commercial banks have greater access to medium and longer term funds, there is a natural affinity between them. Such affinity is present in the rural markets in Ukraine where banks need attractive financial products to market through their extensive branch networks and leasing firms need outlets to offer their equipment leasing products.

Recommendations: The Rural Assessment Team recommends that ATCI focus on the following broad areas:

- Facilitate and accelerate the transformation of new lending to the rural area and to agricultural production and the food processing sector in particular;
- Facilitate lending against agricultural land as the moratorium on land sales is lifted;
- Expand equipment leasing to food production and processing firms.

It is recommended that specific ATCI activities include: rural bank and leasing training, leasing firm financial advisory services, and the development of uniform underwriting standards for agricultural real estate loans.

1. Training

Training Commercial Bank Officers for Rural Lending: Bank need to train the large numbers of new loan officers that are staffing their branch networks across the nation, many of which are in rural areas. Until these loan officers are fully trained, they will be relegated to low level clerical tasks and to facilitating establishing new customer accounts to gather deposits. To be most effective, these loan officers should be trained in the complex area of financial agricultural production, food processing, agriculturally related businesses, and rural businesses. These are the major businesses in the rural areas and require fundamental knowledge of the underlying economics of each crop and livestock production segment as well as the best international practices for appropriate terms and conditions for agricultural lending. This is needed in order to create quality loan portfolios.

Rural Commercial Leasing Professional: Expand the already successful Commercial Leasing Professional training program to include a focus on leasing equipment to agribusiness, food processors and rural businesses. Leasing professionals need to understand the rural business cash flows, which are often substantially tighter than urban businesses to assure adequate coverage of lease payments. Five Ukrainian leasing firms are interested and active in equipment leasing in the rural area. More may become involved as they learn how to approach this market and have trained professionals to represent them.

2. Leasing Firm Financial Advisory Services.

Many leasing firms do not have sufficient capital or access to adequate debt capital to fund their leasing portfolios. ATCI could assist the most promising leasing firms to work with commercial banks to gain access to banks' branch networks for offering their leasing products, gain financing from commercial banks, foreign debt and equity capital investors, and credit enhancements to access better sources and pricing for debt and equity capital.

3. Uniform Underwriting Standards for Agricultural Real Estate Loans

Most Ukrainian commercial banks have little experience loaning to businesses against real estate as the primary capital asset and virtually none in loaning to agribusinesses against agricultural land. The current relatively easy standards for urban residential mortgages are inappropriate for agricultural lending. Commercial banks need assistance in helping them understand international best practices in lending against agricultural land and then facilitating the development of uniform underwriting standards for Ukraine. Uniform standards if adopted would facilitate the development of a secondary market for agricultural real estate loans and enable commercial banks to access longer term funds from the capital markets. Even if a secondary market is slow to develop, uniform standards will improve bank loan decisionmaking, bring transparency to agricultural lending and agricultural land values, and help dampen excessive speculation in agricultural real estate.

II. Introduction

During the past decade, the Ukrainian financial sector has seen a major restructuring, consolidation, and growth resulting in Ukrainian banks being well positioned to become modern commercial banks operating in accordance with international banking standards and best practices. Corporate loans, residential housing mortgages, and consumer lending have all seen significant growth with the latter two categories growing 25 to 50 percent annually during the past five years. Commercial banks now offer an array of financial products and services to businesses and individuals whether as a depositor or borrower. Much economic growth and development of a fully competitive banking industry remains to be realized.

The banking industry estimates that only one-third of the country and its economic sectors are banked. This leaves significant room for bank officers to canvass every productive business in every Ukrainian location. Many banks are only now considering those geographic areas outside of Kyiv and other major cities to be good markets for offering financial services, albeit at the moment they are primarily for deposit gathering.

Still, much of the nation's bank infrastructure is lacking in interconnected relationships that help banks understand and manage their risks or call upon resources to avoid financial downturns, disasters, and crisis. The Ukrainian capital markets, for example, do not yet allow banks to sell portions of their loan portfolios as a way of raising needed cash and of reducing liabilities during a financial crisis. The lack of uniform or even largely congruent loan underwriting standards limits the building of a formal or informal secondary market, except perhaps in the residential housing mortgage market. Even there, there is no real secondary market, despite strong efforts to develop one. As Ukrainian commercial banks move into other markets, it would serve them well to develop plans for addressing financial crisis and for loan workouts that will inevitably occur as the economy next turns down.

A few summary facts of both sectors are worth noting. Total Ukrainian banking assets have grown from $26.75 billion in 2004 to $42.5 billion in 2005 and anticipated to be $59 billion by the end of 2006, achieving growth rates of 59% in 2005 and an expectant 39% in 2006.[1] The banking asset growth rate has remained above 20% for the past five years and is expected to continue to grow between 30% and 40% per year for the next five. Growth of Ukrainian banks reflects a similar growth period of the Ukrainian GDP reaching 9.4% in 2003; 12% in 2004; 2.5% in 2005; and an expectant 5% to 7% in 2006. The NBU has maintained strong monetary policies focused on a stable hryvnia exchange rate and price stability in the country. Indeed the hryvnia has fluctuated in a relatively narrow range between 5.03 to 5.5 hryvnias to the US dollar for the last six years.

Such high growth in the Ukrainian banking industry attracted international attention resulting in international bank purchases of controlling interests at high valuations in a number of the largest Ukrainian banks—Aval, Ukrsotsbank, Ukrsibbank, Forum, Vabank, and Mriya, for example, and a few smaller banks—like Index-Bank and Megabank. Other

[1] Financial statistics will be expressed in US dollars unless otherwise noted.

transactions are still in the process of completion or in negotiation. As of this writing, more than 30 per cent of Ukrainian banks now have foreign owners. These strong commitments of international banks to the Ukrainian financial markets will have a significant impact on Ukrainian bank standards and practices, loan decision making, loan portfolio and asset/liability management, workout of troubled assets, loan officer training and development, and competitive pricing and marketing.

Ukrainian agriculture has a different but also promising growth story. Agricultural production has not yet returned to the volumes and yields of Soviet production following dramatic declines in crops and livestock from the 1990s. Nevertheless, average yields are approaching the former yields (exceeding them on some farms) with one-third less of the nation's arable land now lying fallow. Ukrainian Agricultural production, largely unsubsidized compared to the EU and US, has quickly moved to large economic units that have better management, inputs, crop varieties, access to markets, and production financing. Smaller units in appropriate climates have moved to intensive irrigated and hothouse production of high value fruit and vegetables. Agriculture is the primary rural sector generating about $9 billion annually in production of crops and livestock. Important too is where the production goes. During Soviet times, Ukraine was a net importer of cereals and oilseeds used in producing a large portion of Soviet livestock. Today, Ukraine has developed export channels shipping much grain to other countries and bringing Ukraine valuable foreign exchange. The remaining production has been providing the raw materials to domestic food processing firms that have been growing in productivity, quality, and market penetration.

The largest economic sector based in the rural area is agriculture and from the growth of the Ukrainian agricultural sector during the past five years, it is clear that a lot of financing fueled that growth. Where did it come from? Farmers, government officials, and commercial banks generally say the same things about financing agricultural production—that very little commercial financing comes to farmers. This is simply not a true statement by any rational measure. Public officials, economists and bankers widely report that agricultural production contributes about $9 billion annually to the Ukrainian GDP. That crop production was produced with seed, fertilizer, crop protection chemicals, fuel, equipment, machinery, laborers, and a host of other inputs. Somebody provided the funding to enable farmers to produce those crops. Somebody provided the funding for feeder pigs and calves and hatching chicks and for feed to raise the livestock to maturity and for the equipment, machinery, electricity, laborers to slaughter and process the livestock into meat and poultry products.

Due to the high margin, low volume nature of agricultural production, however, most farming, livestock and food processing operations must start small and gradually ramp up to larger and larger production reinvesting revenues into the business year after year. For profitable agricultural operations this is the most common form of financing, but it is never enough. Farm managers seek and obtain credit from any source willing to consider lending but the earliest sources come from those lenders who know the business best and know which farm managers are likely to generate revenues that can repay them. Farm input suppliers, traders, and food processors are usually the first lenders to the agricultural sector. They know the industry and they need farmers as customers for different reasons.

Input suppliers (seed, fertilizers, crop protection chemicals, and other supplies) must have farmers purchase their goods to generate sales. Often, they are unable to make sales unless they extend some credit giving producers until harvest to repay for these inputs. To be able to provide the farmers with these inputs until harvest, input suppliers often receive financing from the manufacturers of the products they sell by consignment, floor planning, or short term requirements to repay the manufacturers some time after harvest. These suppliers generally also have some bank financing and their own funds to make down payments to the manufacturers. Input suppliers travel the countryside to observe the farming operations of their customers so that they know who is the better producer and farm manager. Input suppliers keep very close tabs on their customers often visiting them prior to harvest to secure repayments. Sometimes they demand payment directly from the buyers of their customers' crops and insist on receiving contract rights assigned to them.

There are myriad financial schemes between supplier and farmer designed to sell as many inputs as possible, minimizing risk, and maintain healthy margins to enable the supplier to absorb some credit losses and still maintain profitability. Traders were often the middlemen between suppliers and producers and between producers and endusers. In a large sense, traders performed the intermediation function usually provided by bankers in more mature markets. Traders are very close to the agricultural producers, suppliers, and endusers, charge hefty commissions and margins for themselves and facilitate movement of agricultural products, primarily grains and oilseeds, to the market. Ukraine was largely financed by barter in the 1990s to early 2000 until the Ukrainian government forbade such trade in agricultural commodities to prevent fraud, collusion, tax avoidance, and other inappropriate activities. Farmers do not like this form of financing due to the high control that suppliers exert on the farmers and the high cost. The cost of the inputs have imbedded implicit interest rates that often range from 30% to 40% annual interest rates or more.

Food processors have a similar interest in helping to finance farmers. They need the harvested crops to process into flour, bread, baked goods, edible oils, processed fruits and vegetables, dairy products, sugar, and a wide variety of foodstuffs. Some food processors have difficulty securing sufficient raw materials at harvest and must resort to contracting with farmers to produce for them. They provide farmers with seed, seedlings, fertilizers, chemicals, and so forth in exchange for the right to purchase the crops at harvest for payment after deducting the cost of the inputs plus imputed interest. Food processors receive this financing from their bankers which they repay after the harvested crops are processed and sold.

Food processing also has a strong growth story increasing at a 15% or more annual rate for the past several years. The food industry has also attracted better managers, developed products equally attractive to consumers as imported food, and better access to debt and equity capital. The food processing segment of the agricultural sector has grown so much since 2000 that it now represents 20% of all Ukrainian manufacturing. When the value of the food processing sector is combined with the annual crop and livestock production of $9 billion, the total Ukrainian agricultural sector amount to $19 billion or about 24.6 % of the annual GDP.

Ukrainian agricultural production has recently been so capital starved, however, it has been unable to finance greater growth and production. Today, with a number of large cereal and oilseed operations, integrated livestock enterprises, and intensive fruit and vegetable production units, Ukrainian agricultural is ready to provide the increasing volumes of raw materials that domestic processing and foreign buyers want. But they need capital. Today, many Ukrainian agricultural firms could safely pledge their agricultural land for the longer term working capital they need to reach the next productive level and adequately service this debt. Today, several Ukrainian banks are better capitalized, staffed, and funded to intermediate funds to agricultural production against such security. Tomorrow, or in the next year, for many reasons provided in this report, Ukraine is ready to lift the moratorium on the sale of agricultural land permanently. This makes high value collateral available for approximately $40 billion in new lending potential. This is more than adequate to fuel agricultural production and the food industry to the next level of productivity.

Bankers and farmers both gradually cut out the suppliers and food processors as sources of financing and farmers find each other. Due to the significant natural and market risks that agriculture faces, banks often struggle to lend to agriculture prudently up and down the economic cycles. They want solid collateral to support them during these downturns. Ukrainian bank reluctance to enter the rural area with more lending and financial products is directly tied to the lack of sufficient valuable collateral to support that activity. The inability of owners and holders of agricultural land to sell that land also prohibits them from pledging it to receive a loan for working capital or longer term funding for equipment and machinery.

Until the moratorium on the sale of agricultural land is lifted, the rural sector will continue to receive far more modest amounts of debt and equity capital than would be the case if there were an active agricultural real estate market just as there is in every comparable developed market. Arguments that the moratorium protects the landowners and makes certain that agricultural land remains in Ukrainian hands are specious. Various myriad leasing and sales schemes have already transferred ownership or use of the land to large corporate entities many of which have foreign owners. This report looks closely at the agricultural land moratorium issue, reveals what may be on the near horizon, and what the Ukrainian banking industry needs to do to prepare.

A. Methodology

The fundamental objective of this Rural Financing Assessment is to provide USAID and ATCI as accurate a picture as possible of what financial services are being provided to the rural economy directly or indirectly by the financial sector. A corollary to this objective was to assess the interest of commercial banks, leasing companies, and financial institutions in financing more agribusiness, food industry firms, and other rural businesses if the investing and lending conditions as well as the business and economic climate were more favorable.

These objectives are not easily attainable due to the fact that commercial banks typically do not categorize their loan portfolios by industry segment nor break down segments, such as agribusiness or the food industry, for example, into the volume of loans in dairy, fruit and vegetable processing, oilseed processing, milling and baking, and other agribusinesses. The NBU does not demand the breakdown of bank loan portfolios to this degree so the banks do not organize their information in a manner that enables one to find out easily the number and volumes of loans that are going to the rural area or to the agricultural sector.

Frank W. Naylor, Jr., former Undersecretary for Small Community and Rural Development of the US Department of Agriculture and Kenneth L. Peoples, former chief executive of the Farm Credit System Financial Assistance Corporation that restructured the financially troubled US agricultural banking system comprised the ATCI Rural Financing Assessment Team that conducted the interviews, research, and prepared this report. Prior to arriving in Ukraine, detailed communications were established with officials of commercial banks, leasing firms, agribusinesses, investment firms, food processing and industry firms, equipment dealers, and trade associations.

For commercial banks, a template for the bank’s financial data was provided that requested a breakdown of a portion of their loan portfolio by a variety of identified agribusiness and food industry categories, rural businesses, rural residential housing, and rural consumer loans. This was an attempt to obtain the data that is not easily otherwise obtained from annual reports. Similar data was requested of the National Bank of Ukraine (NBU). The ATCI Project informed the banks that all data would be aggregated and no information would be attributed to a specific bank. In addition, the Team informed them that no data received from any bank would be given to any other party.

The Team spent three weeks in Ukraine and met with more than 50 bank, agribusiness, food processing, trade organization and other officials (see Annex I List of Contacts). No financial institution completed the provided sample template for financial data that we provided them. Only one bank mentioned that it intended to record its loan data in accordance with similar categories but had not yet established these new categories in its management information system (MIS). The Team did receive annual reports from most banks visited and in most cases were provided annual reports for the last two years. Some banks have not yet issued a report for the year 2005. In some cases, the banks provided copies of their auditor’s report for 2005. Auditor’s report by international accounting firms have been increasingly more commonly issued for Ukrainian banks as they are requested by foreign correspondent banks, international debt rating agencies, investors, and potential purchasers of the bank.

The Team did not rely on financial statements and loan data alone. The Team also asked bank officials interviewed about their current lending in the rural sector and the number, volume, and percentage of their loan portfolios for agricultural production or food industry loans, rural small businesses, rural residential mortgages, rural consumers, and other rural businesses. They were asked about their interest in financing the rural sector if economic and business conditions improved. Specifically, they were asked whether their bank intended to offer a full range of loans and financial products to customers from their rural branches. They were asked if they would try to expand their lending to agribusiness, agricultural production, food processing, and agriculturally related businesses if agricultural land could be mortgaged as collateral to their loan.

From this information, the Team made a presentation to USAID officials prior to departure giving a picture of how rural Ukraine appears to be financed, making observations about the recent history of both the financial industry and the agricultural sector and how they are now poised to intertwine more in the future to bring greater growth to rural Ukraine. This report continues and expands that discussion with greater detail in the findings and recommendations. In some cases, the findings have been amended to reflect data analyzed after the presentation. The report compiles as much information as the Team could synthesize from all sources on financing of the rural economy loans to the agriculture sector and food industries. Still, these figures are not complete due to the lack of sufficient data of a quality that could be considered reliable.

B. Qualification of Data and Results

The Rural Financing Assessment Team has made a number of observations and recommendations based on the data and information obtained. Much of the bank industry data is gleaned from a variety of secondary sources. While the NBU may collect data that specifically relates to the rural economy and the agricultural sector, it only publishes very summary data that does not go into any depth. Nor does the NBU publish reports on the banking industry's loan assets in aggregate detail. Therefore, banking industry data can only be developed from secondary sources or from annual reports of the banks themselves. Secondary sources of information on the Ukrainian banking industry generally do not reveal from where they obtained their information. In some cases, the authors suggest that they have estimated the data of some banks based on news reports regarding the banks activities. The Team has obtained much of its data from the annual reports of banks interviewed. Though the interviewed banks are but a small percentage of the total Ukrainian banks, they include most of the large banks and therefore represent a substantial portion of the Ukrainian bank assets.

It is important to recognize that the financial information presented is not precise and does not include all banks. But the information comes from a significant sample and involves the financial institutions that have shown a strong interest in serving the rural market. In addition, the Team gained information from bank officials regarding their business strategies for offering financial services to rural customers. Other industry data found from other sources could not be verified from any original sources, and as indicated earlier, some authors reported that they collated the data from a variety of sources. Accordingly, the data sources may have some errors. Nevertheless, the Team concluded that all data reasonably mirrored the discussions with officials to be sufficiently accurate for purposes of the assessment.

The combination of financial data that was available with information gleaned from the interviews was sufficiently useful to develop a good understanding of the current banking trends and concomitantly the needs that bank managers have to execute their strategies effectively. Identifying the trends and knowing how banking industries evolved based on past history in other similar markets enables the Team to make quality judgments about financing rural Ukraine. From these judgments, the Team makes recommendations in this report to ATCI and USAID on what assistance may be needed to accelerate this process and to help banks implement their strategies in accordance with the best international banking practice for lending to agribusiness and the rural areas.

III. Ukrainian Financial Sector

A. Strong Ukrainian Economy

During the past five years the Ukrainian economy and the financial sector have witnessed strong growth periods. Ukraine's GDP has hovered around 10 percent for the past five years—with 9.4% GDP growth in 2003, 12% in 2004, 2.4% in 2005[2] and expected to be close to 6% in 2006. Annual inflation has averaged less than 10 percent and below 7 percent for most years. The government has maintained a fiscal deficit around 2 percent, lower than many Western European countries. Hard currency reserves topped $20 billion in 2006 or in excess of 3 months of imports. Ukrainian productivity and product quality is expected to grow as Ukrainian firms are beginning to import more efficient equipment.

Government accelerated economic reforms in 2005. The Yushchenko government improved the government revenue picture eliminating most tax privileges and exemptions, reducing the privileges of economic zones, and reducing the gray economy by curtailing smuggling. These measures reduced the fiscal deficit to less than 2 percent and leveled the playing field enabling more firms to compete. The NBU has voided regulations requiring firms to sale 50% of export proceeds to the central bank and the regulation requiring multiple conversions of currencies for non-residents investing in Ukrainian enterprises. These regulations hampered cross border trade and investment making transactions more complicated and expensive. Not all is positive. Government interventions in natural gas and gasoline prices, meat and sugar prices, and grain exports distort these markets and retard trade and investment.

Much of this growth has been a consumer led boom that is fueling growth in every urban area and even stretching to some rural areas. Consumers have huge pent up demand for new and renovated housing, modern appliances to make their lives easier and more comfortable, automobiles for mobility, reliability and comfort, and many electronic goods. Urban shopping centers are common and filled with many clothing shops with the latest fashions,

[2] The slowdown in 2005 is somewhat attributed to the disruption caused by the Presidential elections and the eventual accession of Victor Yushchenko to the Presidency. These of course are the official statistics for 2005, though the actual GDP growth rate is estimated at 5% or more due to technical statistical collection methods.

sport and casual clothing, and leather goods, media electronics of all types, furniture, housewares, and other consumer items of all types.

Growth in housing demand has sent residential apartments and land values soaring. Urban residential housing has increased in value from 20% to 50% per year for the past five years depending upon location and whether it is new or renovated construction. New construction has risen from $500 per square meter to more than $2,500 depending upon location. Renovated construction in the city center is reported to cost more than $20,000 per square meter. New residential housing construction has fueled growth in construction materials, construction employment, and furniture and housewares. There has also been a surge in purchases of new and late model used cars, so much so that Ukraine had near the highest purchases of new automobiles per capita for 2005.

B. Overview of Ukrainian Banking Industry

The Ukrainian banking industry has gone through several development and growth periods from the time of independence till now. In the early 1990s, Ukraine transformed the Soviet era state banks into a two tier central bank at the first tier and commercial banks in the second. The central bank NBU performs normal central banking functions including managing the nation's money supply, foreign exchange activity, establishing standards and norms through prudential regulations for safe and sound operation of commercial banks, licensing banks, and performing bank oversight through examination and supervisory activities. Some former state banks were privatized but many more new banks were privately established and capitalized. More than one hundred banks were chartered, mostly as universal banks, but most of these were so called pocket banks operating as a captive bank operation for an industry or industry groups. Many of these banks provide limited financial services to the public and generally only at the bank headquarters. Several banks during this early period were involved in inappropriate activities with depositor and government funds, experienced heavy losses due to economic downturns and fraudulent activities, became bankrupt, and were liquidated by the NBU. Others reduced their activity based on losses and became all but dormant.

Many businesses also went bankrupt leaving bankers to take over the firms to try to salvage their loans in default to the firms. Often the banks restructured their interests in conjunction with other strategic investors willing to take over, run the businesses, and commit anew to repay a restructured debt package. Several banks performed these restructuring operations for very large farming operations placing them into affiliated or non-affiliated farm management companies often headed by financial specialists to assure sound management of the firm's finances. These operations were often the combination of the farming operations of several defaulted loans resulting in large farming units of 7,000 to 12,000 hectares for efficiencies of production, ease of marketing large quantities of grains and oilseeds, and the ability to use modern machinery efficiency and effectively.

The third period started from about 2000 when several banks emerged as industry leaders determined to build full service banking operations in Ukraine for corporations, small businesses and consumers, international trade and documentary credits, credit and debit cards, savings and current accounts, to name a few services. The top 20 Ukrainian banks hold more than 85% of the nation's banking assets and five to ten of those are clearly leaders in trying to develop nationwide banking services to serve all communities. Banks like Aval, Ukrasotsbank, Ukrosibank, VA Bank, Credo Bank, and Nadra Bank are building nationwide banking networks and service outlets. These banks along with two state banks Ukraeximbank and Orchadny Bank own more than 70% of the bank assets.

Meanwhile another round of bank liquidations occurred during this period for those banks that became over extended in unprofitable business activities or failed insider lending. The largest of these was Bank Ukraina that formerly served the agricultural and rural sector as a state owned bank. It became bankrupt from continuing to finance former coholzes and sovholzes for inputs and machinery credits without being assured that they would receive repayment. Nonpayments and heavy loan losses were so high that the bank became bankrupt and liquidation was commenced in 2001. In many respects, this helped set the stage for today's commercial banks having an opportunity to enter the agricultural market. Several years now have transpired with many farming operations not receiving commercial bank financing directly but through more restrictive and more expensive terms by inputs suppliers, traders, and food processors. Banks were beginning to finance the large affiliated farming operations restructured from loan defaults in the late 1990s and turn of the century. At least one large bank is financing 15 or more such farming operations covering approximately 120,000 hectares. Neighboring farm managers were beginning to see what it took to access bank financing and use the funds efficiently. In the meantime, commercial banks found other areas to place their funds profitably in housing and consumer financing.

C. Rapid Finance Sector Growth

From the moment Ukrainians gained greater freedom, the population worked toward having more comfortable housing and modern appliances to improve their living and leisure. Initially, people saved their cash to make purchases of building materials and appliances to improve their current apartments. Those that could bought newly constructed apartments. When the Ukrainian consumer boom started at the turn of the millennium, the banking industry was there ready and prepared to finance this growth. Consumer lending started slowly until banks learned how to use financing structures appropriate for consumer financing, but bank loan portfolios began to swell once banks and their customers became comfortable with the lending structures. Banks also increased their lending to businesses producing and retailing consumer goods, building materials, and industrial products.

Ukrainian banks experienced an earlier growth period during the 1990s that ended with many poor quality loans and several bankrupt banks. What made it different after 2000 was the real income growth of the population that people were willing to spend on housing, cars, and consumer goods. Banks helped employers and then employees and consumers intermediate this new income growth into purchasing power for the housing and consumer goods they had wanted for years. During 2001-2005 banking assets increased almost five times reaching about $42.5 billion at the end of 2005. By the end of 2006 total bank assets are expected to have grown almost 40% to $59 billion or 61 percent expected nominal GDP for 2006 of $95 billion. Ukrainian banking assets have grown 300% during the last five years.

Banks know that their current banking assets, both business and consumer, are largely concentrated in Kyiv and a few urban markets. Bank officials indicate an interest in moving into the rural sector but intend to do so cautiously after fully understanding the credit risks of business operating there and the income streams of individuals. For the moment existing and newly established branches in urban areas will attempt to duplicate the same type of financing business that has been successful in Kyiv and the larger urban markets but that have not yet reached the smaller markets. For the rural areas, gathering deposits and making note of potential banking business opportunities is the essence of the current strategy. Building branch networks stretches available professional staff thin requiring the bank to engage and train large numbers of new bank officers as quickly as possible. This means that the banks will place their resources first at the most promising opportunities. For most, this means concentrating on business in smaller urban markets that are not yet fully banked.

When asked what would change their business strategy or accelerate their plan eventually to devote more resources to the rural sector, every banker questioned brought up the lifting of the agricultural land sale moratorium. Banks declined to give any specifics on how they would approach expanding in the rural areas if the moratorium were lifted but many had clearly considered how much their credit risk would be lowered for a number of their current customers. Some bankers were cautiously optimistic that the moratorium would soon be lifted and that the bank was taking this into consideration in developing its business strategies. In addition, the Association of Mortgage Bankers revealed that its board had asked the association to study how the members should approach lending safely. The Director indicated that the members wanted to know what the best practices were for lending against agricultural land and acknowledged that this is certainly the first step toward developing uniform agricultural real estate mortgage standards.

A brief overview of the current banking business of the more serious Ukrainian commercial banks will help put their business and business strategy into perspective of the growing Ukrainian economy. Many know the direction that the industry and their individual bank must take in continuing the good growth of recent years. They also know that they have a number of operational and financial management challenges to execute a reasonable bank business strategy for the Ukrainian market. This overview will identify some of the risks that the banks face, how movement into the rural market may be a part of a solution, and what the banks said they need to encourage them to move faster to make the rural sector a more important part of their banking business than it has been to date.

1. Residential Mortgage Lending

New housing construction grew slowly due to the need to pay cash for housing. Developers and builders did not have the funds to build apartments for sale so consumers were required to pay construction firms in cash prior to construction of their apartments. The risks were high for both sides. Consumers searched for ability to purchase on credit backed by their new regular incomes that resulted in people borrowing in myriad bridge financing structures until the apartments were constructed and the official government measurements confirmed the space purchased in square meters. Some construction firms failed due to their poor management ability and sometimes fraud leaving consumers in ruin. Successful firms attracted strong consumer demand for their units and bankers to develop acceptable loan structures enabling large numbers of housing construction projects to begin in many new part of urban areas across Ukraine. Slowly a conventional residential mortgage evolved in Ukraine from one or two banks and then rapidly expanded to all major banks.

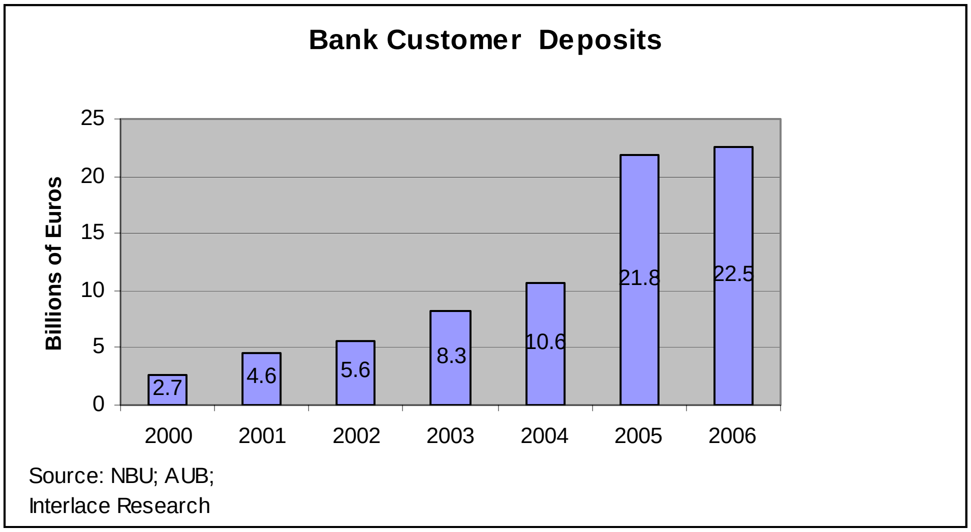
Terms varied from ten to even twenty years. Initially, consumer down payments of 25% or more were required. As the price for new and existing housing rapidly increased in value, however, banks lowered their down payment requirements relying on the increasing real estate values to provide consumers with an equity stake in their new home within a short period. Banks hungered for the interest and large fee income from residential mortgage loans.

2. Consumer Financing

During this last banking period, Ukraine banks entered the consumer financing surge. Ukrainians wanted new appliances, electronics, and furnishings in their new apartments and wanted cars to travel to new jobs and consumer outlets in locations farther and farther from the city center and public transportation routes. What enabled this to happen revolved around banks solving businesses dilemmas for paying their workers.

a. Direct Deposit Employer Bank

Firms formerly had to pay workers weekly or monthly in cash and arrange the difficult and dangerous logistics of assuring cash was available timely and safely to pay employees. These, of course, were the growing businesses that were producing goods and services profitably and wanted to make sure that they retained their employees by paying them timely. Banks developed plans to solve several of the firms' problems and simultaneously created many financial opportunities for the banks. The business' bank would establish accounts in the bank for every employee and pay into that employee's account his salary due on specified dates. If the firm did not have sufficient funds in its account, then the bank advanced funds to the firm secured against receivables not yet collected. This approach eased Ukrainian cash flow problems in major ways enabling the firm to be more productive in its core business activities.



b. Consumer Debit and Savings Products

The firm employees could use this firm account and access a number of other services from the bank or have the funds transferred electronically to another bank account. In either case, the employee's primary bank that received its salary weekly or monthly was now willing to provide the customer with a debit card enabling the customer to withdraw funds through an ATM, through the bank tellers inside the bank, or through the purchase of consumer businesses accepting the debit cards for payment. The banks received good fees from merchants and therefore encouraged the use of debit cards. Because the banks had this regular cash flow through the bank, they became comfortable with offering credit cards and point of sale consumer loans, savings, funds transfer, residential mortgages, and other consumer financing products. Point of sale loans work in a similar manner to a credit card but are approved electronically or by phone at the time of sale. In a sense, the bank is approving an increase in a customer's credit limit incrementally as the consumer makes purchases. Many banks actually approve the limit tied to particular products. For example, a consumer call to many banks for approval of a purchase of a refrigerator or washer would likely receive approval, while purchases of goods such as electronics and small items such as cell telephones received more careful review before granting approval.

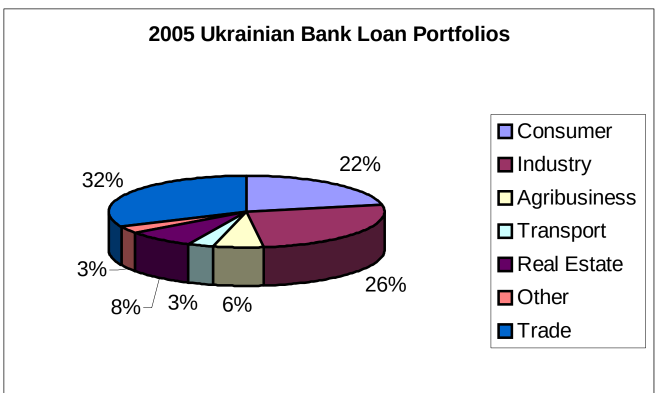
Interest and fees for these consumer products were high. Banks charged consumers a small fee for every credit or debit card transaction in addition to a relatively high, annualized interest rate of 25% to 35%. By the time the fees were taken into account, the overall effective annualized interest rate amounted to 40% to 60%. The top five Ukrainian banks have issued more than 20 million debit and credit cards, two-thirds of which are debit cards.

c. Building Branch Networks

Banks needed multiple locations throughout the cities to make it attractive for consumers to seek out financial services—current accounts, savings, and residential housing and consumer loans. Competition among banks to finance their purchases led to rapid development of more and more branch locations. Branches were even more important to attract consumer deposits in current and savings accounts to obtain loanable funds, which enabled loan growth. For this reason, larger banks set out to establish several hundred branches across Ukraine including many rural locations to facilitate firms' payment of employees, make working capital loans, gather the consumer deposits, and offer consumer financing products. The more rural the branches, the more likely the primary purpose of the bank branch was to gather deposits.

d. Corporate Financing

Ukrainian banks began expanding lending to corporation and small businesses prior to the consumer and residential housing credit boom. Banks worked with businesses to provide them with a variety of financial services to help their customers and earn fee income. Banks helped businesses manage their cash flow and working capital needs without the necessity to have and transport substantial amounts of cash to its suppliers, services businesses, and employees on payday. The more that a bank worked with a business, watched its cash flow through the bank, it became more comfortable with the firms' businesses and financing needs and developed financing structures that minimized credit risk but enable the firm to make payments safely for all supplier, employee, and customer needs. The chart below shows the breakdown of total Ukrainian bank portfolios for 2005 by category of business lending.



Source: NBU, Dragon Capital

1. Trade Credits

An important part of the corporate banking business has been the ability to facilitate the Ukrainian firms' trade credit needs for exporting metal and metallurgical products, chemicals, machinery, and agricultural commodities to its major trading partners—Russia, Germany, Turkey, Italy and the USA. Competitive trade credits requires a bank to have good correspondent banking relationship for issuing and confirming letters of credit, bankers and trade acceptances and other documentary credits. Having transparent financial statements in accordance with international accounting standards and audited by an international accounting firm is a basic requirement for establishing quality bank trade relationships.

2. EBRD Micro and Small Enterprise Program

Important funding support and technical assistance to the Ukrainian banking industry has come from the Ukraine Micro Lending Program (UMLP) established by the European Bank for Reconstruction and Development (EBRD), the German Ukrainian Fund supported by USAID and Kreditanstalt für Wiederaufbau. The primary purpose of the UMLP is to foster the development of micro and small enterprises through facilitating access of these businesses with banks to obtain credit on a permanent basis. Participating banks received funding, training of loan officers in the best international practices for lending to micro and SME businesses in these markets, and mentoring banks departments for development and administration of UMLP loan portfolios. This program has helped more than $800 million in loans flow through the participating Ukrainian banks to these businesses for more than 150,000 customers. Some of the commercial bank so value the UMLP training that they are using their own funds to make loans under the rules of the program in exchange for having additional bank loan officers trained in the best lending practices to these market.

UMLP has additionally developed an Agro-Lending Program targeted to agribusinesses in rural areas. Most of the borrowers under this program are small and medium size agricultural producers and processors primarily engaged in high value crop production in southern Ukraine. Some of the same principles for lending to micro and small businesses are adapted to the agricultural context. Banks take a variety of collateral in rural areas to support the loans—rural housing, autos, agricultural machinery, and even consumer white goods—to focus the borrower on working hard to ensure that the loan is repaid. This program has led to a significant increase in total rural loans at competitive rates, giving many smaller agribusinesses access to the only formal institutional credit that they have. Bank managers have had relatively few of these Agro loans to enter nonperforming status and have been interested in expanding to other rural markets as a result.

e. Ukrainian Bank Purchases

1. International investors

The high growth, high return Ukrainian banking market has recently attracted international investments from a number of European banks. The 30% to 50% growth rates with similar rates expected for the foreseeable future encouraged large European banks to pay high prices for the banks. Raiffeissen's purchase of Aval Bank in October 2005 was an early purchase at a relative low book value multiple. Later purchases commanded much higher multiples of the banks' book value for European bank investors to purchase 51% to 100% ownership in the target banks. At first blush, these appear to be very high prices for these banks given current book values, total assets, and total capital even in face of the very strong current and potential growth. Others believe that the purchasing banks, in face of competition from other buyers, prepared their bids based on the costs and time required to build the branch networks that the Ukrainian banks had already established. Based on this evaluation method, Raiffeissen obtained high value for its bid.

The table below provides information obtained through public announcements on some of the more prominent recent bank acquisitions during the past year.

Name of Bank	Investor/Purchaser	Terms of Deal	Date Announced
Aval Bank	**Raiffeissen International Holding Bank (Austria)**	**$1.028 Billion for 98% ownership**	**October 2005**
UkrSibbank	**BNP Paribas (France)**	**51% ownership for undisclosed amount**	**December 2005**
Ukrsotsbank	**Banca Intesa (Italy)**	**$1.16 billion for 85.42%**	**February 2006**
Index Bank	**Credit Agricole (France)**	**$260 million for 98% ownership**	**March 2006**
Raiffeissen Bank	**OTP Bank (Hungary)**	**€650 million for 100% ownership**	**September 2006**

3. International banks

International banks now own approximately one-third of Ukrainian bank assets. Articles and editorials in the Ukrainian press have decried the banks' purchase by European banks suggesting that this will lead to Europe exerting greater control over the Ukrainian economy with little benefit to Ukrainian business. This is not likely to be the case. When international banks purchase domestic banks, they typically change the policies, procedures, and banking practices of the purchased bank to be compatible with the host bank. This process generally improves the quality of bank administration, bank credit decisions, asset/liability management, and loan administration, collection, and workout. International banks bring access to additional debt and equity capital at maturities and terms more appropriate for Ukrainian businesses than may have been available prior to the international bank investment. International banks also provide Ukrainian businesses with important business connections to find the plant, equipment, machinery, and technical services to enable the firms to improve their product quality and efficiency. The banks can provide access to potential customers for their products and even provide them with expertise to help them develop new products.

This has been the pattern of European banks investing in banks of other Eastern European countries of the former Soviet bloc. In many Eastern European countries, Bulgaria and Romania, for example, foreign banks own more than 70% of the nation's banking assets. The injection of large amounts of debt, particularly long term debt, fuels further growth in the thriving economy. Because the European banks changes the bank credit policies, procedures, and practices, the loan decision making and administration process typically improves lowering the risk for making poor loans or for extended loans turning into losses due to poor administration. All banks have some substandard or loss loans. Better loan administrative practices help to minimize the number and volume of nonperforming loans, and institutes more effective action promptly to work out such loans to minimize the bank's losses.

ii. Growing Bank Portfolio Risk

Rapid bank growth in consumer, residential housing and business loans has given banks very strong income streams. The strong GDP growth resulting from business expansion and consumer purchases suggest that this growth will continue for sometime. The fact that a limited portion of the Ukrainian business and consumer activity (reported to be only 30%) is intermediated through banks means that banking growth will continue. The upward spiraling commercial and residential real estate values fuels more lending based on the higher collateral to support the loans.

As favorable as this economic growth appears, it is not sustainable. Eventually there will be an economic downturn sparked by some economic news that will reverse the value of real estate and eventually lead to increasing nonperforming loans and loan losses. Ukrainian commercial banks have been through three difficult periods during the last 15 years and should be well positioned to manage an economic downtown. The NBU has instituted good capital adequacy standards based on risk weighted assets and monitors bank performance. Out of more than 160 banks, the NBU examination and supervisory staff concentrates on the two dozen banks that hold most of the nation's banking assets and therefore, represent the most systemic risk to the Ukrainian financial system. Most of these larger banks report on attention to risk management with respect to credit risk, asset/liability management for funding risk, foreign exchange risk, and other types of bank operational risk. Several banks report on their asset/liability management in their annual reports cited the different maturities and the matching funding maturities.

Even though, many banks report that nearly 60 percent of their loans are denominated in foreign currencies (primarily Euros and US dollars), they have not experienced much foreign exchange risk in their portfolios to date. The NBU carefully manages the value of the hryvnia maintaining successfully a very narrow trading range of the hryvnia against the US dollar (between 5.43 and 5.04/$) for the past six years. Hard currency reserves have been building at a fast pace reaching over $20 billion by 2006. The stable exchange rate actually encourages borrowers to borrow more money in foreign currencies at lower rates than would be available if denominated in hryvnia. Borrowers do not sense any measurable exchange risk due to the relative hryvnia stability in recent years.

Still, there are a number of signs that Ukrainian banks may indeed experience high losses should a significant economic downturn occur for a number of reasons:

1. **Variance From Residential Mortgage Underwriting Standards.**

Though the ATCI project has worked with the industry to establish sound underwriting standards for residential mortgages, several banks are straying from strict discipline of using those standards. This is somewhat understandable. Real estate values have been spiraling upward at 30% to 50% annually along with demand for residential housing. Banks can easily figure that even if a potential borrower does not have a 25 percent down payment for the apartment he or she wants to purchase that amount of equity in the apartment will be present in one year. So some banks offer residential mortgages at 0% down payment. This is not the only problem. The high rising real estate values have also made banks less concerned about borrowers abilities to service debt. Several banks did not require extensive information about borrowers other consumer debt for autos, white goods or other consumer items.

Bank officers explained that the borrower's salary was either paid through the bank or soon transferred to borrower's account with the bank. In addition, they contended that the bank had greater problems with early repayments than with missed payments and defaults. One bank said that its residential lending growth spurted after it offered no early payment penalties. The bank said that this provided asset/liability management challenges to make sure that the 10 and 15 year amortized loans are properly long funded and to ensure that the bank was able to adjust quickly to a wrath of early mortgage prepayment. One large Ukrainian bank said that due to early mortgage prepayments that the average life of mortgages in its portfolio was about two years.

There are several flaws to these banking strategies. Real estate markets in transitioning economies are frequently volatile. Markets can experience dramatic growth for several years and then plateau or fall responding to downturns in the general economy or other adverse economic events. If residential real estate values suddenly decline, this is likely to occur due to a general economic downturn involving rising unemployment and declining real incomes. During these declines, the bank neither has a vibrant real estate market nor strong borrower incomes to service mortgages. Defaults and nonperforming loans are likely to mount. Housing foreclosures in a down real estate market are difficult to liquidate.

2. **Consumer Loan Practices**

Similarly, bank consumer loan practices may be legal and currently profitable but are perhaps not sustainable. Consumers are being allowed to purchase white goods, household items, electronics and other consumer purchases with credit cards and POS loans. Interest rates and charge fees have been reported by bankers to total 35% to 60% on an annualized basis. If borrowers only pay their minimum monthly balances, then their total outstanding consumer loan balances will rise rapidly and may quickly eclipse their ability to repay.

Ukrainian banks appear quite confident that Ukrainian consumers will continue their habits of trying to repay their loans as quickly as possible. While this may be true, it is also true that in such a volatile economy, an employee can find himself out of work for several months before finding new employment. The rapid climb of his consumer debt in the interim may make it impossible to regain control and pay down this mountain of consumer debt for years. Banks concentrated in consumer debt need diversification.

3. Concentration of Risk

Most of the banking growth is concentrated in Kyiv and a few regional urban areas. More than half of the Ukrainian banks and all but two of the top ten banks are registered in Kyiv and have most of their operations focused there. More than one-third of the corporate and individual bank deposits originated in Kyiv. While most of the large banks are moving rapidly to establish several hundred branches each in most parts of the country, most of their financial assets are still tied to Kyiv. If a downturn occurs in borrower incomes or in residential real estate values in Kyiv, then a major portion of the Ukrainian banking industry would experience financial difficulty.

4. Loan Classification Practices

Some banking specialists believe that Ukrainian bank loan classification practices do not accurately classify risk in their loan portfolios. No category exists for substandard loans that are technically performing but in significant risk of becoming nonperforming or loss loans. Others suggest that Ukrainian banks under report nonperforming loans. The International Monetary Fund (IMF) has estimated Ukrainian banks have nonperforming loans at 5 to 6 times the NBU official report of 4% of total loans. The combination of weakly classified loans and low capitalization can mean bank failures should a major economic downturn occur.

5. Capital Adequacy.

Ukrainian bank capitalization as an industry remains relatively low despite the robust loan and other asset growth during the past several years. The NBU minimum capital requirement for a general banking license is €5 million and lower for a more restrictive regional banking license. Most banks appear to be relying on growing retained earnings as the primary source of capital growth. Unfortunately, retained earnings are not growing as rapidly as loans leaving a lagging gap need for bank's capital to catch up with bank's assets. The NBU is tightening minimum capital requirements and many smaller and medium size banks may risk losing their banking licenses if they are unable to meet these requirements.

The larger Ukrainian banks that have funded most of the banking growth do not have the low capitalization issues of the smaller and medium size banks. But they are not strongly or overcapitalized either. The larger banks suffer from lagging capital adequacy due to the significant loan growth. Those that add more capital in addition to annual retained earnings are soon undercapitalized as they put more loan assets on their books. In addition, if the under reporting of nonperforming and substandard assets is correct, then the banks need even more capital to cover adequately the true weighted risk of their loan portfolios. The lagging capitalization issue is typical of markets exhibiting robust growth.

6. Bank Ratings

Fitch Ratings visited Ukraine in September and October primarily to review the sovereign debt rating of Ukrainian debt and review of some Ukrainian banks issuing bank paper into the capital markets. In early September, Fitch had previously issued concerns for systemic risk regarding the banking industry in 81 countries, including Ukraine and Romania, due to recent high growth without sufficient attention to risk management. Fitch will continue to monitor these banks over the next six months and issue a revised risk advisory report.

At the end of October, Fitch announced an upgrade of Ukrainian sovereign debt due to the good robust economy, the stability of the hryvnia, the rising NBU reserves of foreign currencies above $20 billion, and improved government revenues. A few Ukrainian banks had their own corporate debt and commercial paper rates upgraded though the overall Ukrainian banking system remains under Fitch watch during the next six months.

7. Foreign Exchange

Most banks interviewed reported that about 50% to 60% of their total loans were denominated in foreign currencies, primarily US dollars and Euros. Their borrowers are fully responsible for repaying the loans in the foreign currency selected and therefore are assuming the foreign exchange risk. Borrowers seem unconcerned with this issue due to the relative stability of the hryvnia against the US dollar and Euro. Though the hryvnia has been very stable for the past six years, there is no guarantee that the stable will continue forever. The exchange rate would certainly be tested if there is an economic downturn.

The foreign exchange issue is another point that could contribute to rising nonperforming loans and loan losses. If the hryvnia dropped significantly relative to the US dollar or Euro, borrowers may have difficulty having sufficient funds to meet the new higher loan payments. The foreign exchange risk of the borrowers become credit risk to the bank should a major devaluation occur.

The Team raises these issues because a drop in the Ukrainian real estate market or a downturn in the economy causing rising unemployment could occur at any time resulting in rising nonperforming loans and mounting bank loan losses. Each point has reasoned explanations from Ukrainian bankers or bank watchers.

1. **Residential Housing.** The pent up demand for renovated and new quality urban residential housing is so high and the current and near term stocks so low that strong real estate values and strong demand will continue for several more years. May be but all rapidly upward spiraling markets reach a point of overshooting and collapse

to a rational level based on the ability of consumers to service debt to pay for the housing. A bubble is developing and sometime it will burst.

2. **Consumer Debt.** The bank receives the consumer's salary paid through the employer and therefore has the ability to deduct payments for consumer loans if absolutely necessary. While this is true, it assumes that the borrower continues to have a job. Without employment the debt rapidly runs up further perhaps so high that it cannot be easily paid even when new employment is found.
3. **Risk Concentration.** Most large commercial banks are rapidly building a branch network across the country that will significantly dilute the concentration of risk. This of course is partially true. For most banks, the branch network is building but it is used primarily for gathering deposits of firms and individuals to continue to fuel urban loan growth in Kyiv and other established markets. Most banks have neither the trained professional staff nor the expertise to lend to the businesses that are operating in most rural areas—predominantly agriculturally related.
4. **Capital Adequacy.** New foreign bank owners have the capital to infuse into their newly purchased Ukrainian banks and will shore up the Ukrainian banking industry. This is quite true but only for the one-third of the Ukrainian banking assets now owned by foreigners. Others must domestically raise the capital and few have shown the ability to do so. Ukrainian bank have had healthy retained earnings due to wide margins in loans and other financial products. This is typical in the growth stage of bank industry development. As competition rises, rates and margins will tighten making it much tougher to maintain profitability and increase capital through retained earnings.

These issues are important because they suggest that the leading commercial banks have strong reasons for wanting to diversify out of Kyiv and throughout urban and rural Ukraine and to enter other economy segments such as agribusiness. They also suggest that these banks should enter other sectors carefully and do so in accordance with known international banking practices for financing these businesses. Other concerns are present. If banks have entered the rural market to any significant degree with loans and mortgage products, then it is likely to slow its entry or withdraw entirely before establishing a firm beachhead in that sector. This could squeeze rural businesses and borrowers who have access to fewer alternative financing sources than urban borrowers and lead to a domino of rural loan defaults based on the urban economic downturn.

Still, the agricultural economy is generally counter-cyclical to industrial business cycles and consumer spending. Banks that build good portfolios of agricultural and agribusiness loans may be buffered in any downturn by the good growth in the rural sector. Much depends upon how quickly and properly a bank builds its rural loan portfolio. Thus, while the Team believes that they are several opportunities to help accelerate the Ukrainian banking industry to finance the rural sector, there are factors that may slow the development before it entirely starts. The commercial banks that are seriously interested in expanding into the rural market and to the agricultural and food industry need more professionally trained bankers as rapidly as possible both to staff the growing branch network to generate new quality financial assets and to manage the more diversified portfolio risks from headquarters.

iii. Immediate Need for More and Better Professional Bankers

The previous section demonstrates that Ukrainian commercial banks know that they are concentrated in Kyiv with nearly 50% of their loan portfolios in residential housing and consumer financing. Many commercial banks understand that they need to broaden their branch network and penetration into the national Ukrainian economy. To some degree, there is a catch up race to build branches rapidly by those banks not well positioned. Initially, these branches are gathering deposits from businesses and individuals and are not fully integrated into the bank's total offering of products and services. Professional staff have yet to be fully trained to perform as loan officers to local businesses within the territories of the branches.

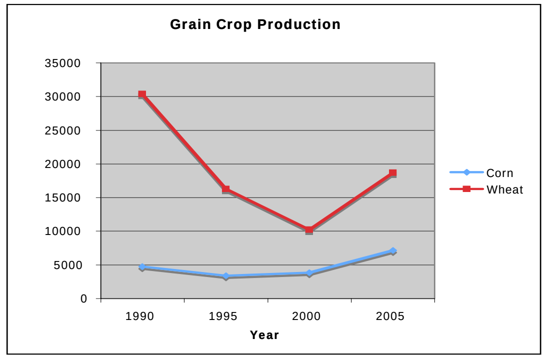
Wise Ukrainian bankers realize that diversification their portfolios by geographic and economic segment are important to balancing the risk potentials cited above. They know that Ukraine is over banked in Kyiv and under banked in many other regions further supporting the expansion strategy. They know that the foreign owned banks will be moving quickly to execute a broad strategy of penetration Ukraine nationwide to offer a wide variety of financial products and services to all creditworthy customers. Either they must meet the challenge with a similar strategy or become very efficient and the best provider of services in the markets in which they currently operate.

Banks will take various approaches to penetrating the rural areas where they establish branches. Some will concentrate on deposit gathering and limit the amount of loans and other services provided due to the perceived risk and the low revenues and incomes to support debt service. Others will offer selective products where the bank is competitive and the perceived risks are manageable. Still others will attempt to provide full services to all levels of business and consumer customers.

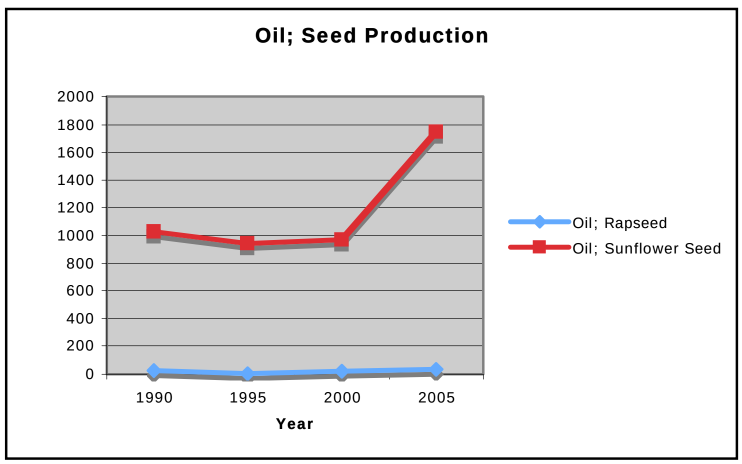
Helping the banks to make these choices and encourage them to penetrate the rural markets more than they otherwise would is a factor of bank business strategy and professional staff able to execute the strategy. Having bankers trained in the best practices for lending to rural businesses, especially agricultural production and agriculturally related businesses would encourage banks to consider greater penetration of the rural market more carefully. Having bank headquarters staff better trained in the best practices of risk management of loans extended to the agricultural and rural sectors would improve the ability of bank's to execute a rural marketing strategy. A close look at the Ukrainian agricultural sector that dominates the rural market will help understand the potential options for technical assistance interventions.

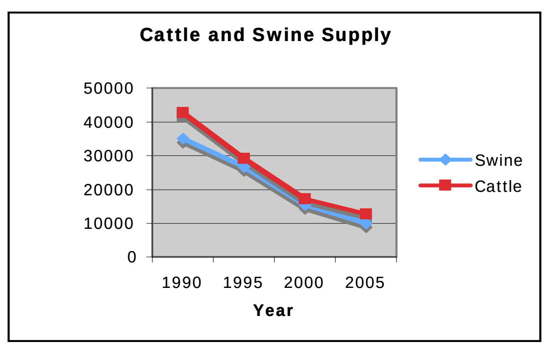
IV. Ukrainian Agricultural Sector

A. Changing Production and Processing of Cereals and Grains



The Ukraine has the finest black soils in the world with a climate very similar to the US wheat and corn belt in the Midwest. There are approximately 42 million hectares (ha) of arable agricultural land in the Ukraine. It is estimated that approximately 32 million ha are sown and produce crops. The primary grain crops are wheat, spring barley, and corn. Sunflowers and sugar beets are the main industrial crops. Soybeans, long thought to be inappropriate for the Ukraine, have been shown in the last few years to be feasible. The crop is rapidly expanding. The 2005 soybean crop was 611,500 tons up from 363,300 tons in 2004. [3] The southern section of the Ukraine is a major fruit and vegetable area, providing product primarily for domestic use. With the official breakup of state and collective farms and their dismantling in 2000, farm property was divided among the farm workers in the form of land shares. The loss of farm subsidies had an enormous impact on Ukrainian agriculture. Input use fell by 85% over a ten-year period beginning in the late 1980's and farms were coping with fleets of inefficient and aging farm equipment. Credit was not available for equipment replacement. The decline in livestock (cattle and swine) begun in the late 1980's has continued. Total cattle stocks fell from 25.2 million head in 1990 to the current level of 6.7 million head in 2006. Total swine stocks have fallen from 19.5 million in 1990 to 6.5 million in 2006. Corn and wheat production also fell significantly during the period of 1990 to 2000.





The new landholders quickly began to lease land, initially, back to newly formed private agricultural associations beginning in 2000. Often these operations were managed by the former collective farm managers. The most

[3] Source USDA Ukraine Agricultural overview

capable of these farm managers have expanded and developed highly efficient farming operations during the last five years. Other wealthy individuals also have acquired leases for large tracts of land and begun successful farming operations with skilled farm managers. As weaker farms failed and defaulted on loans, financial institutions began to become holders of large tracts of land. This has led to the formation of subsidiaries or independent farm management firms that operate these properties. In addition, a limited number of foreign buyers, primarily from Europe and the US, have begun to lease and acquire large tracts of land and are operating efficient commercial scale farming operations.

With the emergence from the Soviet style command economy, the better-managed farming operations have increasingly begun to make market-based decisions for crop selection and management that has resulted in profitable farming operations. Farm sizes have continued to grow particularly for grain and industrial crop production to take advantage of increased efficiency of operation. Some of the larger banks are reported to have in excess of 100,000 ha under management. Individual farm sizes as high as 45,000 ha are emerging. The optimum size farming operation for these crops is estimated by various sources to be from 2500 to 10,000 ha in the Ukraine.

The larger operations have been able to obtain financing for crop inputs and equipment replacement has begun. Banks have begun to arrange pass through financing of up to five year terms from the US Export Import Bank (US ExIm) and similar institutions plus value added tax (VAT), duties, and bank fees for capital equipment for the farms under management on their behalf and for the most efficient of their large farming customers. This has led to significantly improved yields and profitability for these commercial scale farms.

Smaller and less efficient units are still experiencing difficulty in obtaining credit financing for inputs and are trying to make do with aging and inefficient equipment. The high cost of production and lower crop yields are resulting in operating losses for these farms. It is unlikely that these struggling farm operations will survive in the grain and industrial crop markets. As these farms fail the land shareholders are leasing their land to larger and more efficient operations further accelerating the land consolidation process. The reduced farm labor requirements and leasing of land to large commercial operators has led to a significant out migration of rural residents who are moving to urban areas in search of employment. This has resulted in rural areas having an increasingly aging population, vacant housing units, and a shortage of services. This process is also likely to continue in those areas where significant land consolidation is taking place.

B. Intensive Commercial High Value Crop Production

Unlike the production of grain and oilseed crops which is now dominated by large agricultural enterprises, the production of fruit, vegetables, and potatoes had remained on small household plots which until recently represented 90% of the Ukraine’s production. The emergence of large super markets, food processing plants, and increasingly integrated food delivery chains in the Ukraine has led to an increasing demand for high quality reliable sources of fruit, vegetable, and high value crops from the domestic market. There is a trend, particularly in the southern regions, to move to highly efficient commercial scale operations to meet this demand. This includes the development of commercial scale hothouses and intensive cultivation of specialty crops. These facilities range from rudimentary plastic covered houses to Dutch glass fully automated and atmospheric controlled facilities.

These smaller plots (some even in the 5 to 10 ha range) through the use of irrigation, fertilizers, food supplements, appropriate chemicals and seedlings are highly efficient and have the potential to be very profitable. While small home plots will continue to supply a significant portion of the vegetable and potato crops, particularly during in season farm market periods of the year, these units will remain subsistence level operations. In many cases these plots provide a food source primarily for the rural residents own family needs. The rapidly developing food processing industry in the Ukraine will continue to expand the demand for commercially grown domestic product leading to continued growth in the number of these operations. These commercial scale units will also provide significant employment opportunities for local residents.

It is too early to determine how much integration of these supply sources into the food processors' operations may occur over time. Poultry in the Ukraine has rapidly become a fully integrated industry even down to the operation of the poultry houses. These commercial scale fruit, vegetables and high value crop farms are providing a very strong economic return for their owners and are likely to remain largely independent.

C. Food Processing

Improving personal incomes in the Ukraine and increased tourism are translating into increased expenditures for food purchases. This trend has facilitated the rapid growth of the food processing industry that is averaging about a 15% annual rate of growth. This amounted to approximately $10 billion annually or approximately 12% of GDP last year. The growth rate has been so strong that food processing now represents about 20% of all manufacturing in the Ukraine.

As recently as five years ago a visit to a small neighborhood grocery store would have found almost all processed food was imported and limited in selection. There are now more than 19,000 companies providing food services in the Ukraine. These firms are producing a wide range of processed food products in modern state of the art packaging using competitively priced domestic sources of fruits and vegetables. A visit to any of the emerging large supermarkets dramatically demonstrates the impact of the change as a wide range of processed foods can be found on the shelves with almost all of them being prepared by Ukrainian food processors. Food processors are undertaking rapid horizontal growth to offer new product lines and to enter new food related services. Some, such as the poultry industry, have aggressively pursued fully integrated operations from the farm to the store.

As the industry looks at new market opportunities they are paying increasing attention to the EU and Russian markets. The latter, despite recent political problems that led the Russians to restrict some food exports into their markets, remains a major potential export market for the Ukraine. These markets are requiring that the food processing industry move to improve the quality and safety standards of food products to meet international standards and to respond to domestic consumer interest in better products. Commercial banks interviewed for this study reported active commercial lending to the food processing industry. Should the Ukraine successfully negotiate a free trade agreement with the EU or achieve WTO accession it will be necessary for the food processing industry to fully meet EU and international standards for food processing. There is growing confidence in the industry that it will be able to become a major supplier of food products in world markets.

These trends will continue to increase the demand for reliable sources of high quality fruits and vegetables to meet the growing processing capacity of the industry. This will provide ample growth opportunities for commercial scale growers. However, it will offer limited opportunities for the independent family plot growers in the rural areas who will largely continue to operate subsistence level farm, which that will continue to decline in number.

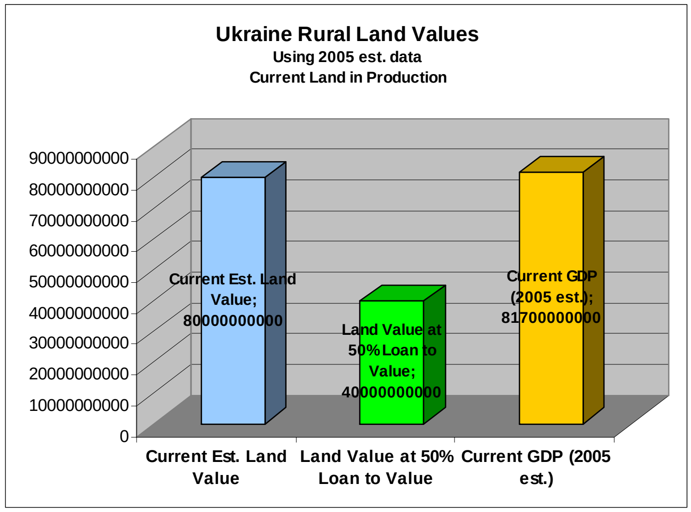
D. Food Retailing

During the last five years a fundamental change has occurred in the retail marketing of food in the Ukraine. Historically fresh and processed food was offered in small grocery stores or open air markets typically with the growers bringing their fruit, vegetables, dairy and meat directly to the market for sale. This is rapidly changing as urban markets areas witness the growth of major supermarket chains demand a wide range of quality food products to meet the expectations of their more affluent customer base. These chains also require a reliable source of adequate quantities of processed foods from their suppliers to meet the high volume turnover in their stores. They are increasingly finding it locally available.

E. Moratorium on Agricultural Land Sales

The approximately 42 million ha of agricultural land in the Ukraine is the last major untapped capital resource in the country. While the sale of urban land and commercial entities has been available there has been strong political resistance to approving the sale of agricultural land. The Ukrainian Land Code became effective on January 1, 2002. A moratorium was passed by the Parliament imposing a moratorium on the sale and purchase of agricultural land that was initially in effect until January 2005. This moratorium has subsequently been extended to January 2007. Currently there are proposals before Parliament to extend this moratorium until 2012 or 2015. Leaders in the government have indicated that they believe that the moratorium should be lifted by January 2008. At the time of the preparation of this report the strongest support appears to be for an extension of the moratorium until January 2008, which will permit adequate time to resolve any remaining technical issues relating to the sale and purchase of agricultural land.

Anecdotal evidence indicates that there is a growing view by business and political leaders that it is time to permit the sale of agricultural land thus opening up this valuable source of capital that is needed to fully develop the agricultural potential of the country. This source of capital is particularly important to facilitate the massive purchase of capital equipment that is needed to permit farms to achieve the levels of productivity that are possible in the Ukraine. The estimated value of agricultural land currently in production is $80 billion.[4] Using a conservative loan to value ratio of 50% this would indicate that up to $40 billion of new capital can be created for development of agriculture. This does not take into consideration the approximately 10 million ha of agricultural land that is currently not in production.



Over 6.9 million Ukrainian rural residents have obtained basic rights of private ownership in the form of land shares. Of those individuals who have received land shares, 3.6 million have completed all necessary legal and administrative procedures to formalize their private right to land as of 2004. Land shares can be leased and upon the lifting of the agricultural land sale moratorium they can be sold or transferred. As of January 1, 2004 land shareholders had concluded 5.235 million rent or lease agreements covering a land area of 20.927 million ha. Initial leasing contracts were typically short term with only 2% of the leases exceeding 10 years or more.[5] Leases of less than five years constituted 55% of this early leasing market. Several sources reported that more than 70% of all holders of land shares have received the necessary titles to their land and that this percentage would approach 100 percent should the moratorium be permanently lifted in 2008.

Land shares held by individuals have been leased primarily to entities developing commercial large-scale grain and oil seed operations and to a lesser extent the smaller commercial high value fruit and vegetable farms. Initially land leases were short term of one to three years duration. However this has evolved as renewals occurred into longer-term leases of five to fifteen years with options to purchase the land when agricultural land sales are permitted. Without these longer term leases or removal of the agricultural land sale moratorium there is little incentive for investors or creditors to provide the funds needed to develop these farms into efficient profitable businesses or to maintain soil quality through sound land management practices.

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[4] The projected land value is based on the assumption that the US (Iowa, Illinois, and Indiana for example) and international market for farm land of similar quality to the grain producing areas of the Ukraine has a current value of approximately $2500 per ha. The Ukrainian grain belt soils are considered to be among the finest agricultural soils in the world. Because of the high-risk nature of farming, loan to value ratios typically are not allowed to be more than 50%.

[5] Kobzev, Alexander, *Policy Agenda for Advancing Land Relations in Ukraine*, Open Society Institute International Fellowship Paper, April 2005.

There are reports that in some instances aggressive operators have found methods to work around the current moratorium and to actually acquire ownership of land. In the case of banks, holders of land shares that have defaulted on loans has resulted in these institutions obtaining large agricultural land holdings that they have placed under the management of subsidiaries or land management companies. Concerns are also raised about the common land lease structure that includes an option to buy the land should the moratorium be lifted. Those wishing to buy land and those wishing to get value out of land that they could not cultivate commercially came together with this structure to overcome the statutory prohibition. Arguably, this leasing with an option to buy system may have resulted in land sales by individuals who lack the knowledge to have negotiated a fair price for their land. On the other hand, most commercial operators want to know that they will have access to the land for a long time to warrant their investment in reconditioning the land to achieve competitive yields and in equipment and machinery to enable efficient production and harvesting. In any event, the land moratorium has clearly delayed or slowed the re-capitalization of Ukrainian agricultural land. The moratorium clouds whether willing investors would receive an eventual return for their investment should the land they are working be ruled under the law to go to other operators.

One can equally argue that the moratorium also increased the number of landholders who received less than fair value for their lease and buy option rights. The legislative attempt to set a price for leasing agricultural land did not repeal the law of supply and demand for quality agricultural land to produce crops. Without an open and active agricultural land market, landholders and lessee/owners have higher transaction costs to gain sufficient information to learn what the true value of the lease and of the buy option price should be. Many ignorant of how to go about calculating these values and obtain the information needed to make the calculations merely entertained offers and selected the most seemingly advantageous at the moment. The lack of certainly encouraged offerors to present low monetary offers in the lease/buy option terms to a large numbers of small landholders.

An alternative concern is that during the immediate period after the land moratorium is lifted outside buyers may attempt to buy small pieces of land strategically located in existing large scale operations that would adversely impact on the farms ability to operate efficiently without use of the small piece of land. It is feared that such activity would lead to attempts to resale this land to the existing operators at excessive prices. This appears to be encouraging existing operators to seek longer-term leases with stronger right to purchase options as a defensive action.

As employment opportunities have declined in rural areas the lease income from land shares has become the only source of income for many rural residents. Once agricultural land sales are permitted and small land shareholders are paid for their land this source of income will be gone. This presents a potential serious economic problem in the rural regions if and when this source of funds is exhausted and individuals will have to find employment. This is likely to accelerate the movement of rural residents to urban areas to seek jobs. The demand for workers in rural areas will continue to decline as the land consolidation continues and farming operations become more mechanized and efficient. This issue will primarily exist in the grain and oil seed growing areas. The labor-intensive commercial fruit, vegetable, and high value crop growers will continue to need low cost labor to efficiently operate their businesses.

Information gathered during interviews seems to indicate that major landholders and commercial banks have concluded that further development of the consolidation process and the re-capitalization of the agricultural industry has progressed to the point that it is necessary to have access to the untapped capital source of agricultural land. The two remaining issues that need to be resolved to develop an open and transparent agricultural land sale market are a land registry and credible land productivity data.

A national land registry system is necessary to establish an open and transparent land sale system. The establishment of a National Cadastre System and Land Registry (Cadastre) has been a high priority with program support from the World Bank and USAID. While much has been accomplished disputes remain between the Ministry of Justice and the State Land Resources Committee over who will administer the Cadastre and how it will be operated. The current land registry system is rather rudimental, fragmented, and difficult to use. It is critical to the establishment of a rural land market that the general public have access to the Cadastre if the market is to have transparency and the ability to work efficiently.

Further delays in establishing a functioning Cadastre are cited as a reason that removal of the rural land sale moratorium could be further delayed. However, it must be noted that, although it is difficult to use, the current system is available and is used daily by buyers and sellers of land. Transaction costs to ensure that a particular land title is valid are certainly higher than they would be if a fully modern functioning land registry were operational. Nevertheless, buyers and sellers of agricultural land would use the current system in order develop a land market as well as mortgage agricultural land if the moratorium were lifted.

Land productivity data is a fundamental component in establishing the value of agricultural land. In the US virtually every acre of land has extensive long-term records of its productivity, soil types, and its risks for damage from adverse weather. This serves as the basis for determining land value for sale purposes. In the Ukraine past data does exist but its accuracy is uncertain and it is not kept in a central location nor is it readily available to the general public. Some more current but incomplete data has been developed by the crop insurance industry but it also is not generally available. Until a system of providing land productivity data that is generally available to the public is developed for the Ukraine this important element of transparency for determining land value will not be available to facilitate the establishment of fair land pricing based on productivity. The old adage of "buyer beware" will certainly apply in the interim but this element will also not be an impediment to the development of an agricultural land sale market once the land sale moratorium is lifted.

Other issues will need to be addressed before a fully developed land market can exist. For example, it is important to establish a straightforward foreclosure procedure. This is a critical part of advancing mortgage relations and establishment of legal rights to land. Land disputes are a common issue complicated by a low level of confidence in the national court system. Another important component of establishing a viable land market should be development of new procedures for rapid, low-cost dispute resolution. Part of the process leading to the removal of the land moratorium should also be a legal and regulatory review of current government practices that could impact the value and types of uses for rural agricultural land that could impact its value and marketability.

Certainly while all of these concerns impact the development of a viable agricultural land market, none of them alone or collectively are serious enough to prevent the establishment of a agricultural land market should any or all of the impediments remain at the time the land moratorium is lifted.

It is important to note that the industry has already rapidly evolved into consolidated economic units with more than an estimated 20 of the 32 million planted ha. already under lease agreements. Commercial banks have been willing to extend credit to their own subsidiaries and affiliates, quality farm management companies, and best-known large customers. Capital equipment is beginning to be replaced as banks arrange pass through lending agreements for their best customers. Meeting the full capitalization needs of these businesses will still require a significant infusion of new capital for which the land remains the best untapped capital resource.

It is likely that an argument can be made that the environment in the agricultural land market is less transparent under current conditions than it will be as a result of the establishment of a land market following removal of the land sale moratorium. Certainly, little information is available to establish true land values or the appropriate lease value of land in the current market. Therefore it seems probable that all parties are moving towards recognition that the time is rapidly approaching when it makes the most economic sense to remove the agricultural land moratorium and to establish as quickly as possible a truly transparent and viable land market.

F. Cereals and Oilseeds export quotas and licensing

The recent restructuring of the government and its actions to impose export quotas on some grains and require export licenses has raised concerns that the government is returning to economic control practices of the Soviet era that are harmful to the agricultural industry. While explained, as has been the case historically, as related to the need for state reserve requirements, there have been arguments that some of the actions more likely have been targeted to favor the milling and baking industry. At the time of the preparation of this report, it is premature to make judgments on the intent and direction the government is taking in this policy area. It is important to note that such actions tend to have a chilling effect on international investment interest in the industry. With the rapid acquisition of major Ukrainian banks by the international (primarily EU) banking community, this could have an adverse impact on the further development of the huge but still largely untapped economic potential that the agricultural industry represents for the Ukraine.

V. Rural Financing

a. Production Agriculture

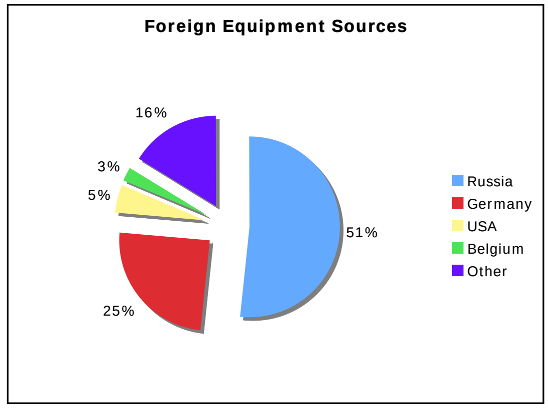
1. Large Corporate Farm Operations

The rapid consolidation of large commercial scale farms primarily raising grains and oilseeds is reflected in the more than 20 million ha. now under lease. The most successful of these farming operations have been established through the skills of some of the best of the old collective farm managers or through the hiring by investor and commercial bank owners of professional farm managers frequently with past successful international experience to run these new enterprises. These managers have successfully put together large economic units ranging in size from 2,500 ha to well in excess of 45,000 ha. At least one of the major commercial banks has more than 110,000 ha. under management. Commercial banks have been closely involved in the development and review of farm operating budgets. The best of these enterprises have been able to obtain operating loans to pay for adequate crop inputs to insure quality product with high yields. In addition, input suppliers and traders remain an important source of short term crop year financing in the Ukraine. Lenders are showing a willingness to take land leases as collateral in support of short-term loans and loan to collateral ratios are becoming less stringent.

Recognition of the importance of proper crop management and use of inputs has helped move the crop yields to more nearly reflect the real potential that is possible with the high quality of the Ukrainian land. These large commercial operations are rapidly approaching the yields that should be expected in this growing environment. This compares to the broader view that overall the Ukraine is producing yields that reflect perhaps only half of what should be possible taking into consideration soil quality and the use of proper crop management practices.

Equally important is the replacement of old and inefficient farm machinery with new "state of the art" western equipment. Farm machinery production in the Ukraine has continued to produce equipment of low quality and inefficient operating characteristics. Farmers are refusing to purchase this equipment except as a last recourse to replace inoperable machinery when producers are unable to qualify for purchasing western equipment. The Russian Federation and Germany have been historically the leading suppliers of grain harvesters, accounting for 52% and 25% of the supply respectively. In 2005 agricultural enterprises purchased 2937 tractors and 604 grain harvesters from foreign suppliers. This level of replacement is substantially below the rate needed to replace the aging fleet of equipment currently in use in the Ukraine and reflects the huge potential pent-up demand for agricultural equipment.

Longer term financing for this equipment remains difficult to obtain in the Ukrainian market. This is further complicated by import duties and VAT taxes that substantially increase the cost of machines. Current VAT taxes on equipment are 20% and customs duties are 12%. The VAT tax is effectively a false VAT tax in that no real value added is provided. Even though these additional taxes add substantial capital cost to the business costs, this equipment can be operated at a profit on the farm if financing can be obtained.



Several of the largest commercial banks have found a way to provide longer term financing for machinery and capital equipment by taking the longer term loans of institutions like the US ExIm Bank and passing these equipment loans effectively through to the business adding VAT, import duties and their own fees to the loans. This service is being provided to only subsidiary or farm management firms managing bank properties or to the very best large commercial farm customers. Increasingly lenders are accepting the equipment with a 25% or higher down payment as the only source of collateral for these capital equipment loans although they will take other forms of collateral if available to strengthen the credit. Such financing remains unavailable to smaller independent farm operations.

For smaller independent operators replacement equipment is often smaller and less efficient equipment acquired from limited Ukrainian sources. Crop loans are available primarily input suppliers and traders as well as from SME lenders to the best of these smaller operators. The government has provided an interest rate subsidy program for agricultural loans, which has not been fully funded. Payment of the subsidy is also frequently delayed so that the producer pays the full bank rate in the hope of being reimbursed at some later date. In some cases there have been assertions that the government has selectively reimbursed the interest subsidies to preferred producers. This program has reduced costs to producers that have successfully used it but it does not appear to be a significant factor in their survival as farm enterprises.

Many smaller grain and oil seed growers are struggling to survive and are finding it difficult to obtain crop financing from any source. While several SME lending programs have been beneficial, the inability to use the best crop management practices or to replace any of their aging equipment will in time result in their leaving the industry. In some cases this may be accelerated when individuals leasing land to these growers decide not to renew leases and instead to lease their land to more successful farm managers.

2. Agribusiness Financing Needs

The need for new capital sources to move farms to the next level of productivity and profit is increasingly important to the continued success of consolidation of farming enterprises into economic units. Most of the successful large commercial enterprises can use additional funding efficiently to make capital investments that will improve productivity and profit. Production capacity and yields are increasing and with these successes so is the need for farm infrastructure to support the operations. This includes on-farm storage, auxiliary equipment (trucks, cars, bulldozers, front end loaders, and trailers of all kinds as examples), and administrative support for record keeping and management needs.

Farms are expanding operations and in many cases will find that profitability can be enhanced with more vertical and horizontal expansion of their operations. This may include post harvest processing and handling, machine shops, equipment repair, and construction activity for their own activities and for others.

All of these activities will require new capital resources to take full advantage of their growth potential. Agricultural land remains the one untapped resource in the Ukraine for these purposes. The high-risk nature of this industry will always make third party equity sources difficult to find and attract. Superior operations are finding sources of debt and equity investment but only on the most selective basis.

ii. Smaller High Value Production Operations

There are a growing number of small commercial scale fruit, vegetable, and other high value crop enterprises developing particularly in the southern region of Ukraine. The enormous growth of the Ukrainian food processing industry and its insatiable appetite for additional high quality product is driving a rapid expansion of existing units and the addition of new enterprises to meet this demand. These operations are very capital intensive and heavy users of low cost labor. Capital expenditures for facilities, irrigation, and crop management are substantial. Conversely, the profitability of the enterprises is substantial and can be realized very quickly by successful operators.

Commercial banks have entered this market both at the large scale level and through their SME lending activities. There are reasonable sources of collateral for these lending activities such as glass houses and the larger more advanced irrigation and crop management equipment as well as off-take contracts with processors. Nevertheless this industry is high risk and very expensive to operate until the crop is successfully delivered to market. The most skilled farm managers can consistently sustain profitable operations and these commercial scale operators are likely to succeed and continue to grow to meet the expanding demand for product. While some vertical integration is likely to occur this industry still tends to rely on efficient independent commercial producers. Further, Ukraine is well positioned to sell into the old Soviet markets and to have entries into the EU particularly if a free trade agreement is obtained or upon WTO accession.

b. Food Processing to Retailing

i. Equity Investment

The steady growth of the food processing industry in the Ukraine during the last five years has been driven by strong equity investments from outside and by Ukrainian investors. The average rate of growth in this industry has been 15% and the sector now represents 20% of the total manufacturing within the Ukraine. There are more than 19,000 firms engaged in this industry.

The Western NIS Enterprise Fund and EBRD have focused on food processing and retail sales as a high priority for their portfolios. In 2005 the EBRD committed almost 530 million Euros to the Ukraine. [6] EBRD has focused its agribusiness activity in food processing, food packaging, and the retail trade. These developments also involve close cooperation with international food processing firms. Heinz has become the leading manufacturer of liquid and dry baby food and is representative of the major global food processors making substantial investments in the Ukraine. The Odessa State Regional Commission (OSRC) reported that meat processing grew 42.3 %, fish processing 34.6%, fruit and vegetable processing 46.2%, and alcoholic beverages by 28.4% in 2003. The national rate of growth during the same period for food processing was 22%.

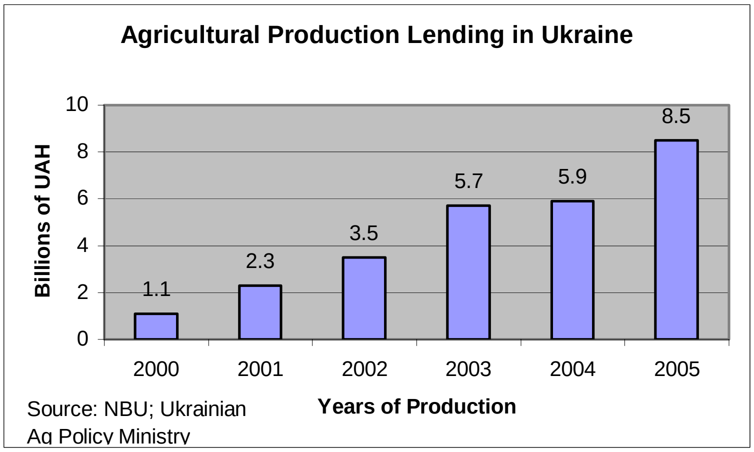
This level of growth is continuing and is being further fueled by the development and growth of large supermarket chains in the urban areas that require reliable supplies of high quality processed foods. The growth is also being sustained by the strong development of the restaurant business with more than 56,600 businesses being reported at the close of 2005. The Ukrainian population has one of the highest rates of food expenditures compared to the EU countries ranging from 50-80% of their wages. [7] This sector represents approximately 12-14% of the Ukrainian GDP. To meet this demand will require a continued influx of equity capital from Ukrainian and international sources. As this sector continues to grow it will require new sources of equity. The current environment for strong continued investment in this sector appears to be excellent.

ii. Working Capital, Plant, and Equipment Financing

Commercial bank financing has been generally readily available for short-term loans to the sector. Commercial banks do not typically breakout this category of lending. However,

[6] EBRD Country Fact Sheet Ukraine
[7] Euromonitor Ukraine Market Analysis Report, March 2004

interviews with the leading banks in the Ukraine indicate this is a very active and growing market for them. EBRD and other SME funding sources from international donors are very active in the food processing sector and have facilitated the development and expansion of new food processing and retail businesses. Longer term financing for capital equipment remains difficult to obtain from commercial banking sources but the rapid acquisition of many of the leading Ukrainian banks by international banks may begin to ease this problem.



iii. Production Financing Through Food Companies

Historically, production financing has been from input suppliers, traders, food processors, and gradually from commercial bank sources. Another source in developed markets is off-take contracts and long-term supply contracts between food processors and commercial growers of fruit, vegetable, and high value crops. This provides the processors with a reliable supply of product and the grower with a source of collateral or in some cases direct funding to be used for production expenditures. There is evidence that as the food processing sector has rapidly developed the use of these contracts is growing for the commercial scale growers and will provide a source of sales on which they can rely at pricing that will allow them to lock in strong profit margins for their product. This source is not available to the small independent plot grower who will continue to operate at subsistence levels and will sell into small local stores or on the open market. Eventually many of these growers will leave farming while commercial scale businesses continue to expand to meet the growing product demands of food processors.

c. Bank Industry Standard and Training Needs

i. Rural land Mortgage Underwriting Standards

Agricultural lending is complex and requires a thorough understanding of the economics of the business to properly evaluate and determine the appropriate lending for each enterprise. Farming may be viewed as a manufacturing facility in which the land is the factory facility, the inputs are the raw materials, the farm machinery are the production tools and the crop as the end product. It is important to understand this concept to avoid lending excessive amounts of funds for the land (the manufacturing facility) or for production loans to pay for the inputs or capital loans for the equipment. Too often agricultural land is viewed as just real estate driven by what buyers are willing to pay. This is only one part of the equation. The other value metric is the income that land can generate revenues, pay operating expenses including mortgage interest, and provide a profit meeting needs of the owner and his family to live.

Agricultural loan officers need to be strongly grounded in understanding the business model for each of the crops or livestock enterprises on which they may be asked to make real estate, production, or capital equipment loans. They need to understand the inter-relationship of each type of lending and how to view this business in its totality. To achieve this level of knowledge requires a strong understanding of basic agriculture and the associated economics. This needs to be combined with a thorough training program in commercial and real estate lending. The training should use the agricultural business model to determine what types of lending are appropriate and the revenues that each farming enterprise capable of generating to cover expenses, including interest and living expenses on a consistent basis.

Historically, with the exception of banks specializing in agricultural lending, the training programs for rural branch loan officers in agriculture amounts to little more than brief seminars occasionally combined with short field work. This lack of intensive and appropriate training often leads to poor loan plans that can result in unnecessary defaults and problem loans. Experienced agricultural loan officers know that each customer requires careful financial planning followed by regular farm visits during the course of the crop year. These visits are used to determine progress and to address problems early on and to find solutions before the problem leads to a foreclosure.

In Ukraine, there is limited experience in commercial agricultural lending on which to build a trained cadre of qualified agricultural loan officers. Agricultural enterprises have been producing for local and global markets for only a little more than a decade. To develop this core of trained officers will require intensive training with regular seminars to build the experience and knowledge of rural branch loan officers and their senior managers.

The second important component of agricultural lending is to develop uniform lending standards for agricultural real estate. This practice will improve the standard of lending for real estate and assure all parties that the lending standards for agricultural land are uniform and that only appropriate land loans have been made. All institutions will not use the standards. Those that chose not to use standards meeting international best practices, however, will not be able to sell agricultural real estate loans into a secondary market and will be subject to closer examination and evaluation of their loan portfolio.

Uniform agricultural real estate mortgage standards will help:

1. Improve bank portfolio quality and credit risk;

2. Promote openness and transparency regarding land values;

3. Reduce agricultural land speculation

4. Enable the development of a secondary market for agricultural real estate loans.

It will take some period of time to develop an agricultural real estate portfolio among agricultural lenders of sufficient size to be able to establish pools of loans for placement in a secondary market. However the use of uniform underwriting standards will reduce the time required to obtain critical mass for the formation of a secondary market.

Among the benefits for the agricultural real estate lender when a secondary market can be established are:

1. Enables the making and selling of loans into the market without having to add as much capital to the bank;

2. Gains access to long term funding;

3. Enables the bank to retain loan servicing and the associated fees; and

4. Enables the bank to provide better marketing services to its customers.

From the customers perspective, the development of a secondary market will lead to better financing costs for the businesses using this real estate.

ii. Bankers Need Training

During the course of discussions with commercial banks all acknowledged a need for more extensive training for their staffs. Banks were particularly sensitive to the importance of developing additional product lines for customers using their branches particularly in their rural branch network. This will require the development and training of rural branch loan officers with particular emphasis on agricultural lending of all types including real estate. It will also require training for some institutions that want to offer both loan or equipment leasing products.

Banks are developing varying degrees of internal training programs or using external training resources to provide professional development for their employees. In either case banks will need to provide an intensive program of training for their loan officers assigned to work in agricultural and food processing lending. These officers will need to be trained to understand the underlying economics of these businesses and how to properly use uniform underwriting standards for agriculture real estate mortgages. They will need to be well trained in understanding risk management tools and techniques for use as appropriate with each loan. This includes insurance, hedging, collateral requirements and loan adjustments as needed to maintain a strong loan portfolio. They will need to understand portfolio management (asset/liability management, portfolio insurance or guarantees as examples). Finally this training package will need to be integrated with a basic training package for new bank officers based in rural branches.

These training requirements are fundamental to maintaining sound banking standards in the agricultural lending and leasing markets. While agricultural lending is correctly viewed as high risk, proper use of available risk management tools and understanding of agriculture business fundamentals will maintain a strong portfolio and significantly reduce the risk exposure for the banks.

VI. Equipment Leasing in Ukraine

Equipment leasing provides a more narrow but very important opportunity for businesses to obtain the equipment and machinery they need to run their businesses and for commercial banks to find good debt placement. Equipment leasing provides a financing structure that most complies with underlying economics, use, and useful life that a firm has for the equipment. Leasing companies need substantial amounts of debt capital to purchase equipment for leasing to firms and individuals. For firms, the equipment can be cars, trucks, airplanes, manufacturing and processing equipment, generators, storage bins and silos, or any other equipment needed to operate a business. For individuals, the most commonly leased equipment are cars or in some cases trucks.

For firms, leasing allows the firm to use the strength of its capital and balance sheet to finance working capital and trade credits. This structure is especially important to growing firms and growing nations trying to put all scarce capital to work into building revenues and productivity. In a large sense, a firm under a leasing contract pays for the productive use of the equipment and no more. Under the best of legal and accounting frameworks, the equipment (and any debt to finance) is not on the firm's balance sheet. For individuals, leasing generally means access to and use of the equipment when loans may not be available. Leasing fees and imputed interest rates based on the total purchase price of the equipment and the monthly lease payments are generally higher than other loan products. But typically, neither the firm nor the individual have to provide the bank with additional collateral, though a down payment is usually required. Depending upon the credit rating of the customer, the leasing firm will vary the down payment.

This brief review of the fundamentals of equipment leasing is provided to put the issues facing leasing firms in the rural context in perspective. ATCI has substantial experience in equipment leasing in Ukraine so this section will focus directly on facilitating acceleration of equipment leasing product availability in rural areas. Most of the impediments[8] to equipment leasing in the rural area can be identified in a short list:

- Needed debt capital to fund equipment purchase for lease

- Lack of leasing firm outlets in rural Ukraine
- Poor customer understanding of leasing terms
- Lack of trained professionals to explain equipment leasing to rural businesses, especially for agricultural production and processing;
- Leasing firm need for business advisory services

1. Capital Needs. Leasing firms need debt capital to fuel their equipment leases, and in today's market, leasing firms are able to place financial leases on autos, trucks, and light manufacturing equipment fairly quickly. Many operate in affiliation with one or more commercial banks or other funding sources to fund their leases and enable the purchase of the leased equipment. Typically, these banks are also focused on urban markets for providing financial services. Therefore, most leasing firms have not shown an interest in developing leasing in the rural market because they can easily place debt capital in equipment leases in urban areas and would have to work harder to gain access to that capital for rural areas. So certainly, the lack of available debt capital to fund equipment leases is one impediment. But this impediment stems from the fact that most leasing firms and their funding sources do not understand the economics and business risks of rural Ukraine. More may be interested if they fully understood the market opportunity.

2. Rural Leasing Offices. After vaulting the first hurdle, leasing firms wanting to enter the must still have a rural distribution network to reach rural customers. Most leasing firms do not have offices except in urban areas, and most of those offices are located in Kyiv. Developing a branch network like commercial banks is too costly for the business that each generates.

Leasing firms are better advised to work with commercial banks so that the branch bank staff professionally offer their equipment leasing products. Banks are often looking for additional products and services to offer through their expensive branch networks and equipment leasing is a natural addition. This affiliation would be particularly appropriate if the commercial bank were funding the leasing firms leased equipment purchases. Some banks want to offer both products in their branches as a part of their branch building strategy. Some leasing firms have already developed such bank affiliation relationships for funding and cross marketing. Some have worked well. Some have not. There is a natural competition between selling a customer a loan for purchase the equipment outright versus an equipment lease. Commercial bank staff may have a tendency to push loans for quality customers but leases for those with poorer credit histories. Such affiliations are not easy to develop but they represent the most cost effective way for leasing firms to penetrate the rural market.

3. Customer Understanding. Even if a leasing firm has a marketing channel that reaches rural customers, the firm must build demand for leasing equipment. Several informed the Team that rural customers do not understand the leasing concept and are concerned that they will pay months and years of leasing payments and not receive the equipment at the end of the leased period. This is a common misconception of leasing that must be cured through customer education. Developing simple marketing materials as well as talking points for rural customers will help alleviate the problem. Materials should be tailored to the customers, businesses, and likely equipment to be leased.

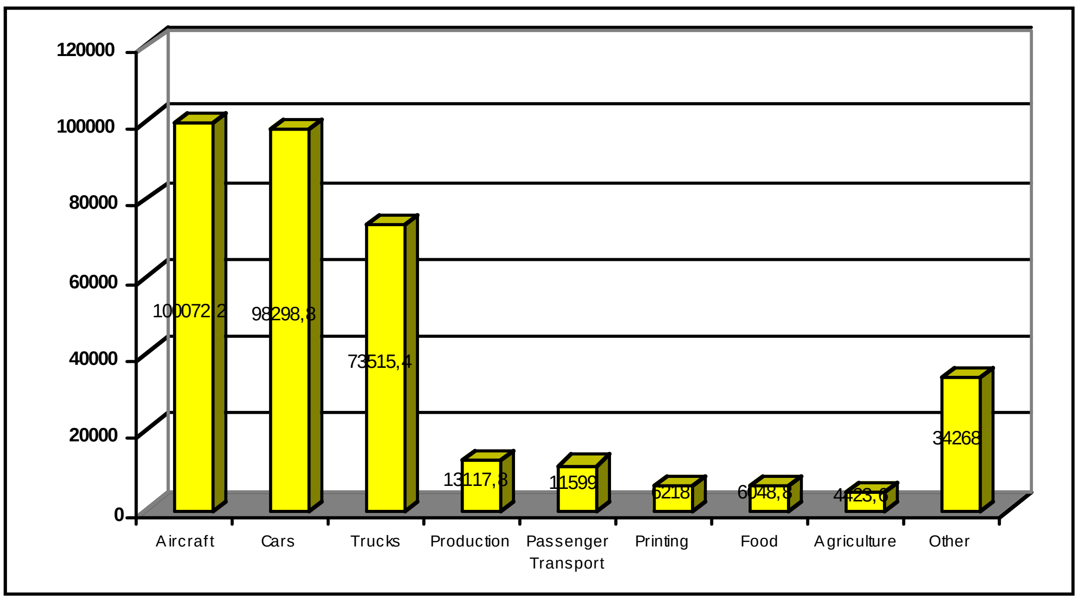
4. **Professionally Trained Staff.** Leasing firms that locate sufficient capital, develop an acceptable marketing channel, and customer marketing program still need professionally trained staff to oversee equipment leasing in the rural area. These staff members must be available to explain all terms and conditions in the simplest terms for rural customers and be the leading firm marketing spokesperson. They must fully understand rural businesses particularly agriculture and agriculturally related businesses which have different leasing terms due to when they receive their revenues. The staff must also train any bank staff in rural branches that may be offering their leasing products to rural customers.

5. **Leasing Firm Business Advisory Services.** Leasing firm debt capital, training, marketing, and affiliation needs suggest that business advisory services tailored to leasing firms would be appropriate. Most leasing firms do not have capabilities of tapping into international sources of debt capital nor an understanding of the information package that they must create in order to have their debt needs seriously considered by one or more potential investors. Often, leasing firms need both equity and debt capital and the sourcing may be different for each depending upon the firm. Unless Ukrainian leasing firms gain access to additional capital, however, they are not likely to accelerate interest in penetrating the rural market for leasing. Due to the limited number of leasing firms, the number of service requests are not likely to require significant ATCI resources and can be supplied from current staff and leasing training already committed.

Leasing advisory services could help these firms affiliate with Ukrainian commercial banks. This is an important opportunity. Leasing firms can affiliate with one or more banks to provide funding for their leasing products at good corporate rates. The leasing firm applies its operating margin and fees on top of this funding cost in establishing its leasing rates. The leasing firm then seeks out customers that seek the equipment and need off balance sheet financing or have slightly more credit risk than the bank would provide directly. Some Ukrainian banks own or are affiliated with leasing firms. Over time as equipment leasing firms reach maturity in their market penetration and product offering, they tend to be purchased by commercial banks with whom they are affiliated. Assisting in developing those relationship can accelerate development of the leasing market.

There are other impediments to leasing in the rural area but many of these are faced by urban equipment leasing transactions. For example, import duties and VAT add significantly to the cost of equipment for the current state of the art processing equipment needed to be competitive in the food processing market and to meet food safety requirements for exports into the EU and Russian markets. While further legal and regulatory reform are needed to fully develop the leasing option, interest and use of this source of capital equipment is continuing to develop regardless of these legal impediments and will become an important financing tool in the expansion of the food processing sector. As banks and leasing companies become more acquainted or commercial banks develop their own equipment leasing subsidiaries or affiliates, the banking industry is likely to lobby the Ukrainian parliament to take action to reform laws affecting leasing to put equipment leasing on a par with offerings in other European countries.

Commercial leasing of capital equipment in the Ukraine for the agricultural and food-processing sectors remains a small percentage of the total leasing activity. Below is a chart showing the number of equipment leases extended in Ukrainian during the past two years. Note that a very large percentage is devoted to cars and trucks. This mix will likely be similar in the rural area but the purposes may be different. Whereas a substantial portion of the urban auto leases are for individuals and consumers that have no business purpose other than transportation to and from work for salaried employees, rural residents tend to work for themselves, whether as agricultural producers or part of an agriculturally related business, and their cars are frequently primarily used for business purposes. If rural residents commit substantial resources to lease equipment of any kind, it is highly likely that the main purpose is generating family income and secondarily providing transportation for the family.



Total Ukrainian equipment leases from 2005 through 2006

VII. Findings and Recommendations

A. Lifting of Agricultural Land Sales Moratorium?

The current agricultural land sales moratorium is scheduled to be lifted in January 2007. Legislative proposals to extend this moratorium to 2012 or 2015 have been proposed. The consensus is that the government's political leadership will propose and parliament will pass an extension of the moratorium until January 2008. This extension recognizes that it is important to move forward with permitting agricultural land sales and that the remaining perceived issues preventing that change can be fully resolved within the next twelve months.

Agricultural land is the last major untapped capital resource in the Ukraine. Further consolidation and development of the real agricultural potential of the country needs substantial additional capital. This capital is needed to replace aging farm equipment and to fully capitalize large commercial farming operations to facilitate their meeting their full production and financial potential.

Most of the preferred land amounting to approximately 20 million ha. has been put under lease and consolidated into economic units. Some banks have allowed use of land leases as collateral for short term loans. Full development of the remaining business capacity of these farms, however, requires infusion of new capital that is really only feasible through capitalization of the agricultural land. Farming operations are considered to be high risk. That results in limited third party investment interest except for a very small number of the best commercial scale operations. Interviews during the course of this review indicated that most farm companies, investors, and banks believe they can complete fully positioning their positions within a year and the time will be appropriate to then end the agricultural land sale moratorium.

To a large extent the initial period of land speculation is probably already past. Indeed, lifting the moratorium may work to the advantage of current landowners by potentially providing a more transparent market than currently exists. This is particularly applicable to unsophisticated holders of land shares who have little basis on which to determine the true value of the small plots of land they own.

Concerns continue to be raised that the lack of a functioning national land titling system remains a serious impediment to removing the moratorium. Certainly the development of a truly transparent and fair land titling system remains a critical component to the development of the agricultural land mortgage market. The fact is that land sales can and do take place within the current system and that it is unlikely this impediment will delay the removal of the moratorium.

Similarly, other impediments including accurate information concerning the productivity of the land and confidence in the legal systems ability to fairly and on a timely basis resolve land disputes and facilitate foreclosures are unlikely to be fully resolved in the next twelve months. However, these impediments are also not likely to further delay removal of the moratorium. The commercial banking sector is well represented in parliament and under the environment that now exists is likely to prevail in lifting the agricultural land sale moratorium in the next twelve to eighteen months providing access to this essential source of untapped capital.

B. Agriculture Needs Capital.

Significant strides have been made in achieving the full productive capacity of the rich farmland that exists in the Ukraine. But overall the country is achieving perhaps only 50% of its actual productive capacity. Individual commercial scale farming operations have increased yields through better land management and more effective use of inputs but they still fall short of what can be achieved. Until capital farm machinery, facilities and auxiliary equipment, and full implementation of best farming practices are in place the full crop and profit potential of these businesses will not be reached. To accomplish this substantial task will require substantial amounts of fresh capital investment. Because of the high risk nature of farming it is unlikely that these resources will come from third party investors but will more likely only be fully achieved through tapping of the capital value of the land.

C. Equipment Leasing Urban Based.

The current Ukrainian leasing market is almost exclusively focused on car and truck leasing. Food processing and agricultural equipment represent only a small fraction of the existing market. Almost all of the approximately 70 leasing companies are located and focused on major urban center markets. There are very few branches of these firms located in rural areas. The development of a leasing market aimed at capital equipment for manufacturing and the agriculture sector still faces significant legal and regulatory impediments that have limited the appeal of this market for the business community. In the rural agricultural market there appear to be three primary impediments to its effective use. These include:

1. Several commercial banks involved in leasing expressed the view that most rural customers lack any knowledge of the benefits and operation of leasing agreements;

2. Commercial banks with leasing operations and independent leasing companies lack experienced personnel to provide customer understanding and service in their rural branches;

3. Urban based commercial leasing companies lack rural branches and trained personnel to provide support for capital farm machinery activity;

4. While a reasonably sound leasing law has been passed by the Ukrainian parliament, serious problems remain with VAT and customs taxation and regulations that limit the usefulness of leases for the equipment needed for agricultural and food processing uses. Even with these impediments a modest leasing market is feasible as better customer understanding of the leasing product becomes available and confidence that leasing companies can fairly provide this information and support services through rural branches.

Even with these impediments a modest leasing market is feasible as better customer understanding of the leasing product becomes available and confidence increases that leasing companies can fairly provide this information and support services through rural branches.

D. Leasing Terms not Attractive to Customers

Commercial banks have been offering longer term lending for major farm machinery purchases by very select customers and their own subsidiaries or farm management firms by passing through loans from the US ExIm bank and other similar sources to the end customer. In the process banks are adding VAT, custom duties, and bank fees to the amount loaned and are requiring 25% or more down payments. Despite this significant added cost running to more than a 40% increase in equipment costs, customers believe the replacement of old and inefficient with state of the art equipment can still be economically justified.

This process is viewed by customers as easier and more attractive than pursuing leasing of the equipment. Several things provide some insight into this situation:

1. Customers are likely to lack familiarity with leasing and to not understand the benefits of considering leasing products as an option;

2. Legal and regulatory issues continue to provide obstacles to making leasing an attractive and relatively easy option to use from the customers perspective; and

3. Commercial banks are planning to begin programs to explain and offer customers at their rural branches the option of loans or lease products to replace farm machinery and to purchase auxiliary equipment. Currently with a few exceptions, banks are not offering this option to their customers.

E. Competition Improving Terms for Customers

The development of competing leasing and loan products for the rural market will tend to provide significantly better terms and conditions for customers. Currently equipment loan products and a few leasing options are being offered to only the very best customers, bank subsidiaries holding farmland or their farm management companies. As the need for additional services to be offered within the banks rural branch system becomes more critical to the banks the commercial banking sector will add new leasing and lending lines. Commercial scale farming operations should expect that improved terms and conditions will result and become available to a broader range of customers.

F. Business for Rural Branches

The commercial banking industry has been aggressively pursuing the expansion of their branching networks throughout the Ukraine including many rural locations. Initially these branches are focused only on deposit gathering while offering few, if any, additional banking services to their customers. This focus recognizes the banks urgent need for additional funds to meet the demand for consumer loans and residential real estate mortgage lending. International banks are paying substantial premiums to acquire banks with well-established branch networks.

All of the financial institutions interviewed for this review recognized that branch networks could not be economically sustained without expanding the banking services offered to their customers. They also recognized the risks associated with current consumer lending and real estate mortgage product practices. Development of fee based services and properly managed rural product lines would facilitate alternative income sources for the banks and provide better balance for their portfolios.

A major concern is the lack of trained bank employees to staff the branches, particularly those located in rural areas. Most institutions are developing or have in place training programs but still lack intensive development programs to prepare rural loan officers to handle agricultural lending and leasing products. Some financial institutions are planning to offer both agricultural lending and equipment lease options to customers at the branch level as soon as they are confident that rural loan officers have adequate training. Institutions offering active SME lending programs expect to also offer lease products to this market although the equipment made available will more likely be focused on cars and trucks as well as some smaller farm machinery lines for the SME customer.

VIII. Recommendations

A. Bank and Agriculture Sector Systemic Risk Reduction Through Uniform Agricultural Real Estate Mortgage Standards.

1. Uniform Agricultural Real Estate Underwriting Standards.

With the likely elimination of the agricultural land sale moratorium within the next twelve to eighteen months there will be a substantial surge of agricultural real estate lending demand. Agricultural land mortgages are considered to be high risk lending and can easily result in significant defaults if lending procedures and underwriting standards using international best practices are not in place, loan officers are not thoroughly trained in the economics of agricultural businesses, and these practices are not strictly followed by the banks. The commercial banking sector is beginning to recognize that current underwriting practices for real estate mortgage lending is fueling a real estate bubble in the Ukraine and that many real estate mortgage loans do not meet international best practices. Portfolios may contain significant high-risk loans subject to default when the bubble breaks. Most banks have recognized this situation but few have put into place aggressive programs to improve underwriting and lending practices to correct these risks. Failure to implement uniform underwriting standards prior to the opening of an agricultural land mortgage market could only compound the systemic risk that is emerging in the banking sector.

Development of an agricultural real estate land market will place substantial additional capital requirements on the banks which are already strained to meet capital requirements resulting from the double digit rate of growth they are experiencing that is being driven by the consumer and real estate mortgage lending markets. One of the most effective ways to mitigate this problem is the development of a secondary market for agricultural land mortgages similar to the Farmer Mac program in the US. Secondary markets require the use of uniform underwriting standards to facilitate a transparent market and to make mortgages attractive to third party buyers. Development of a secondary market will only occur after a large pool of uniform agricultural land mortgages has developed that can be formed into pools of loans for sale into the financial markets.

The use of uniform underwriting standards for agricultural land mortgages will also tend to improve the transparency of the market and facilitate the establishment of fair market values for land. It will be critical to have uniform underwriting standards in place prior to the opening of this market to preclude to the extent feasible the development of substandard lending in this new market. Not doing so will likely result in the further increase in the systemic risk currently developing in the commercial bank system.

2. Bank Officers Need Intensive Agribusiness Loan Training

Historically, except in banks primarily focused on agricultural lending (i.e. for example the US Farm Credit System), bank officer training for agriculture and agribusiness is typically limited to the occasional seminar with little or no field experience or specific training in agricultural business economics or risk management. There is no base of trained agricultural lending officers in the Ukraine and none of the training programs currently offered or planned provide intensive training for this sector. With the large rural branching networks that are evolving in the Ukraine it will be critical that rural branch lending officers receive intensive targeted training to prepare them to work effectively with the rural customer base. Such a program necessarily entails intensive classroom training combined with field training components to insure a sound base of knowledge for the large numbers of newly minted loan officers that the banks will be placing in their rural branch networks. A suggested course list is provided in Annex II. It will be important for the banks to develop and execute either internal or externally supplied training programs to meet this need before the banks can safely expand their product and service lines or should offer agricultural real estate mortgages in their rural branch networks. Because there is no base of experience to develop this type of training, that will meet international best practice standards for the agricultural sector, in the Ukraine this is a appropriate opportunity for donors to offer expertise to facilitate meeting this training program need.

B. Training and Rural Business Advisory Services for Leasing

1. Rural Certified Leasing Program

Because of the unique risks associated with agricultural equipment leasing programs it is appropriate to modify the existing certified leasing program provided by the Access to Credit Initiative to develop qualified lease executives for rural bank branches and to facilitate the development of rural leasing branches by independent leasing companies. This type of program will provide trained executives capable of accurately and effectively presenting the opportunities and benefits of using leasing as an option for agricultural and rural businesses to rural customers and to facilitate the implementation of economically sound leasing programs for this market.

2. Rural Leasing Business Advisory Services

Almost all of the approximately seventy independent leasing companies are urban based and primarily focused on car and truck leasing. Agribusiness and agricultural leasing represents only a very small percentage of the leasing market and is typically viewed as a high-risk business. Management of the leasing companies lack information and understanding of the potential offered by rural markets as consolidation into commercial scale units continues in the agricultural sector. Development of advisory support for these firms in the form of business strategy services will be needed to encourage the establishment of rural branch leasing offices and development of an agriculture leasing market. While commercial banks are generally developing their own business models for rural leasing activities, offering of business strategy advisory services in this market could be a useful resource for these institutions as well.

3. Debt and Equity Sourcing

Leasing of capital equipment is a capital-intensive activity that requires leasing businesses to have ready access to equity and debt sources. It will be difficult to find adequate access to long-term financing and equity sources to support the kind of funding requirements needed for agribusiness and the re-equipping of farms in Ukraine. It is likely that the best source for equity and debt funding for leasing operations will be found in the EU and to a lesser extent perhaps the US. Successful debt and equity funding has been developed for leasing companies in other Central and Eastern European countries. Providing advisory services by experienced executives in these markets, particularly for the independent leasing companies, would provide an important support activity to facilitate the early development of leasing activities for the agricultural sector and to facilitate the growth of leasing activities in Ukraine.

Annex I List of Contacts

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Annex II Agribusiness Training for Ukrainian Bank Officers

Suggested Course Curriculum for Intensive Agriculture and Rural Business Training for Ukrainian Bank Loan Officers

A. Journeyman Loan Officer Bank Training Topics

- Elements of Rural Business Development
  - Production chains
  - Rural organizations (corporate/cooperative forms for rural business)
  - Rural business development (how to structure a business plan)
  - Market analysis for agricultural and processed food products
- Basic agricultural concepts
- Credit analysis (parametric, scoring, traditional elements)
  - **C**haracter (reputation for implementing plans)
  - **C**apacity (Technical Ability to undertake project)
  - **C**apital (cash, liquid assets, and plant, equipment and real property)
  - **C**ollateral (assets to support business, other assets, gurantees, etc.)
  - **C**onditions (economic business conditions)
  - Loan application process, due diligence, and environmental impact assessment
  - Credit scoring models and analysis
- Project Finance analysis
  - Basic accounting
  - Financial analysis (cashflows, performance indicators, etc)
  - Financial engineering
  - International Elements (international pricing; correspondent banking relationships, cross border partners, product and money flows, and collateral)
- Loan/Project Administration (Monitoring, Workout & Collection)
- Other rural sectors
  - Tourism—Hotels, restaurants & other consumer services
  - Storage, Transport, and Logistics Services
  - Commerce

B. Advanced Agribusiness and Food Industry Specialization Modules

- Advanced financial analysis
- Portfolio Risk management—asset/liability management
    - Loan Classification (portfolio examination, classification, and intermediary CAMEL review)
    - Diversification, credit enhancement, insurance, derivatives
    - Loan Workout Strategies
    - Auditing, inspection & internal control
    - Consolidated Accounting System
- Project development (identifying problems and matching them with solutions)
- Project presentation
    - Loan documentation & due diligence process
    - Presentation to Loan Committee
- Bank product and service marketing
- Dairy and Dairy Products
- Poultry and Meatprocessing
- Grains and oilseed crops
- Horticultural products (hothouse, irrigation, and intensive agriculture)
- Fruit production
- Vineyards and wine production
- Tourism (including tours, hotels, restaurants, and services)

Strategic Specialization Modules

- Budgeting & Strategic Planning

- Rural business development strategies
    - Budgeting & Accounting
    - Gradual Business Expansion

- Rural business organizational strategies
    - Cooperative
    - Partnership
    - Limited liability company
    - Corporation
    - Sole proprietorship

- Rural Community Lending—microfinance strategies

- **Trainer Specialization Modules**

    - Training plans and strategies
    - Case study development from actual Ukrainian project examples
    - Evaluation instruments (Oral and Written Testing)
    - Incentive structures
    - Mentoring programs

Annex III Presentation to USAID: Rural Access to Credit

[To be added to final report]

ATTACHMENT 4

ATCI

Sevastopol, November 16, 2006

Issuance of Covered bonds in Ukraine: Considerations for Regulators

Sponsored by The Access to Credit Initiative/USAID/Ukraine

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ATCI is about Building Investment Capacity and Wealth By Developing Primary Markets and Secondary Trade In:

- The Mortgage Industry
- Financial Leasing
- Municipal Bond Market

Facilitated by Development of Credit Information Facilities (Credit Bureaus)

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Development of the Fixed-income Market

BENCHMARK PRICING NEEDED FOR:

- Corporate bonds
- Mortgage-backed bonds
- Securitized assets
- Municipal bonds

OBJECTIVE: BUILDING A LONG -TERM GOVERNMENT YIELD CURVE

- **GOVERNMENT BOND ISSUANCE**
  - Ten and twenty year maturities
  - Inflation indexed

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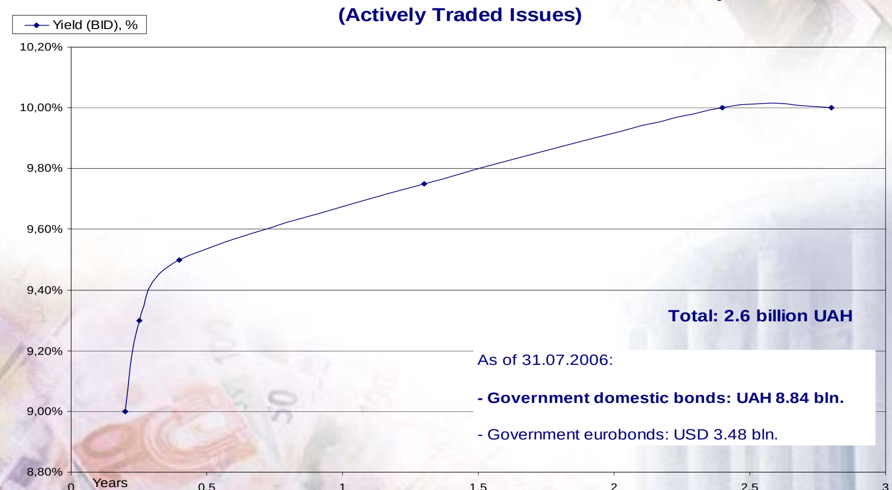
Domestic Government Yield Curve - Yield to Maturity (Actively Traded Issues)



Source: Ukrsib weekly bond market review, Aug 21-25 2006

As of 31.07.2006 (Source: Minfin, cbonds)

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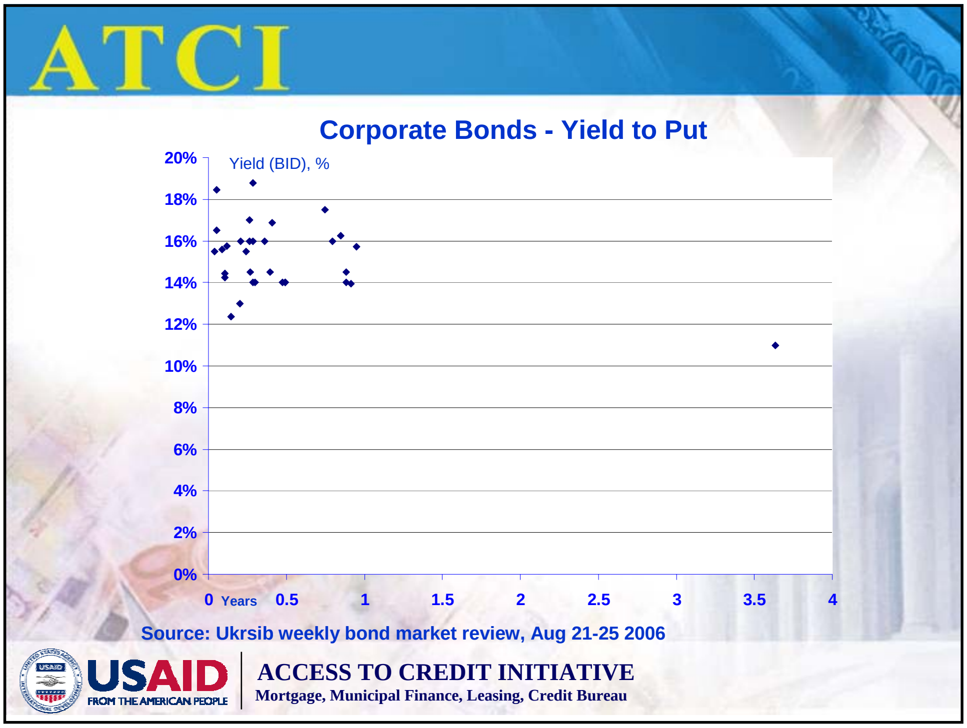
ATCI
Corporate Bonds - Yield to Put
Yield (BID), %
20%
18%
16%
14%
12%
10%
8%
6%
4%
2%
0%
0 Years 0.5 1 1.5 2 2.5 3 3.5 4
Source: Ukrsib weekly bond market review, Aug 21-25 2006
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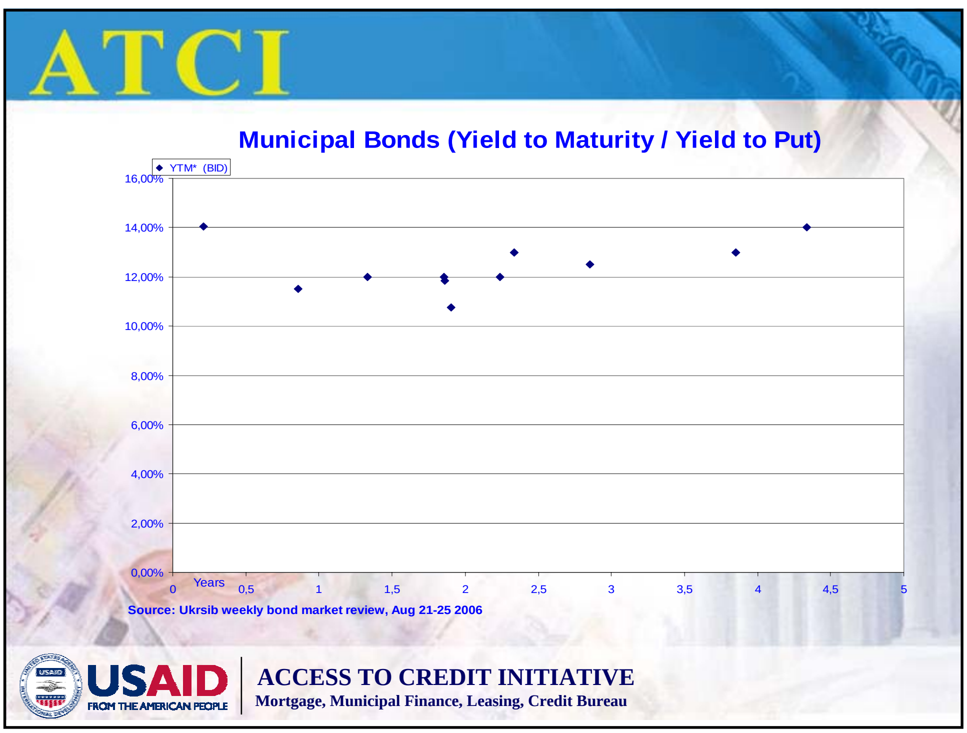
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Municipal Bonds (Yield to Maturity / Yield to Put)
YTM* (BID)
16,00%
14,00%
12,00%
10,00%
8,00%
6,00%
4,00%
2,00%
0,00%
Years
0 0,5 1 1,5 2 2,5 3 3,5 4 4,5 5
Source: Ukrsib weekly bond market review, Aug 21-25 2006
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Mortgage Component

- Primary market
- Secondary market
- Associated market infrastructure

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Outstanding Residential Mortgage Debt

(By country, in % of GDP)

*Old EU Members (2005) The Netherlands 115% - Italy 17%

*New EU Members (2005)

Estonia	24%
Latvia	18%
Hungary	10.5%
Czech Republic	9.7%
Poland	5.8% (5.4% at ATCI start)
**Ukraine	2.5%

* Source: European Mortgage Federation ** Source: Ukrainian National Mortgage Association

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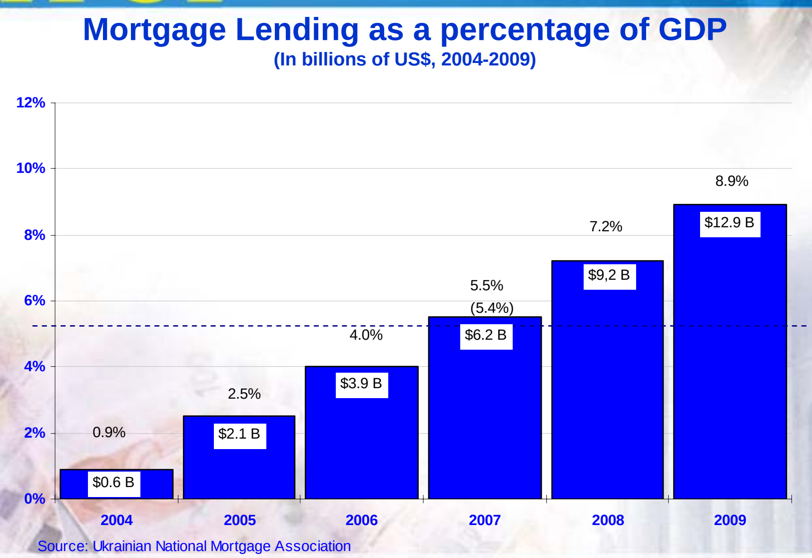

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Mortgage

Secondary Market

TO DATE:

- ESTABLISHMENT OF STATE MORTGAGE INSTITUTION
- PASSAGE OF THE MORTGAGE BOND LAW
- CONFIDENTIALITY AGREEMENTS SIGNED: UKRGAZBANK; UKRSIBBANK; UKRSOTSBANK; PRIVATBANK; STATE MORTGAGE INSTITUTION

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CB Legislation

Geographical Overview - Covered Bond Legislation in Europe
(as of January 2006)

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Mortgage

Secondary Market

TO BE ACCOMPLISHED:

- ADOPTION OF IMPLEMENTING REGULATIONS
- ISSUANCE OF AT LEAST THREE PILOT MORTGAGE BONDS
- LIQUIDITY FACILITY (SMI)

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Mortgage

Associated Market Infrastructure

TO DATE:

- COMPLETED ASSESSMENT OF REAL ESTATE SALES PRACTIONERS AND APPRAISERS
- COMPLETED ASSESSMENT OF MORTGAGE TERM LIFE

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Mortgage

Associated Market Infrastructure

TO BE ACCOMPLISHED:

- CERTIFICATION OF APPRAISERS IN ACCORDANCE WITH IVSC STANDARDS
- MLS PRACTICES FOR PRICING TRANSPARENCY
- COMPETITIVE MARKET FOR MORTGAGE TERM – LIFE INSURANCE

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Credit Bureau Component

First National Bureau of Credit Histories

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Credit Bureau

TO DATE:

- PASSAGE OF CREDIT BUREAU LAW
- CREDIT BUREAU ESTABLISHED
- BUSINESS PLAN PRODUCED
- TENDER DOCUMENTS DRAFTED
- INTERNATIONAL OPERATOR (CREDITINFO) SELECTED BY FNBCH

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Leasing Component

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Leasing Volumes in Neighboring Countries

(in billions of Euros)

Source: Leaseurope **Country**	**New Leasing Volume in 2005**
UK	55.8
Germany	49.3
Italy	44.2
Russia	**6.8**
Austria	6.7
Hungary	**4.7**
Poland	**4.0**
Czech Republic	**4.0**
Slovakia	**1.5**
Romania	**1.1**
Estonia	**1.0**
Ukraine	**0.24**

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Leasing

Main Impediments:

- Lack of capital
- Lack of know-how

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Leasing

What are we doing?

Importing Capital and Know-How

Building New and Renovating Existing Leasing Companies

Professional Development

Market Development

Building a sustainable and competitive leasing industry in Ukraine

Enabling Environment

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Leasing

Importing Capital and Know-How

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Leasing

PROFESSIONAL DEVELOPMENT / CLS PROGRAM

- Development of CLS program with Ukrleasing Association, IFC and leasing industry
- Targeted training for bankers: Co-sponsored conference on improving conditions of debt funding with NBU, UAB and IFC
- Targeted training for lessors on agricultural leasing

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Municipal Finance
Component
Lighting up Ivano-Frankivsk
UAH 5.5 million, 12%, 5 years
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Municipal Finance

- BOND CAPACITY ASSESSMENTS:
  - Komsomolsk (pop. 51,000)
  - Korasten (pop. 66,600)
  - Cherkasy (pop. 295,000)
  - Berdyansk (pop. 121,700) – next to issue
  - Ivano-Frankivsk (pop. 218,000) – issued
  - Lugansk (pop. 452,000) – in process
- CREDIT SCREENING OF TWENTY UTILITIES

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Post-ATCI Domestic Municipal Bonds Issued or Planned

City and Population	Bond Status	ATCI Role
1. Ivano-Frankivsk (pop. 219k)	Bond sale 2/2006 UAH 5.5 M—street lighting	Yes
2. Cherkasy (pop. 293k)	Bond sale 12/2005 UAH 5M - roads	Yes – initially
3. Odessa (pop. 1M)	Bond sale 12/2005	None
4. Berdyansk (pop. 119k)	Bond sale expected November 2006 Up to UAH 10M for roads	Yes
5. Vinnytsa (pop. 360k)	Bond sale UAH 20M 06/2006 UAH 20M--roads	None
6. Komsomolsk (pop. 51k)	Bond sale UAH 8M 07-08/2006 12% 5 yrs.	Yes - initially
7. Korasten (pop. 65k)	City wanted to issue bonds, but ATCI assessment showed no capacity in 2005.	Yes
8. Lugansk (pop. 452,000)	City Council approved bond of up to UAH 30 M in July 2006	Yes
9. Rivne (pop. 248k)	City wants to issue bonds for wastewater treatment facility, up to UAH 30 M	Yes

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POST-ATCI Domestic Municipal Bonds Issued or Planned (continued)

City (Republic) and Population	Bond Status	ATCI Role
10. Kamyanets-Podilsky (pop. 99k)	Secured a credit rating in 05/2006 Proposes to issue UAH 20M.	None
11. Donetsk (pop. 1M)	Rating update 06/2007 City Council has approved UAH 50M.	None
12. Sumy (pop. 282k)	City is discussing bond issuance with Kreschatik Bank.	None
13. Dnipropetrovsk (pop. 1.1M)	Rating issued 2006. Proposed UAH 50M, for heat utility upgrades	None
14. Brovary (pop. 88k)	Secured credit rating in March 2006	None
15. Sevastopol (pop. 340k)	Credit rating has been continuously in effect since 2004.	None
16. Autonomous Republic of Crimea	S&P rated Crimea on July 31 2006 (B+, uaA+). S&P states that no borrowing is planned for 2006, but "Potential issues of small domestic bonds and of Eurobonds for up to $45 million-$50 million (up to 25% of budget revenues) in 2007-2008 are under discussion."	None.

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All Domestic Municipal Bonds Issued From Odessa Default in 1998* through September 2005

City and Population	Bond Status
1. Donetsk (1M)	12-2004 UAH 20M
2. Donetsk	Approx 9-2005 UAH 45M
3. Kyiv (2.6M)	11-2003 UAH 150M
4. Zaporizhya (815k)	01-2004 UAH 25M
5. Zaporizhya	Approx 09-2005 UAH 75
6. Kharkiv (1.5M)	07-2005 UAH 100M

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Background: MFF Development in Ukraine

- **2001-2005: World Bank Municipal Development Loan Fund**
- **April 2005: Ukraine country team attends USAID's conference on pooled financing, Bucharest**
- **January 2006: Nine experts present MFF experience worldwide at Kyiv workshop co-sponsored by ATCI/USAID**
- **February-June 2006: Construction Minister creates Task Force including Ministry of Finance, Ministry of Economy (Executive Order 213)**
- **March 2006: Expert report on possible ownership structures for MFF**
- **June 2006: Cabinet of Ministers Decree 363-p approves special infrastructure finance facility as a priority measure**
- **July 2006: Minister of Construction receives presentation of expert report on options for creating and operating MFF**

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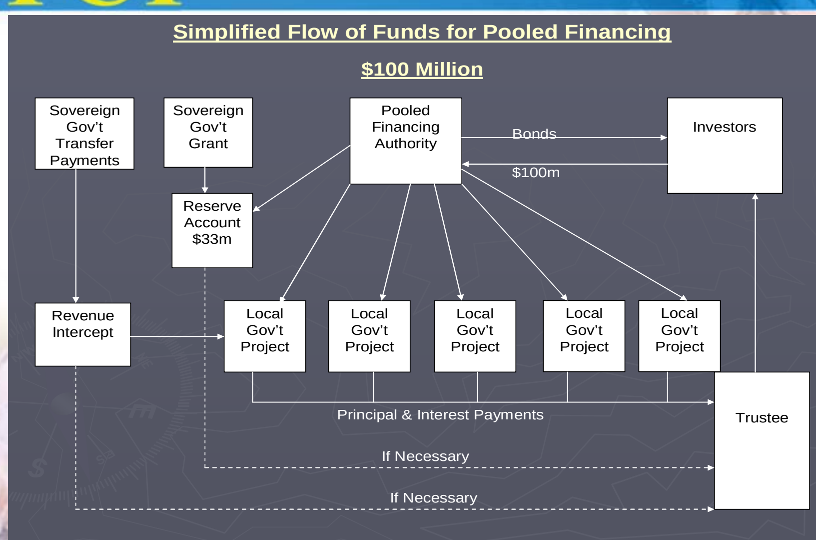

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Municipal Finance Facility vs. World Bank Municipal Development Loan Fund

MFF	MDLF
Municipal Finance Facility will be a financial institution, probably a non-bank credit institution.	MDLF was not a financial institution, but a technical board for project selection.
Will not require sovereign guarantee to raise loan funds.	Required a sovereign guarantee to raise loan funds.
Loan rate could be just 2.5 points above sovereign cost of funds—BUT must have legal reforms, optimal capitalization, professional management and track record.	Interest rates at commercial loan levels: 7 to 11 points above sovereign cost of funds.
Expertise, economies of scale and credit enhancements reduce interest rates.	Banks' unfamiliarity with city finances generated high risk premium.
MFF will add to supply of high-quality investment instruments in capital market.	No impact on capital market development.

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Leveraging MFF Equity

- A key objective of MFF is to "leverage" its equity funds by borrowing.
- This allows MFF to borrow in Ukraine's capital market, and lend the borrowed funds to cities.
- Leverage can multiply MFF lendable capital, up to 6 times amount of its equity.
- Ability to leverage equity will depend on MFF loan portfolio quality and credit enhancements.

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Key Recommendations for MFF

- **Mixed public-private ownership including State, development finance institutions, cities, and private investors.**
- **MFF should contract with an independent operator, such as a commercial bank, to perform key functions.**
- **MFF should be established by special legislation.**
- **To improve city creditworthiness, legal framework for municipal finance and local borrowing must be reformed.**

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Creating MFF: Option "A"

A. State-owned MFF corporatizes under special law.

- Initial State investment creates MFF as State-owned company.
- State enacts legal and regulatory changes within one year.
- Equity investment is attracted from city and development finance institutions.
- State-owned company corporatizes under special MFF legislation, with mixed ownership. *State share value diminishes to 25 percent or less.*

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Next Steps …

1. Must identify a champion to lead State support
2. State decides on MFF's basic structure
3. State commits to provide initial capital and to make legal reforms
4. Develop detailed business plan for MFF equity investors
   - Development finance institutions
   - Cities
   - Commercial banks?
5. Finalize business plan
6. MFF begins operation
7. Complete legal reforms within one year

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Conclusion

The Municipal Finance Facility concept has four key requirements:

- State sponsorship and capital to start.
- Laws and regulations that support its unique mission.
- Lend only to creditworthy borrowers.
- Operate non-politically and professionally.

If these requirements are met, the MFF can succeed. But all four factors need to be satisfied.

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ATTACHMENT 5

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Municipal Finance Facility

Market-Based Infrastructure Finance
for Ukraine

October 26, 2006
Kyiv

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Why MFF?

- Tremendous need for infrastructure investments: $14B for water and heat alone
- State subventions and local resources are inadequate

Solution: **MFF uses limited State financing to leverage private sector funds**

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Municipal Finance Facility

What is it?

A new, specialized financial institution
that provides infrastructure loans
to creditworthy cities
at the lowest possible market interest rates.

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Examples of Successful Municipal Finance Facilities

- Western Europe (Netherlands, Norway, Finland, Sweden, Denmark, Belgium, France)
- India
- Philippines
- South Africa
- Canada
- United States

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Municipal Finance Facility Raises Loan Funds

- MFF borrows in Ukraine's capital markets
- It borrows based on its own financial strength, without sovereign guarantee
- Strong initial capitalization (example: UAH 100M)
- Conservative, 1:1 financial leverage at the beginning
- Must build track record

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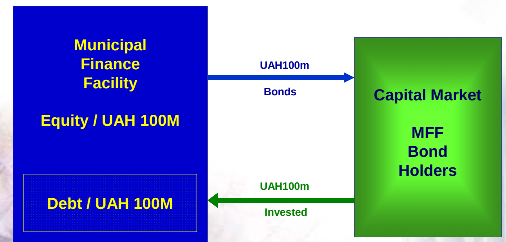
Municipal Finance Facility Raises Loan Funds



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Municipal Finance Facility Makes Prudent Loans to Cities

MFF lends to *creditworthy* cities and communal enterprises

(In Ukraine, creditworthiness is weak. Reforms are essential.)

Loan interest rates must cover MFF's operating costs plus borrowing costs

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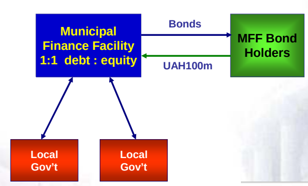
MFF Lends to Cities



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How MFF Benefits Cities

- Access to credit
- Low transaction costs
- MFF financial structure reduces cost of capital for individual cities
- Low *market* interest rates
- Faster and cheaper than bonds

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MFF is designed to get the best possible deal from Ukraine's capital markets

But MFF is subject to market conditions that drive interest rates:

- Expectations for inflation
- Expectations for UAH currency movements
- State budget deficit/surplus

- Market rates could rise to a level that cities can't afford
  MFF might have to suspend lending temporarily

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MFF Returns to the Capital Market to Raise Additional Loan Funds

- Cities' timely loan repayments build MFF credibility
- Over time, MFF financial strength and track record
  - reduce its borrowing costs
  - enable MFF to increase leverage of equity capital
- MFF debt-to-equity ratio could reach approx. 3:1 after 3 years
- Leverage grows pool of funds available for loans to cities
- Leverage also increases risk

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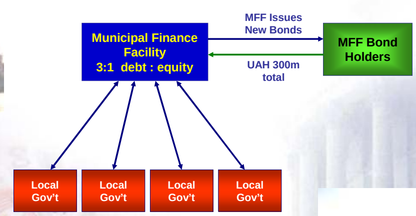
MFF Leverage Generates Funds for New Loans



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Optional Feature: Credit Enhancement

Credit enhancement is a financial arrangement that increases MFF investors' assurance of timely repayment.

Examples:

- standby line of credit
- collateral
- guarantee

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Possible Credit Enhancements for MFF Investors

- Loan guarantees or credit lines from donors or international finance institutions
- Pledged debt service reserve held in bank
- "Intercept" Basket Two revenues in case of city default

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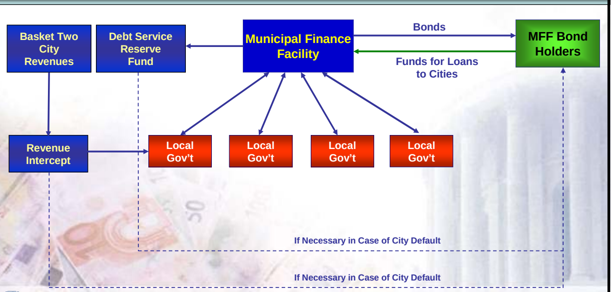
Municipal Finance Facility With Credit Enhancements



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Optional Feature: Trustee

Trustee

- MFF could hire a trustee to administer and enforce agreements between MFF and its investors
- Trustee gives investors confidence that agreements will be kept
- A respected commercial bank could act as trustee
- Investor confidence = cheaper money for MFF

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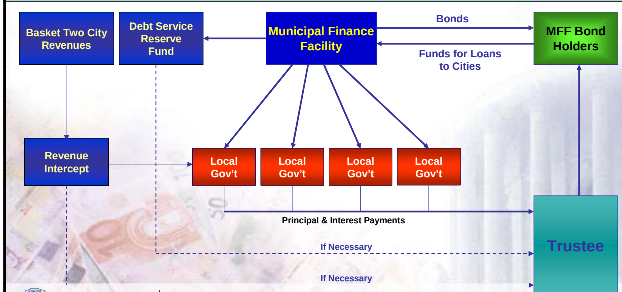
Fully-Developed Municipal Finance Facility



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Optional MFF Activities

- Provide loan guarantees
- Advocate for policy reforms to improve creditworthiness in communal sector
- Vehicle for State subsidy to bring loan rates down
- Provide technical assistance to potential borrowers

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How does MFF generate low interest rates on loans to cities?

- A few large MFF borrowings fund many small loans to cities, creating *economies of scale*
- MFF's expert knowledge of municipal finance *reduces credit risk*
- *Credit enhancements* cut MFF borrowing costs
- MFF earns a *high credit rating*
- MFF minimizes its *operating expense*

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They Work!

International Examples

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Infrastructure Finance Corporation Ltd. (INCA-South Africa)

100% private infrastructure finance corporation established in 1996

- Financial services company Kagiso owns 44%
- Dexia Credit Local owns 4.4%

Total assets:	USD	$1.286 B
Net income:	USD	$9.2 M
Loan portfolio:	USD	$838.7 million (Rand equivalents, 2005)

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Infrastructure Finance Corporation Ltd. (INCA-South Africa)

- Non-performing loans <1% of portfolio
- Loans outstanding: equity capital (leverage ratio) = 12.5: 1
- Debt finance sources include Agence Française de Dévelopement, European Investment Bank, and a loan guaranteed by USAID

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Infrastructure Finance Corporation Ltd. (INCA-South Africa)

- Credit rating: BBB+ (Fitch, international scale)
- No sovereign guarantee
- Low borrowing costs: only 105 basis points (1.05%) above the South African government's 10-year bond.

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State of Tamil Nadu India - Urban Development Fund

- Has attracted 49% private equity funding. State of Tamil Nadu owns 51%
- Managed by a private asset management company
- Debt: equity ratio 3.7:1
- No sovereign guarantee
- Loan security mechanisms include escrow accounts for city tax revenue and water fees

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State of Tamil Nadu India - Urban Development Fund

Source of Loan Funds:

- Formerly on-lent World Bank funds guaranteed by Government of India
- Now raises funds in India's capital markets
- Has issued two bonds totaling USD $29M (as of 11-2005)

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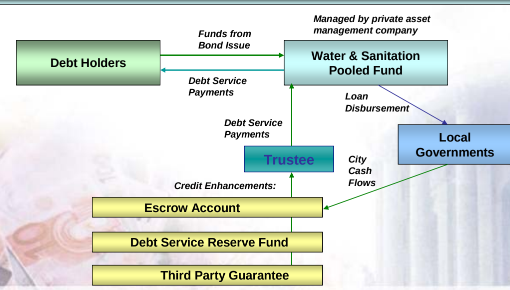
Tamil Nadu Fund - structure



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Meanwhile, Back in Ukraine…

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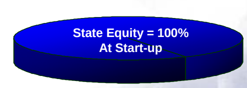
State Equity Investment in MFF

- Initial State investment would
  - demonstrate commitment
  - enable rapid start-up
  - help to attract other investors
- Recommended State investment: UAH 100 million
- Potential source: Infrastructure Subventions (UAH 1 Billion in 2006, Budget Line 54)



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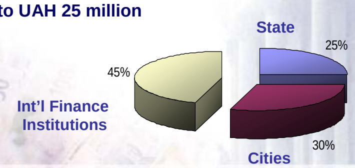
Example: equity structure after corporatization

- Corporatization with minority State share would meet International Finance Institution requirements
- Sell MFF shares to other investors
- Reduce State share to UAH 25 million



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MFF Loan Funds Generated by UAH 25M State Equity Investment

Years After MFF Corporatization*	Cumulative Loan Portfolio	Ratio of Cumulative Loan Portfolio: State Equity
3 years	UAH 633M	UAH 17:1
5 years	UAH 1132M	UAH 25:1
10 years	UAH 2614M	UAH 34:1

*Assumption: MFF corporatizes one year after start-up.

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Municipal Finance Facility

Market-Based Infrastructure Finance for Ukraine

October 26, 2006
Kyiv

ATTACHMENT 6

ACCESS TO CREDIT INITIATIVE

MEDIA NOTICE

November 28, 2006

MEDIA NOTICE

USAID-FUNDED ACCESS TO CREDIT INITIATIVE WILL CO-HOST AN AWARDS CEREMONY HONORING THE FIRST RECEIPIENTS OF THE CERTIFIED LEASING SPECIALIST CERTIFICATE

The USAID-funded Access to Credit Initiative will co-host an awards ceremony on November 30, 2006, in Kiev, Ukraine (Conference Hall of the National Academy of Sciences, 55 Volodymyrska St.) to honor 26 Ukrainian individuals who are the first to have passed a set of 3 exams and are now eligible to receive the certificate of "Certified Leasing Specialist." In addition to the Access to Credit Initiative, the ceremony is being co-hosted by the All-Ukraine Association, "UKRLEASING."

Media are invited to attend.

The awards ceremony will acknowledge the achievement of 26 individuals who have qualified to become Certified Leasing Specialists. Many of the awardees will then go into the business of offering training courses for subsequent candidates for the Certified Leasing Specialist.

USAID Mission Director Earl Gast and Mr. Yuriy Sosyurko, President of UKRLEASING will jointly present the certificates, and both will make remarks prior to the awarding of the certificates. After the awarding of the certificates Mr. Robert Homans, President of the Ukraine Society of Certified Leasing Specialists as well as Richard Caproni, former Senior Advisor of the Access to Credit Initiative, will both make remarks. A reception will be held after the ceremony.

For more information, please call Lidiya Ponomarenko, Press Club Coordinator, at (062) 345 17 95 (office), 8 050 946 18 98 (cell).

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SCENESETTER

( )

TO: ( ) **DATE: 11/27/06**

REQUESTOR: OEG/ Local Economic Development Project

NAME OF EVENT: Certified Leasing Specialist – 1st Awards Ceremony

TYPE OF EVENT: Awards Ceremony

SIGNIFICANCE:
The intent of this ceremony is to present Certified Leasing Professional Certificates to 26 individuals who have passed all 3 Certified Leasing Professional Exams and have otherwise satisfied the requirements to become Certified Leasing Professional. This group of 26 individuals is the first group who passed the exam, and many of these individuals will be delivering training to subsequent candidates.

AUDIENCE:
We expect approximately 75 people to attend this event, including the 26 awardees, 11 speakers and translators, and the Press.

TYPE OF PRESENTATION:

- Remarks by Mr. Earl Gast, Mission Director; Mr. David Luchterhand, Chief of Party, Access to Credit Initiative; Mr. Yuriy Sosyorko, President, "UKRLEASING;" Robert Homans, President, Ukraine Society of Certified Leasing Specialists; Mr. Richard Caproni, former Senior Advisor, Access to Credit Initiative (40 minutes)
- Awarding of Certificates by Mr. Earl Gast and Mr. Yuriy Sosyorko (15 minutes)

WHEN: Thursday, November 30, 2006
3:30 – 4:30 pm (Reception to Follow 4:30 – 6:00PM)

WHERE: Big Conference Hall of National Ukrainian Academy of Science
55 Vladimirskaya St. – 3rd Floor

MEDIA EVENT: **Y**

TALKING POINTS: **Y**

TRANSLATION REQ'D: **Y**

OTHER PRESENTERS: **Y**

DRAFT AGENDA

3:30 – 3:35PM	**Introduction of Mr. Yuriy Sosyorko, President "UKRLEASING"** By - Mr. David Luchterhand, Chief of Party Access to Credit Initiative
3:35 – 3:45PM	**Remarks by Mr. Sosyorko**
3:45 – 3:50PM	**Introduction of Mr. Earl Gast, Mission Director** By – Mr. David Luchterhand
3:50 – 4:00PM	**Remarks by Mr. Gast**
4:00 – 4:15PM	**Awarding of Certificates by Mr. Sosyorko and Mr. Gast**
4:15 – 4:20PM	**Remarks by Robert Homans, President Ukrainian Society of Certified Leasing Specialists**
4:20 – 4:25PM	**Remarks by Richard Caproni, Former Senior Advisor, Access to Credit Initiative**

SEATING ARRANGEMENT: N/A

PROMINENT ATTENDEES: Mr. Earl Gast

VENUE DESCRIPTION AND LAYOUT (N/A):

PROJECT BACKGROUND: (see attached below format)

Project Duration: 3 Years (until 9/30/07)
Total Estimated Cost: ( )
Prime Contractor: The Pragma Corporation
Associated Firms: All Ukraine Association, "UKRLEASING"

The Certified Leasing Specialist Program is designed to increase the competencies of professionals working in the Ukrainian Leasing Industry, provide a pool of trained professionals that the Leasing Industry in Ukraine may draw on as the volume of funded leases increases in Ukraine, and instill a sense of pride and accomplishment among those who have satisfied the requirements to become Certified Leasing Specialists.

By the end of the contract, USAID expects that the following objectives will be achieved:

1) There will be a significant number of Certified Leasing Professionals in Ukraine.

2) There will be a group of well-qualified individuals to provide training for candidates who will be taking the Certified Leasing Specialist Exam.

3) There will be a Ukrainian NGO, called the Ukraine Society of Certified Leasing Specialists ("USCLS") in which all Certified Leasing Specialists will be Members, who will be responsible for administering the Program including administering and grading exams and awarding of certificates.

Achievement of these objectives will have a profound influence on the Ukrainian Leasing Industry, by increasing the level of professionalism generally, as well as providing the Industry with a large pool of certified specialists on which to draw as their businesses expand.

Results achieved thus far by the Certified Leasing Specialist Project include:

- ➢ Course of study ("Body of Knowledge") has been prepared.

- Exam questions for all 3 exams have been prepared.
- Exams have been administered and graded.
- 26 candidates have passed all 3 exams, and have thus qualified to receive the Certified Leasing Specialist Certificate.
- Many of the 26 candidates will become trainers, responsible for providing training sessions to future candidates.

CERTIFIED LEASING SPECIALISTS

	Name	Company	Position
1	Sergiy Babelo	Eurofinance	Head of Credit Department
2	Lyubov Bilyaze	Donetsk National Technical University	Associate Professor
3	Dmytro Bogodukhov	LeaseIT	Director
4	Vitaliy Bondarenko	Universal Leasing Company (Odesa)	Development Director
5	Olexandr Budanov	Leasing Agency “CALIUS”	Director
6	Yuriy Vasin	Eurofinance	Lease Project Director
7	Andriy Vyshnyak	First Lease Finance	Director
8	Iryna Glushchenko	Kharkiv Polytechnic Institute	Senior Lecturer
9	Anton Dyadyura	Eurofinance	Business Development Manager
10	Yuriy Kolyadyuk	International Finance Corporation	Leasing Advisor
11	Roman Kamyshanov	Ukrtransleasing	Deputy Head of Air Transport Department
12	Vira Kondratieva	Audit Company “International Standards”	Managing Partner
13	Olexiy Kononets	International Finance Corporation	Analyst
14	Natalya Naumenko	Audit and Consulting Company “Compass”	Director
15	Olexiy Noskov	Ukrainian Financial Leasing Company	Finance Analyst
16	Tetyana Pavlyuk	International Institute of Business	Lecturer
17	Galyna Riznyk	Audit Company “Rivne-Consulting-Audit”	Director
18	Olexandr Rudenko	AIS-Leasing	Leasing Manager
19	Nadiya Ryazanova	International Finance Corporation	Tax & Accounting Specialist
20	Mykola Soroka	UniCredit Leasing	Project Manager
21	Olena Sukhenko	Business School “KIBIT”	Lecturer
22	Dmytro Chernyak	Agricultural Marketing Project	Economist/Market Information Specialist
23	Yuliya Shevchuk	International Finance Corporation	Legal Advisor
24	Larysa Shkurka	Audit and Consulting Company “Compass”	Managing Partner
25	Alla Eismont	Audit Company “International Standards”	Chief Financial Officer/Managing Partner
26	Kostyantyn Yuryev	Diamantbank	Leasing Program Coordinator

ATTACHMENT 7

Report
Trip to Moldova
December 3 – 7, 2006
Prepared by
Robert Homans

From December 3rd through 7th I visited Moldova, for the purpose of conducting an assessment of the leasing companies in Moldova and the prospects of offering advisory services to these companies. An additional purpose of the trip was to assess the opportunities, and challenges, of offering a Certified Leasing Specialist Program in Moldova.

During the course of my trip I met with 6 of the 7 largest leasing companies in Moldova. The only major leasing company I did not meet with, East-Auto-Lada & Iveco Leasing, is a "niche" auto lessor and I understand is not likely to change their strategy in the near future. I also met with a major insurance company offering insurance products to local lessors, whose General Director formerly worked with one of the major lessors. He gave us valuable perspective on the Industry. I also met with representatives from "Dina Cociuc," a large vendor of food manufacturing and foodservice equipment in Moldova, who has a strong relationship with one of the lessors we met with. Finally, I met with Corneliu Rusnac, Project Manager for USAID/Moldova, as well as Eugenia Stancu and Doina Nistor of the Competitiveness Enhancement and Enterprise Development ("CEED") Project.

In all my meetings I was accompanied by Mr. Vlad Railean, Financial Leasing Advisor attached to ATCI's Program Office in Chisinau. In addition to Mr. Railean, Mr. Rick Dvorin joined us for the meeting with Mr. Rusnac of USAID. I found Mr. Railean to be extremely knowledgeable and helpful. Mr. Railean's notes of each one of our meetings, including the names and Titles of those with whom we met, are attached to this Report. In his notes Mr. Railean provides detailed data about each company with which we met. Therefore, I will not repeat the data in my Report, except in general terms.

Overall Conclusions/Leasing Market:

1. **High Level of Knowledge and Professionalism –** Almost without exception, I found high level of knowledge and professionalism among the leasing company representatives I met with. Underwriting conditions in Moldova are probably more difficult than they are in Ukraine. Therefore, as a leasing company, in order to make money it is important to have extremely strong credit and underwriting skills.
2. **Moldovan Leasing Industry is Very Small, but Growing Fast –** Presently, the two largest lessors in Moldova, each with approximately 40% of the market, have outstanding portfolios of approximately $17 million. This puts the overall annual volume, all the lessors in Moldova, at around $42.5 million. One of these two, IMC, stated that they have a current monthly "run rate" of around $1 million. This indicates, at least for IMC that their business is growing substantially.
3. **Lack of Capital –** All the leasing companies we met with said that lack of capital was limiting their ability to offer "new" products, especially more leasing of capital equipment. One of the 2 largest lessors, MAIB, has accessed the Moldovan capital market, having completed 1 bond issue, for approximately 5.6 million Moldovan Lei (approximately $427,000.00), and are about to register another for 20 million Lei (approximately $1.5 million).
4. **The Moldovan Leasing Market is a "Duopoly" –** As mentioned in No. 2, above there are two lessors, MAIB and IMC, that together have approximately 80% of the local leasing market. Additionally 2 other companies, EuroLeasing and BS Leasing, together have approximately 15% of the market. Of these 4 only 1, IMC, is not owned by a Moldovan commercial bank. IMC has backing from a US private equity fund based in Kyiv.
5. **More Innovation Coming from Smaller Players –** As might be expected, the smallest of the 6 leasing companies with which we met, appear to be the most innovative, especially with respect to the desire to lease more capital equipment. This is especially true for BS Leasing and Electro Systems Leasing.

6. **Significant Potential Demand from Equipment Vendors –** If our meeting with "Dina Cociuc" (the distributor of food Manufacturing and foodservice equipment) was any indication, there is a significant unmet demand for capital equipment leasing, along with a history and willingness to use leasing as part of vendors' marketing programs.
7. **Few Problems with Legal or Regulatory Conditions –** At only 1 of our meetings, with IMC, was there any mention made of existing legal or regulatory problems. IMC raised issues having to do with accounting treatment of leasing. They promised to provide us with more details on this issue. In addition, MAIB Leasing mentioned problems associated with the requirement of having to register vehicles with the Ministry of Defense.

Overall Conclusions/CLS-Training:

1. **Significant Desire for Training and the CLS Program –** Every leasing company we met with expressed a strong desire for training of the type that is offered in connection with the CLS Program. They all asked the same question, "when do you plan to start?"
2. **Strong Desire for the Training and CLS to be "Moldovan" –** Most every company we met with expressed the strong desire that the Training and CLS Program be adapted to Moldovan conditions, as it was in Ukraine, and that the Program must be run by Moldovan institutions. I agree with both these sentiments, but it must be understood that meeting them will put significant demands on the ATCI Program Offices in both Chisinau and Kyiv.
3. **No "Local Counterpart" –** Presently there is no leasing association, similar to either "UKRLEASING" or the Union of Ukrainian Lessors, which could serve as a local counterpart in a Moldovan CLS Program. The existence of a local counterpart would appear to be essential, for the continued success of a CLS Program in Moldova as an independent entity. At our meetings it was revealed that there is informal communication among Moldovan lessors, but no great desire for an actual Association. A Moldovan association is also a pre-requisite for eventual membership in LeasEurope, which itself is an organization made up of national leasing associations. The representatives of the CEED Program, with whom we met, have offered to be of assistance in setting up a Moldovan Leasing Association.
4. **Danger of Co-Option –** Care should be taken that the CLS Program in Moldova does not end up being controlled by one, or both, of the 2 largest lessors. This is especially important because it appears that at least 2 of the smaller lessors appear to be the most innovative and thus may be the biggest beneficiaries of the training program included in CLS.
5. **Timing –** Development of CLS/Moldova should begin in earnest in the 1st Quarter of 2007, but not until after the protocols with the Ukraine training providers are executed and training sessions begin in Ukraine. The reasons for this recommendation are as follows: 1. I believe it is important that the Ukraine CLS Program be fully operational, at least with respect to the on-going training, before work is begun setting up a similar program in Moldova; 2. Developing a CLS Program that is "Moldovan" is going to place significant demand on the ATCI Program Office in Chisinau, not to mention Kyiv, if the body of knowledge is to be adapted to Moldovan conditions, Moldovan institutions to be set up, etc.

Opportunities/Advisory Services –

From the meetings I had I believe there are several advisory opportunities. In addition to the specific opportunities I will mention in this report, I think that most companies we met with could use assistance. I think additional advisory opportunities will arise as a result of continued discussions between the companies and the Program Office in Chisinau, with assistance from Kyiv.

Here the specific opportunities that I would suggest pursuing initially:

1. **Electro-Systems Leasing –** Electro-Systems Leasing is a subsidiary of a Moldovan bank called Energbank. Electro Systems Leasing is the only lessor I have met with, in either Ukraine or Moldova, who is utilizing their Parent's branch network to generate business. Energbank has 29 branches throughout Moldova. Electro-Systems Leasing, along with MAIB and IMC uses radio

ads. No leasing company in Ukraine, that I am aware of, uses radio ads, especially to advertise the financing of capital equipment (Electro Systems' portfolio is 50% capital equipment). When I asked Ms. Semionova, the Vice Director, if the radio advertising has been effective, she answered in the affirmative.

As far as I am aware no bank-owned leasing company, in either Ukraine or Moldova, is using their Parent's branch network, to generate business, they way Electro-Systems is using their Parent's branch network. This has significant for increasing the volume of agricultural leasing in Moldova, among other industries. For example Reiffeisen/Aval Leasing has the potential of using Aval's network of branches throughout Ukraine. However I understand that most, or all, of Reiffeisen/Aval's lease volume is generated from Kyiv.

The advisory services for Electro-Systems might include advice on marketing and credit, with the idea on better utilizing their Parent's branch network and more aggressively going after business is certain industries, including agriculture. Electro-Systems is not one of the 4 largest lessors in Moldova, so their portfolio is currently very small. In addition Electro-Systems' current portfolio is 50% capital equipment, a far higher percentage than any other company we met with, including furniture, pharmaceutical and medical equipment. In other words, Electro-Systems has already diversified their portfolio, at a time when others are only talking about it.

2. **BS Leasing –** BS Leasing is a subsidiary of the Moldovan bank, Bank Socialia. When we met with Mr. Oleg Kovaliov, the General Director, he observed that he wanted to move the company's portfolio over to capital equipment as fast as possible.

   BS Leasing's current portfolio is 70% titled vehicles and 30% equipment. Mr. Kovaliov expressed a desire to shift the portfolio to 50% capital equipment within 2 years and, eventually, to 70% capital equipment. Mr. Kovaliov stated that local leasing companies who continue to rely on titled vehicles for future growth are going to run the risk of having to compete with better-capitalized Western Europe car lessors (Sixt, First Lease, etc.) who are beginning to enter the Moldovan market and can offer much lower rates and better term structure.

   Advisory services for BS Leasing would include areas in marketing and credit that would facilitate their stated desire to increase the volume of capital equipment leasing. This would be consistent with the stated goals of the Leasing Component of ATCI.

3. **IMC Leasing –** IMC Leasing, one of the 2 largest lessors in Moldova, expressed a desire for advisory services to develop marketing programs directed at certain industries. Such advisory services, if offered, would have to be coordinated with the CEED Program, who is already assisting IMC develop programs for companies in the wine, garment and IT industries.

4. **"Dina Cociuc" –** As mentioned earlier this company sells food manufacturing and foodservice equipment, and is aggressively using leasing in their sales program. They currently have a leasing relationship with MAIB Leasing that, interestingly, did not mention much of a desire to increase financing of capital equipment. Nevertheless, Dina expressed strong satisfaction with their relationship with MAIB.

   The representatives with Dina that we met with stated that they take an active role with customers, making sure that the customers have all the financial information required for MAIB to make a decision. In addition they offer training to their inside sales force on how to use leasing to increase sales volume.

   My company, Norden Capital, specializes in leasing food manufacturing equipment. In addition to Norden's web site, I gave them the web sites of two vendors Norden works with extensively, both of whom carry equipment similar to that sold by Dina. Because of my industry experience, through Norden Capital, I believe the Project can offer extremely useful advisory services to Dina.

Advisory services might include marketing strategies on how to increase the use of leasing. A portion of these services might be offered jointly to Dina and MAIB. In addition similar advisory work could be offered to other equipment vendors, in other industries.

5. **MAIB Leasing –** In addition to a possible joint program with Dina, and as mentioned earlier MAIB Leasing has successfully accessed the Moldovan capital markets, with 1 bond issue. They are in the processing of registering their 2nd issue. Possible advisory services for MAIB might be connected with raising capital, including the bond issue.

6. **Targeted Marketing –** I have suggested in the past drafting a business plan, or prospectus, covering the opportunities associated with leasing "small ticket" medical equipment in Ukraine. I would seriously consider extending this strategy to the furniture industry and do the same in Moldova. These prospectuses could be shared with existing leasing companies, as well as other financial institutions considering entering the market. Moldovan companies seem to be going after certain industry to a greater degree than their Ukrainian counterparts who appear to be more generalists.

   The CEED Program is essentially offering targeted marketing programs in Moldova, with the garment industry, the wine industry and the IT Industry. I see our work in this area as complimenting CEED, but taking a broader focus. In addition the AMACO Finance Business Plan can be seen as a proxy for leasing of agricultural equipment in Ukraine, in addition to its utility for AMACO itself.

Cooperation with CEED:

CEED has requested my assistance in finding a US specialist who could help them, and IMC, develop a leasing program targeted at the garment industry. I know an individual, who I have known and worked with in the leasing industry for the past 15 years, who may be interested. He runs a leasing company in the US that specializes in financing garment manufacturing equipment. CEED has agreed to provide me with the TOR for this position.

In addition CEED has asked our help in finding a consultant to help install and updated IT system for IMC. I have agreed to see if such a person is available, for a 10 day engagement in Moldova.

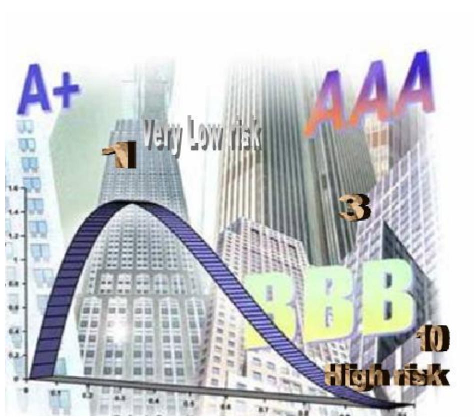
ATTACHMENT 8

ACCESS TO CREDIT INITIATIVE

Mortgage, Municipal Finance, Leasing, Credit Bureau

WHITE PAPER

RATINGS IN UKRAINE



Prepared by

John Michael McMullen

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Acronyms and Abbreviations

AMC	Asset management company
CE3	Central Europe Three (Czech Republic, Hungary, Poland)
CEM	Country Economic Memorandum
COM	Cabinet of Ministers of Ukraine
CSD	Central securities depository
DVP	Delivery vs. payment
EU	European Union
GDP	Gross Domestic Product
FSA	Financial Services Authority
FOP	Free of payment
IAS	International Accounting Standards
IAIS	International Association of Insurance Supervisors
ICI	Institution of Collective Investment
IF	Infrastructure Fund
IFRS	International Financial Reporting Standards
IFS	International Financial Statistics
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
ISMA	International Security Management Association
LIIT	Local Infrastructure Investment Trust
MBS	Mortgage-backed securities
MFS	Inter-regional depository and clearing/settlement organization
MI	Mortgage default insurance
MOF	Ministry of Finance
MOLSP	Ministry of Labor and Social Policy of Ukraine
MSPIL	Mandatory state pension insurance law
MTPL	Motor third party liability insurance
NBFI	Non-bank financial institution
NBFIR	Non-bank financial institutions regulator
NBU	National Bank of Ukraine
NSPF	Non-state pension fund
NSPFL	Non-state pension fund law
OECD	Organization of Economic Cooperation and Development
OTC	Over-the-counter
OVDP	Treasury bill
PFTS	Persha Fondova Torgova Systema
PFU	Pension fund of Ukraine
PPP	Public-private partnership
PRG	Partial risk guarantee
PT	Pass-through
SCRFSM	State Commission for Regulation of Financial Services Markets
SEC	Securities Exchange Commission
SNG	Sub-national government
SPF	State pension fund
STP	Straight through processing
SSMSC	Securities and Stock Market State Commission
TRES	Total return equity swap
UAH	Hrivnya
UND	Ukrainian National Depository
USAID	United States Agency for International Development

1. Executive Summary

A rating is an independent, informed, objective opinion regarding the relative likelihood of default on a fixed income instrument.

This definition, which is discussed in section 7 below, sets the immediate prerequisites for the effective use of ratings in capital markets. In Ukraine, as described in section 9 below, a "rating" is determined on a politically defined "national scale" by "the authorized rating agency" following a rating process created and required by the State Securities and Stock Market Commission. This micromanagement of the industry is unsound in concept and practice when compared with international best practice which entails minimal supervision and reliance on the market to establish best practice.

Independence, the first condition, is tainted by laws and proposed regulations which mandate ratings and attempt to instruct the rating process by permitting authorities to make decisions that belong to the market. Moreover, there are more important requirements for creation of an effective, efficient capital market starting with a suitable and enforceable legislative framework and capacity enhancement for institutional investors.

It is well understood that creation of an effective market to foster capital mobilization is a necessity to accelerate growth. Several problems exist in Ukraine. Among the principal obstacles are:

- Lack of transparency regarding control and price formation
- Inadequate company law
- Reliance on domestic accounting and auditing standards
- Disclosure norms do not capture sufficient data for analysis
- Investor decision processes are unlikely to conform to international best practice
- Analytical knowledge in the market and practice are not consistent with best practice
- There is no standard pricing mechanism or benchmark yield curve
- Long investors like insurance companies and pension funds show limited activity

On the plus side,

- There are many intermediaries able to assist with structuring transactions
- Banks are able to invest
- Many issuers have been able to sell bonds

The basic laws governing the market reflect proper focus on investor protection and disclosure. There is no mention of ratings or rating agencies in the original legislation, although they are known in the market. From 2001, four companies have sought to become rating agencies, the first being Credit-Ratings. In 2004, the Government of Ukraine issued Decree 208 **On Approval of the Concept for Development of the Rating System for Regions, Sectors of the National Economy, and Business Entities** setting a "national rating scale" patterned after those commonly in use in many markets. It also directed the SSMSC to prepare regulations to identify and authorize companies to do ratings through a competitive tender. Three companies applied, but only Credit-Ratings was designated. In a free market, all three companies would be eligible, and allowed to compete for business from investors and consequently issuers.

Subsequently, the Securities and Stock Market Commission prepared an updated draft decree referring to Mandatory ratings provided by an authorized agency. Once again, the Commission is to prepare documents for the tender process. In the event, criteria were established, but no provision made for review of business plans, and assurance of necessary knowledge and expertise. The Commission also proposes to tell the rating agencies how to do the analysis as they apply the required national rating scale. A short time later, without the tender specified in the original 2004 rules and the draft rules, the Commission announced it had designated Credit-Ratings as an authorized agency. An additional rule requiring insurance and pension investments be rated was forwarded by the SSMSC to the Insurance Companies League.

A capital requirement was set in the rules, that bears no relationship to business requirements to develop a rating business. The criteria are barriers to entry.

Principles to be considered:

- Regulation of markets is not control of markets. That is, laws and regulations must ensure market participants have access to adequate and accurate information, providing penalties where this fails.
- The most important rating is that assigned by the investor in his decision process.
- Mandatory ratings of uncertain quality are of limited use to the investor.
- Mandatory ratings force issuers to seek financing alternatives that may be less efficient and ultimately more costly.
- The market - investors and issuers - should determine who gets to do rating business.
- It requires time and education for a rating agency to become effective. If its capacity is sufficient, it will get the investors' business and demand-pull creation will ensue
- In accordance with best practice, ratings should be voluntary, and entry to the business open.

The requirements for further development of the Ukraine financial sector and capital markets are well known. The following recommendations can contribute to creation of an efficient, effective rated capital market.

Road Map/Recommendations

A road map to facilitate development of rating agencies is a road map to develop the capital market. The complex inter-actions among investors, intermediaries, issuers and rating agencies work best when all "professional market participants" are fully trained, qualified and conduct their business in good faith. Although this White Paper is unable to address these issues, two items are especially important:

1. It does not appear that testing is a requirement for the various types of licenses issued by the SSMSC.
2. The most significant problem is political - Lack of transparency.

That said, a rating agency road map should begin with the following:

- Amend the Laws - it is not necessary to mandate ratings or tell people how to do them. The market will give you the desired national scale.
- Amend the Regulations - Register anyone who wants to start a rating agency. When testing begins for investment advisors, test the agency management and staff.
- Conduct a comprehensive market survey to define current knowledge and status of rating use in all segments, investors, intermediaries and prospective issuers.
- Strategic Planning assistance for rating agencies could be helpful. Several of the potential agencies have data bases they would like to leverage.
- The rating analysis as described and as prescribed in the draft regulations would be enhanced by training.
- Other basic market enhancement steps like:

    1. Expand government debt market;
    2. Create benchmark yield curve;
    3. Free interest rates to move as the market determines;
    4. Resulting price changes will offer profit, dealing will follow;
    5. Enhance capacity of investors and intermediaries.

Conclusion: Mandated ratings, whether monopoly or not, and prescribed requirements for quality that do not incorporate the process and standards of international best practice will not protect savers and investors.

2. Introduction

This White Paper on ratings in the Ukraine capital market is a subordinate project of the United States Agency for International Development Access to Credit Initiative (ATCI). ATCI is a five year project being conducted by The Pragma Corporation. The paper surveys the current status of market development, briefly identifies key market participants, reports in summary on issuing activity to date, describes the legal framework for operation of the market, and analyzes the government's decisions to impose mandatory ratings for public debt issues and anoint a single "authorized" domestic rating agency to assign those ratings. The rationale for these requirements will be evaluated as well as the impact on market development. The Paper will introduce the history of ratings in capital markets, the economic and operational rationale for the use of ratings in other markets, and the process employed in many emerging markets to encourage the development of a universe of ratings covering the entire spectrum of issuance. An outline business plan model for rating agency development, and an optimal example of rating policy and process will be furnished as well.

The preparation of the paper entailed an analysis of the currently effective and pertinent legislation and consequent draft regulations as well as an extensive series of interviews with market participants, the four nascent rating agencies and regulators from the Ministry of Finance, Ministry of Economy, the State Commission for Regulation of Financial Services Markets of Ukraine, the Securities and Stock Market State Commission, and the National Bank of Ukraine. The cooperation of the individuals representing those participants and regulatory agencies is gratefully acknowledged with thanks. Discussions with representatives of other donor projects offered insights as well.

Several basic premises derived from experience in other markets and research in Ukraine during the life of the project constitute the foundation for the analysis that informs this paper:

- The government and regulatory bodies of post-soviet Ukraine have demonstrated limited appreciation of the advantages and requirements of a free market;
- Development of the well-established prerequisites for additional FDI and domestically-funded economic growth is constrained by such limited appreciation;
- These prerequisites include:

    1. effective accounting and auditing,
    2. development of the capacity of investors and lenders to perform a sound fundamental analysis in making investment decisions,
    3. adequate disclosure,
    4. transparency (ownership and price formation),
    5. and ultimately the creation of a universe of ratings for all paper sold in the market;

- Credit ratings and the supporting research are tools for investors; it is inappropriate to mandate ratings;
- Rating agency policies and methodology should be based on international best practice;
- Investors choose rating agencies based on the quality of research and perceived correctness of ratings published;
- Arbitrary "authorization" of rating agencies beyond publication of ownership and notification of corporate details is unsuitable in a free market;

3. The Ukraine Capital Market

The real economy of Ukraine is substantially larger than the formal economy and there are significant, only partially measured, resources to support development of the domestic capital market. It is well understood that creation of an effective market to foster capital mobilization is a necessity to accelerate growth. Several problems exist. Among the principal obstacles are:

- Lack of transparency regarding corporate control and price formation
- Inadequate company law
- Reliance on domestic accounting and auditing standards
- Disclosure norms do not capture sufficient data for analysis
- The institutional investor decision process unlikely to conform to best practice
- Analytical knowledge and practice is not consistent with best practice
- There is no standard pricing mechanism or benchmark yield curve
- Long investors like insurance companies and pension funds show limited activity

On the plus side,

- There are many intermediaries able to assist with structuring transactions
- Banks are able to invest
- Many issuers have been able to sell bonds

There has been bond issuing activity in the Ukraine market, driven partly by the tax advantages to construction companies of bonds that buyers purchase which are repayable by delivering property. To date, 1,324 issues have been placed with an aggregate volume of approximately UAH 16 billion, of which about half is in the form of construction bonds. The totals include government borrowings. There have been only two defaulting borrowers.

Despite this activity, like many emerging markets, Ukraine faces great challenges in fostering further development of a capital market that allows effective, efficient mobilization of domestic capital to support economic growth on a sound basis. Basic statistics that stratify the financial sector of the economy reflect the strong dominance of commercial banks. The full array of corporate finance instruments is technically available, although commercial paper (promissory notes) is reported not to be sold. It is unclear to what extent the basic tenets of corporate finance and comprehension of pricing implications drive financing decisions.

The country's mass privatization program resulted in the creation of 20 million shareholders, with very small holdings. Over time, the advent of investment funds, and the activities of individual investors have reduced the number to an estimated 14 million shareholders.

To serve this market, there are two depositories, ten stock exchanges or "electronic trading systems, 370 registrars, 86 custodians, 48 non-state pension funds, and 78 asset management companies and more than 700 broker/dealers. Although there are 262 listed companies, the market is highly concentrated with the ten largest companies constituting a reported 57% of market capitalization.

This is a buy and hold market with very little secondary market activity. Of trading in shares, more than 90% is reported to take place off the exchanges on a non-transparent basis. Consequently, the market mechanism for establishing security prices is severely impaired. Of the 10% of trading that does occur on the exchanges, 86% is crossed on a single exchange, PFTS. There is virtually no trading of debt.

The actual control of many companies is not known, nor is change of control that takes place in the hidden market. The quality of accounting and auditing is widely questioned. The disclosure requirements incorporated in the law and regulations are not well defined and there are no apparent penalties for violations.

In most markets, even those with limited activity, the securities regulators charge issuers a registration fee. Disclosure requirements are clear and specific, and there are penalties for companies, directors and managers who do not conform to those requirements. It is reported in this market that violations are common, and no penalties are imposed.

4. Ratings and Regulation in the Ukraine Capital Market

Consideration of capital market credit ratings for Ukraine has been subject to extensive political and regulatory involvement that has generated an unusual level of cynicism among market participants resulting in severely diminished utility of ratings as an investment tool. Counter to free market experience, Law # 3201 has been passed mandating use of ratings by prospective issuers and regulations promulgated to define a national scale of ratings, prescribe a rating process, and restrict "authorized" agencies to a single entity. However, at the round table in October 2006 representatives of the SSMSC said the Commission intends to substantially mitigate the requirements that have to be met in order for an agency to obtain the authorized rating agency status.

Ratings for the broader domestic market were introduced in Ukraine by Cabinet of Ministers Decree 208 dated 1 April 2004, entitled **On Approval of the Concept for Development of the Rating System for Regions, Sectors of the National Economy, and Business Entities. SSMSC** Resolution 322 dated 17 July 2003 preceded this decree by stating "The Issuer shall submit the following documents to the registration authority with the aim to simultaneously register any bond issue and the related information:
i) the report detailing the credit rating level of an applicable bond issue made either by *any authorized rating agency* (emphasis added) or by any international rating agency such as Fitch Ratings (USA), Moody's Investors Service (USA), Standard and Poor's (USA)."

The decree was followed by the SSMSC resolutions for implementation, principally Numbers 236 and 542. SSMSC Resolution No. 236, dated 1 June 2004, is entitled **On Approval of Measures Aimed at Implementing a Concept of Rating System Development for Assessment of Regions, Sectors of National Economy and Subjects of Business Activity; and Regulations on Conditions of a Tender on Selection of Agencies Authorized to Conduct Ratings and contains provisions regulating conditions of the tender whereby authorized rating agencies are to be selected**. SSMSC Resolution 542, dated 8 December 2004 is entitled **On Implementation of the System of Mandatory Rating for the Subjects and Instruments of the Stock Market.** It required, in particular, "i) report of the authorized rating agency … regarding the level of credit rating of the relevant bond issue". This Resolution was annulled by Resolution 501 of the SSMSC of September 7, 2005 in connection with the Ministry of Justice Conclusion # 10/42 of June 29, 2005 because it had not been published. These actions were preceded by a requirement for ratings on municipal issues in 2003.

The decree, in translation, offers a "Concept" that seeks to establish credibility by stipulating the ratings be established "with due consideration of the best practice of international rating agencies which deliverables are used by investors on international financial markets." However, the guidelines for assignment of ratings are very general and do not correspond in any significant respect with the analysis performed by the global rating agencies and many of the key international banking institutions. A review version of the decree identified a number of problems with the principal features of the law. The original decree and a proposed amended version in process are included as an exhibit.

Resolution 236, reviewed in translation, establishes the process of "bidding through tender" for authority to conduct a rating business. The SSMSC continues to add burdensome regulatory criteria. Cabinet of Ministers Decree 208 foresees the following requirements to the agencies that seek the authorized status:

"1) have a status of a resident;

2) specialize exclusively in rendering credit rating services and information and analytical services associated with credit rating activity;

3) use a national credit rating scale for assessments;

4) possess the information infrastructure, sufficient for effective collection, processing and analysis of data, as well as facilities for publishing of information on established credit ratings;

5) have working experience of not less than 2 years.

The compliance of an organisation with the mentioned criteria shall be confirmed by an expert opinion of the World Bank or International Monetary Fund, or European Bank for Reconstruction and Development."

These basic descriptive requirements are not inherently harmful, as the concept of an "authorized" agency is, and because they have been superseded by a more recent Resolution, the remainder of the discussion will consider the attributes and weaknesses of the more recent action.

Resolution 542 was cancelled by Resolution 501 of the SSMSC of September 7, 2005 in connection with Ministry of Justice Conclusion # 10/42 of June 29, 2005 because it had not been published.

"Pursuant to the Resolution of the the State Committee of Ukraine for Regulatory Policy and Entrepreneurship # 10 dated 28 July 2005 "On the Necessity of Removing the Violations of the Principles of the State Regulatory Policy by the Securities and Stock Market State Commission pursuant to the requirements of the Law of Ukraine # 1160 – 4 dated 9 September 2003 "On the Basis of the State Regulatory Policy in the Field of Economic Activity" and the Resolution of the Ministry of Justice of Ukraine on cancellation of the Resolution of state registration of the legal and regulatory act # 10/42 dated 29 June 2005, the Securities and Stock Market State Commission hereby resolves:

To cancel the Resolution of the Securities and Stock Market State Commission "On Introduction of the Compulsory Rating System for the Subjects and Instruments of the Stock Market" #542 dated 8 December 2004 and the Resolution of the Securities and Stock Market State Commission "On Introduction of Changes and Ammendments to the Resolution of the Securities and Stock Market State Commission #542 dated 8 December2004, registered by the Ministry of Justice of Ukraine on December 30, 2004 #1676/10275" #433 dated 21 July 2005."

The implied objectives of the regulations are sound - that is, to have accurate, credible ratings available for investors for the uses discussed below. However to make ratings mandatory for all paper issued in a market and to insist they be assigned by an agency chosen by the regulator based on criteria that do not assure competence and accuracy, but serve as a barrier to entry, does not extend the availability of professional ratings.

The government, lead by the SSMSC, has initiated a second round of laws, decrees and resolutions that take the process a step further. The explanatory note to the draft decree amending Decree 208 states the following:

> **"1. Rationale for the need to adopt the Decree.**
>
> The Draft Decree of the Cabinet of Ministers *On Amending and Supplementing the Decree # 208-p dd. April 01, 2004 of the Cabinet of Ministers 'On Approval of the Concept of for Development of the Rating System for Regions, Sectors of the National Economy, and Business Entities'* has been revised in pursuance of the Law of Ukraine dd. 3201-IV dd. December 15, 2005 *On Amending Certain Legislative Acts of Ukraine*, Part 7, to the extent applicable to rating services and rating assignments.
>
> Under Part 7, Paragraph 2, Subparagraphs 9 – 10 of this Law and the Law of Ukraine *On Government Regulation of Securities Market in Ukraine*, Article 7, Paragraph 7, the State Commission for Securities and Stock Market shall develop and implement the National Rating Scale for assigning credit ratings for borrowers i.e. local governments, business entities and for debt instruments (hereinafter, the National Rating Scale) and identify authorized rating agencies eligible to assign ratings for issuers and securities on a **mandatory** basis."

The draft revisits the government's national scale ratings and provides more elaborate descriptions. However, the declination that typifies rating definitions is not clear. And the necessity for requiring this national scale as opposed to another is not explained. It is a given that a domestic rating agency will begin with a rating system that compares borrowers (issuers) within the market. The global agencies create similar scales that limit comparisons of issuers to those in the domestic market. But the analytical methodology used, and the information sought from issuers is consistent with that employed for their international and developed market ratings.

The shift to assignment of ratings on a mandatory basis changes the character of the costs associated with issuance from one facilitating access to funds and optimal pricing because they have value to investors to a tax on the issuance process. In conjunction with the new draft decree regarding the rating concept and in pursuance of the mandatory rating provisions in Law #3201, the SSMSC has prepared amendments to Resolution 236. It still proposes tenders for rating agencies **"eligible to assign ratings for issuers and securities on a mandatory basis."** The document describes an elaborate process for forming a tender committee, and sets eligibility criteria and information requirements for candidates. These include:

> **4.1. To be eligible to take part in the tender, a bidder shall confirm its intention to participate in the tender in writing, submit tender documents and meet the following criteria:**
> **4.1.1. To be a Ukrainian resident;**
> **4.1.2. To apply the National Rating Scale for rating purposes;**
> **4.1.3. To follow in its work the rating procedure which is in line with the rating rules applicable for an authorized rating agency as approved by the State Commission for Securities and Stock Market;**
> **4.1.4. To have no individuals participating in the financial services market, having proprietary rights or any interest with any participants of the financial services market, or otherwise affiliated with any participants of the financial services market among its founders and/or members and/or shareholders;**
> **4.1.5. To have no individuals who hold official positions in organizations that participate in the financial services market and/or official positions in any affiliated structures of such participants of the financial services market among its managers;**
> **4.1.6. To assign no credit ratings for its founders and affiliated (related) entities.**
> **4.1.7. To have an infrastructure sufficient for efficient data collection, processing and analysis, namely:**
> **Telephone lines – at least 10**
> **Computers – for each employee but not less that 15, minimum technical requirements – processor CPU 1 GHz, memory RAM 128 MB;**
> **Fax machine;**
> **Access to Internet and an electronic mail address.**
> **4.1.8. To have and to maintain an official website for disclosure of information about assigned credit ratings;**
> **4.1.9. To have enough employees with necessary qualification for fulfilling rating procedures and processing the full volume of mandatory rating assessment, namely:**
> **At least 15 employees having a degree not lower than Specialist in finance and/or economy and at least 2 years of work experience in the respective field.**
> **4.2. Before the deadline indicated in 2.7 of this Regulation, bidders shall submit the following documents to the Tender Committee:**
> **tender application (Appendix 1);**
> **duly certified copies of the Charter and the Certificate of State Registration of the Legal Entity;**
> **a duly certified copy of the certificate confirming that the legal entity has been registered in the Uniform State Register of Legal Entities and Individual Business Entities kept by the State Statistics Committee of Ukraine;**
> **an auditor's report of the financial standing of such legal entity for the last four quarters preceding the quarter in which the tender is held;**
> **a certificate of no budget arrears issued by a tax administration;**
> **a registration card (Appendix 2);**
> **information about branch and representative offices of the legal entity (Appendix 3);**
> **information about membership of the legal entity in any corporate association (Appendix 4);**
> **information about officials within management bodies of the legal entity including the number and value of shares (stock, equity interest) they hold (Appendix 5);**
> **information about founders and/or members of the legal entity including the number and value of shares (stock, equity interest) they hold in the entity (Appendix 6);**

information about business entities in which the legal entity holds or manages (uses) any shares (stock, equity interest) (Appendix 7);
information about the staff (incl. both in-house and freelance staff) of the legal entity (Appendix 8) and documents confirming their qualification and work experience: copies of the degree certificate and the labor book of each employee;
information about founders, shareholders, members of the legal entities holding more than 10% in the authorized capital of the bidder (specifying professional participants of the securities market) (Appendix 9);
a certificate proving that there are no persons among the managers of the legal entity who are participants of the securities market and/or hold official in structures affiliated with participants of the securities market;
documents that confirm having an information infrastructure and tools that are sufficient for efficient data collection, processing and analysis as well as for making information about assigned credit ratings available to public (the number of phone lines, computers, fax machines, modem connections, e-mail address, own mass media, etc.): copies of contracts with telephone connection providers, copies of contracts with Internet service and the official website providers, documents confirming the availability of the required quantity of computers in a proper condition (Appendix 10).

These criteria and rules have little bearing on determining the capacity, objectivity and honesty of prospective rating agency operators. Rather, they are simply barriers to entry that are not necessary or justified in a free market. A version of the draft resolution is included in Exhibit C.

In summary, two significant problems emerge from implementation of the proposed decree and amended resolution. The first is the determination by the government to authorize rating agencies, rather than simply registering the company so the market can assess the operators. The second is the imposition of mandatory ratings, although investors are not yet conversant with the advantages the use of ratings can give them. The imposition of a requirement that insurance companies and non-state pension funds buy only rated paper means that for some time to come it will be impossible to invest in a suitably balanced portfolio.

5. Governing Laws and Regulations

Ukraine is a civil law country, as are most former Soviet dominions. That is, everything is permitted unless expressly forbidden by law. Exhibit C includes English translations of the two main laws that govern the capital market (Law 448/96 **"On State Regulation of the Securities Market in Ukraine"** and Law 3480-IV **On Securities and the Stock Market, dated February 23, 2006), and t**he Law 3201 **On Amending Certain Legislative Acts of Ukraine** dated December 15, 2005 which imposes mandatory ratings and reinforces the concept of authorized rating agency.

6. History and Functions of Capital Market Ratings

Capital market credit ratings offer significant benefits for institutional investors, the principal constituency of a rating agency. Indeed, credit ratings were invented as a service to investors by John Moody in 1909 as part of his effort to enhance the value of the statistical information he was publishing about railroads and canal companies. Over time, these ratings have come to serve a key role in efficient capital markets. If they did not exist, someone would have to invent them to ensure an orderly market with effective allocation of capital among competing uses. In concept, ratings are very simple: A bond rating (or short-term rating) is a symbol denoting relative quality of various debt instruments; it is an opinion or prediction regarding the likelihood a debt contract will be serviced in compliance with its terms, whatever they might be.

Institutional investors, of course, must have the analytical capacity to make such determinations on their own. It lies at the heart of the investment decision process because it must govern policy infrastructure and is key to development of the framework for decisions on alternative instruments. Without a sound investment policy, such decisions are taken on an ad hoc basis with the likely result a less-than-optimum portfolio, or even a dangerous one.

Consequently, western investors begin with a well-defined set of investment objectives. In most cases, they begin with safety of principal and interest as the most important consideration, although there are exceptions. Typically, this is defined in terms of ratings. An acceptable rating level is set as a floor for potential investment. Investors are aware of historical default levels associated with various rating categories. This enables them to define acceptable quality levels for their portfolio in terms of independent ratings. The investor will set a floor by informing investment bankers he will only buy bonds rated BBB or better, or Aa or better. Ratings are thus, first-and-foremost, a tool for investors with rating criteria an integral part of the process for determining whether a proposed investment qualifies for consideration.

Investors are familiar with the scope of fundamental analysis as employed by the rating agencies. Rating agency analysts are highly skilled, well-trained, experienced individuals. Since rating agencies rate all debt in a given market, the analysts are in continual contact with the executives of all significant companies in a given industry and know what is happening. Investor analytical teams are rarely able to do this. Moreover, by virtue of its special position in the market, issuers are often prepared to share detailed information with rating agency analysts on a confidential basis, recognizing it is in their best interest to achieve the highest rating possible. This information is incorporated in the rating decision, although not explicitly published. The result is better information for the market and for the investor.

Further, the rating itself represents additional information content for the market. In developed markets, the absence of a rating is usually construed by conservative investors as an indication there are credit problems with an issue or issuer. This is not necessarily universally true, but it is an appropriate assumption. The ratings constitute a quality framework for the market. They facilitate investor comparison and selection of investment alternatives because the rating agency with its fundamental approach and access to information provides ratings that validly compare and contrast the strengths of a Citibank and a General Electric Company, or other very different organizations.

This quality framework has another, equally important, advantage for institutional investors. Without this objective framework, developed by an agency without a vested interest in transactions or any conflicts of interest, pricing is an ***ad hoc*** exercise perpetrated by investment bankers. The risk premium on an issue may constitute appropriate compensation, but it is far more likely to be set to the advantage of the issuer or the deal maker than to the investor's optimum case. With a rating framework, the underwriter must price according to similarly rated issues in the market - where the broader market has determined the correct yields for that rating category through many actual transactions. This forces rational pricing to the advantage of the investor.

In addition to these basic issues of information content and rational pricing, western rating agencies play a role in efficiency and cost substitution for institutional investors. Access to the analysis, with its informed process, and to the analyst greatly enhances the work of the analyst working for the institutional investor. Investors consult with rating agencies to test their assumptions and expectations, thus speeding and strengthening their own analysis. Finally, investors in many cases, use the full array of rating agency products and services in a way that allows them to maintain smaller, lower cost analytical teams on their own premises.

7. Rating Agency Prerequisites/Business Models

A rating is an independent, informed, objective opinion regarding the relative likelihood of default on a fixed income instrument.

An outline business plan/information memorandum (from Poland) is appended as Exhibit D. The reputation of the global agencies have been established over decades, and are based on statistical analysis of default statistics for each rating category. As might be expected, there is a direct correlation between rating level and the probability of default based on this analysis.

The definition of a rating above identifies the prerequisites for establishment of a rating agency. Apart from that, from a business perspective, the first requirement is sufficient issuing activity such that a very small percentage of the volume taken as rating fees will be enough to meet the expenses of the agency. The second factor is a growing institutional investor community that wants to enhance its traditional investment. In many markets, these policies are dictated, arbitrary and often restrict the opportunity for appropriate returns.

A rating is independent. This means it is the product of an essentially unregulated company. In 1972 there were two fully functioning rating agencies, with a distant third serving the needs to certain Wall Street investment banks. Newer agencies like Thomson BankWatch and Duff & Phelps came into existence. The independence of those companies was a function of long-standing Board practice, or in the case of the newer agencies demonstrated industry-specific expertise managed without parent company interference. The parent companies did not interfere in the agency business on the ratings side. As laws changed, the Euromarket developed, and emerging domestic markets matured. It became clear that domestic rating agencies could assist with quality assurance. Since that time, about sixty domestic agencies have been established. Many of them were formed based on local capital and experience hired in the market. Others were created by government. And in other markets, donor agencies fostered the creation of local rating agencies with funding from IFC and assistance from experts or Duff & Phelps, which worked closely with the IFC.

The ownership model for the domestic rating agencies is most often a diversified group of financial institutions with small investments and board representation only as groups of shareholders. No single holder has control or influence. Company policies, supervisory board resolutions and agreements with executives insulate the rating committee from any interference. Agency management is expected to learn how to do ratings, not follow directions from a regulatory agency. The result is clear independence of rating judgment by the Rating Committee.

A rating is informed. This means the rating results from a clearly defined analytical process that ensures all relevant factors are considered, that the quality of data and information used reflect economic reality and that necessary adjustments to measure economic reality are made to data prepared in accordance with accounting convention. The process incorporates specific information about the market, the industry and the issuer so there is a clear context. The sample rating policy in Exhibit A reflects some of the parameters of such a process.

A rating is objective. Rating Committees are formed to ensure objectivity by arriving at joint decisions. It is normal to seek consensus, but have a mechanism for conflict resolution. All members of the Committee have a say in determining the quality of information. There will always be at least one member who has not met management so that demeanor, charisma or articulation do not affect his vote.

A rating is an opinion. It is the Committee's opinion and it is very specific. The symbology of ratings is intended to be simple. To some extent it is, but the analytical process entails several key elements that are necessary preconditions to effective ratings. In short form, they are:

- Consideration of real economic values, not impaired by accounting convention;
- Independent forecasting by the responsible Analyst;
- Focus on cash, both net cash generated and cash flows through the business;
- Management character and willingness to pay.

There is no single business model for domestic rating agencies. Even the global duopoly have slightly different models in that Moody's has a focus on the creation of demand pull through precise services for institutional investors while S&P looks to a broader buy-side. Ideally for a new company, it should be staffed with five analysts, a Managing Director, a marketing director and an office manager. Plus, if needed, an IT/LAN technician can be employed. The required investment is not great.

8. Regulatory Perspective

The International Organization of Securities Commissions has prepared a Code of Conduct for rating agencies and their employees. In introducing the Code, they wrote:

THE IOSCO CODE OF CONDUCT FUNDAMENTALS FOR CREDIT RATING AGENCIES

> **"As described in the IOSCO CRA Principles, CRAs should endeavor to issue opinions that help reduce the asymmetry of information that exists between borrowers and debt and debt-like securities issuers, on one side, and lenders and the purchasers of debt and debt-like securities on the other. Rating analyses of low quality or produced through a process of questionable integrity are of little use to market participants. Stale ratings that fail to reflect changes to an issuer's financial condition or prospects may mislead market participants. Likewise, conflicts of interest or other undue factors – internal and external – that might, or even appear to, impinge upon the independence of a rating decision can seriously undermine a CRA's credibility. Where conflicts of interest or a lack of independence is common at a CRA and hidden from investors, overall investor confidence in the transparency and integrity of a market can be harmed. CRAs also have responsibilities to the investing public and to issuers themselves, including a responsibility to protect the confidentiality of some types of information issuers share with them."**

The Code of Conduct can be found in Exhibit B.

In the United States, the use of ratings for bank investment in municipal debt was first required by depression era banking legislation. Investment in corporate debt was forbidden. More recently, the net capital rules for licensed broker/dealers (Rule 15c3-1) required a capital calculation haircut for unrated or low rated paper on the balance sheet of the company. Rating agencies are chosen by the market and recognized by the US Securities & Exchange Commission when they issue "no action" letters in response to queries from investors or broker/dealers.

9. Ukraine Rating Agencies

There are four rating agencies established in Ukraine, none with a foreign partner among the global rating agencies. They are Credit-Rating Ltd, IBI Ratings, Stock Market Agency Ltd, and Ukrainian Agency of Financial Development. When the Ratings Concept was initiated in 2004, three agencies applied for authorization. At this time, Credit-Ratings is "authorized" to provide "mandatory" ratings. Market participants say the tender process required by existing and draft regulations was not followed. A comprehensive evaluation of each agency was beyond the scope of this project.

Credit-Ratings Ltd. is the oldest domestic rating agency in the market. During an interview, it was stated the company was founded by its current executives, Alexander Ginzburg and Stanislav Dubko in 2001. The company reports nearly 300 rated clients. As described by the officers, the separation of ratings and marketing is consistent with practice elsewhere. The rating process as described also appears consistent with practice elsewhere. It has published rating methodologies in Ukrainian. The officers were able to provide a file of documents, some of which are on the company's web page, to illustrate its activities.

IBI Rating Agency employs a "rating model" for banks with nineteen variables used to calculate a ranking score. Every quarter the rankings are published covering all banks in Ukraine. The company is now creating models for insurance and pension funds. It also has scoring models for consumer and SME lending. It is a direct lender to consumers using prepaid cash cards worth up to $2000 that are handed over to customers with qualifying scores. IBI pays 1% for the card. The company also offers "experience analysis" which goes beyond the statistical methodology to arrive at rankings.

Stock Market Agency, Ltd. was formed in 2000 as a consulting firm for stock market research. It is a software company with several data base systems that allow stock market participants to fulfill their regulatory reporting requirements. The data can be manipulated to set up comparisons, and the company can do a SWOT analysis based on the comparisons.

Ukrainian Agency of Financial Development was set up by professional securities participants to assist the market by developing ratings and analysis. The shareholders include two associations and eight companies, all with less than 10%. The Director controls slightly more than 10% of company shares. The company assigned two ratings last year, two this year. In addition, like other rating agencies, this company publishes financial models - in this case ranking auto insurance companies.

10. Exhibits

Exhibit A Sample rating policy and procedures (Country Ratings Policy)
Exhibit B IOSCO CRA Code of Conduct
Exhibit C Ukraine Laws and Regulations
Exhibit D Sample Business Plan Outline
Exhibit E List of persons interviewed

Exhibit A
Sample Rating Policy and Procedures

Country Ratings Co. Ltd. - General Rating Policy and Definitions (Confidential)

INTRODUCTION

A rating is an independent, informed, objective opinion regarding the relative likelihood of default on a fixed income instrument.

This rating policy sets forth the basic parameters for rating assignments in the Country capital market. The key objective is to assign accurate, credible ratings supported by professional research reports. The analysis must reduce the issuer to its economic fundamentals. It must explain the business in transactional terms and relate the asset conversion cycle to the financial information used in the analysis. While the ultimate rating decision will include subjective elements, the process ***must*** begin with factual information and numbers.

Defining Ratings

COUNTRY RATINGS provides long term debt ratings on fixed income instruments, issuer ratings for qualified issuers and commercial paper ratings for issuers of short term paper. The rating definitions are presented at the end of this paper, and incorporated here by reference. It should be recognized the definitions are written to permit the market to understand there is a scale or stratification of credit risk associated with investment in debt, and there should be compensation for this risk differential. However, they are also written to permit the Rating Committee to assign ratings to any instrument sold by any issuer with a great deal of flexibility. COUNTRY RATINGS will not publicly ascribe precise characteristics, ratio measurements, asset size, type of business or other analytical considerations to a particular rating level. The determination of entitlement to a particular rating level is at the sole discretion of the Rating Committee. The analysis will not specifically link a given performance measure with a given level, but will suggest "the company's performance is equivalent (not "the same as") to others similarly rated." This "equivalence" weighs many factors.

Dual Rating Scale

COUNTRY RATINGS will operate a dual rating scale. Ratings assigned to debt issued in the Country capital market will reflect the status of the company within the Country market, compared with other Country issuers. The sovereign benchmark rating will be determined without reference to currency exchange considerations, but will incorporate consideration of the relative strength of the Country economy and fiscal management compared with other countries. The scale will employ fundamental analysis to establish the relationships among Country issuers. This rating universe will not equate with the rating scales of the global agencies.
The second rating scale will reflect a country risk assessment, defining the relative standing of government of Country debt issued in foreign currencies. The country limit established will serve as a ceiling for issuers of stature seeking access to capital in other markets. These ratings are intended to be consistent with those of other rating agencies.

RATINGS

COUNTRY RATINGS will provide ratings for all fixed income instruments and high quality issuers. Ratings to be assigned range from B through AAA. For the B through AA categories, modifiers of + and - will be used to more precisely indicate positioning within the generic rating category. In addition to the foregoing assigned categories, the three C rating categories will be used to denote imminent default, and to differentiate prospects for recovery.

As an accommodation to issuers and intermediaries, COUNTRY RATINGS has established two alternatives to the formal application process. Issuers may apply for a rating indication on a hypothetical issue. In this case, the issuer describes a possible debt issue that is consistent with its capital plans, but for which no specific plans are set. In this case, COUNTRY RATINGS will conduct the complete rating exercise with the issuer, and will inform the issuer of the rating on a "when and as issued" basis. If the issuer does not sell the debt, the rating is not published. This rating is available for one year from the date COUNTRY RATINGS informs the issuer of its assignment.
In the second case, an issuer or an intermediary may provide COUNTRY RATINGS with basic public information on a prospective issuer. COUNTRY RATINGS analysts and managers will conduct an informal review of the material and endeavor to inform the issuer if it seems likely the ultimate rating range would not be helpful.

Fixed income instruments include the following:

Bonds or debentures, maturity greater than one year

1. whether registered or not
2. Fixed rate or floating rate
3. Interest bearing or discount
4. Secured (collateralized): floating charge over all assets or specific charge
5. Unsecured: parri passu or subordinated
6. May be convertible into other instruments
7. Income bonds or equivalent
8. Preferred stock or equivalent
9. Specified dividend claim, cumulative without earnings reference
10. Perpetual or stated maturity
11. Convertible or not

Commercial Paper and deposits by all types of Issuers

1. Defined by use of proceeds, not legal basis for issuance
2. Short-term maturities
3. Sold through dealers or direct
4. Not registered with the Country SEC

INFORMATION REQUIREMENTS

The data requests have been prepared for different industries. In general, information should not be "required." Rather, the analyst must specify what would be helpful to the analysis, and be prepared to identify potential alternative sources. All information requested is to be maintained in confidence, solely for the use of the rating committee.

RATING PROCESS

The rating process is memo driven. Everything that transpires with an issuer must be recorded. Memos should be written to describe all contacts with the company. In addition, rating memos must be prepared with the full analysis. Reports are separate documents, and are supplemental to the decision process. The COUNTRY RATINGS rating process will normally begin with an inquiry from a company or bank financial officer who plans to issue debt and is aware of the benefits of receiving a credit rating prior to marketing the issue. Sometimes, an intermediary might be instructed to make the inquiry. All inquiries are received on a confidential basis.

COUNTRY RATINGS welcomes inquiries regarding its ratings, products and procedures from issuers and from intermediaries on behalf of issuers with whom they have a formal relationship. Agency specialists are familiar with rating usage and analytical methodology as used in western markets. We would encourage participants in this new market to discuss these practices and the benefits of the use of ratings with agency representatives during the issuers' planning process.

COUNTRY RATINGS will assign an analyst to be responsible for the issuer relationship, and to guide the rating assignment and publication process. These senior professionals in the firm are experienced professionals with diverse backgrounds and an unparalleled understanding of COUNTRY's economy and transformation. The analyst will provide a package to the prospective issuer that includes:

- An outline of the information necessary to begin the process
- A summary of key analytical considerations for the industry or issuer type
- A suggested schedule for preparation and meetings
- The Application and Agreement for the rating

With the basic information regarding the process in hand (and the analyst is prepared to respond to all questions) the issuer, perhaps with advice of his investment banker determines whether to proceed with the rating application. The decision to use the services of an investment banker is at the sole discretion of the issuer.

If the decision is taken to proceed, the issuer begins the process of compiling the requisite information. Certain of the items are in the public domain. Others will likely be derived from internal management information systems. *ALL information is received and held in the strictest confidence.* Confidentiality begins with the initial inquiry, and the only information published will be the news release, and the rating articles and reports that the issuer will have an opportunity to review prior to publication. Full disclosure and transparency are preconditions to an effective rating analysis.

The analyst receives the information package and application when management is prepared to go forward and establish a formal schedule that coincides with issue marketing plans.

Management meetings are scheduled to allow the analytical team time to prepare for the due diligence discussions. A written agenda must be prepared. The agenda will be set by mutual agreement and is based on the nature of the company, institution or municipality. It is often useful to pay a short visit to conveniently located processing or manufacturing sites or development projects for certain issuers. Guidance with respect to obvious questions should be provided, but the analyst must always be able to follow on to other topics and questions if necessary. Normally, the discussions with management lead to additional questions.

Preparation of Analysis, Rating Recommendation and Reports:

Step 1: Spread the numbers - Five (5) Years is the Standard, Not 3.
Step 2: Relate the numbers to the business: be sure you understand the asset conversion cycle, Porter considerations and SWOT.
Step 3. Write the memo, write the report: these are different.
The Analyst in charge of the rating assignment, once the meetings are complete, will work with issuer management to ensure that relevant additional data specified during the discussions is forwarded to complete the file. The analyst then prepares his analysis, with assistance of COUNTRY RATINGS's expert consultants if they are available. The analyst determines the appropriate rating recommendation, and supports the conclusion with all the analytical tools presented in the course work. The complete package with all source material should be presented to each member of the Rating Committee individually. Each member voting is charged with a complete review of the material, and should help ensure the analyst has all relevant information. This is a joint effort to ensure quality of analysis and decisions.

When the committee has completed its deliberations and COUNTRY RATINGS is ready to publish the rating, COUNTRY RATINGS will inform the issuer (and investment banker, if so instructed), and deliver a press notice providing highlights of the rating assignment and the analysis.

The initial press bulletin will be followed by a more extensive article in COUNTRY RATINGS's weekly rating publication, and the subsequent publication of a detailed analytical report detailing the analytical considerations in the rating assignment. *The report should be published simultaneously with the rating publication if possible.* The report will be used by investors in their decision process.

With normal ratings, the analyst must monitor the progress of the issuer, and receive regular up-dated financial information. The process also requires periodic contact with management, press surveillance, review of industry journals and recording all the contacts and reviews in the rating file. With the assignment of the rating, and pursuant to its Application and Agreement, COUNTRY RATINGS undertakes to maintain the rating for the life of the issue. This entails an obligation on the part of the issuer to provide a continuing flow of information determined necessary for this purpose by COUNTRY RATINGS's Rating Committee. The analyst must use this to develop leverage with the issuer.

The issuer will have a continuing relationship with COUNTRY RATINGS. This will facilitate use of ratings for future debt issues, and the process is much simpler once the initial review and assignment process is complete. It is the analyst's job to make sure this is true.

RATING COMMITTEE MEMBERSHIP

The Rating Committee is the body ultimately responsible for the quality of ratings assigned by the COUNTRY RATINGS Rating Committee. It is solely an internal body, and must make its decisions without external interference. As a corollary, it is imperative the committee utilize the best analytical practice employed by the global rating agencies. The Rating Committee will consist of the members of the analytical team, and (when available) consultants engaged to provide training, analytical support and assistance with the written analysis. In addition, specialist consultants should be consulted on complex issues and in situations where questions of consistency in the market may arise.

The lead analyst is responsible for defining and preparing the relevant (defined below) information to permit a rating decision. Each member of the Committee is charged with performing a comprehensive individual review of the rating file. It is his responsibility to consult with the analyst in charge, and be certain all of his questions about the current status and outlook for the issuer are answered. The information gathering process is to be completed prior to convening the meeting.

RATING COMMITTEE PACKAGE

Rating Committee Package: This will vary according to the character of the issuer, but the following elements will generally be necessary before a rating committee can be convened. The original documents constitute the rating file, and must be available to all committee members. Where information is extracted and used in the rating recommendation, it should be footnoted to permit the reader to refer to the source for context and content. The following information should normally be provided:

Prospectus/draft offering document
Annual Reports and regulatory filings
Issue details: Amount, tenor, SF or amortization
Indenture
Terms and Covenants
Issuing and paying agent
Underwriters
Audited financials (if not in AR)
Management financials
Interview notes
Written analysis

Draft report and news release
Market and product descriptions
Comment on management
- MIS systems
- Personal knowledge of market
- Sharing information
- Succession
- Board relationships
- Regulatory relationships

Corporate status/ownership

The package for the rating committee is intended to provide all the information necessary to draw a rating conclusion. Each member of the committee is charged with deciding for himself whether the information presented is sufficient for that purpose. If he does not believe it is, it is his responsibility to inform the analyst of his questions, and the data he believes are missing.

To elaborate on the key items, the package to be circulated to the committee should include the following:

1. The rating recommendation memo to include the specific rating, strengths and weaknesses and a description of the factors on which the judgment is based. It should address the universe of issuers to be considered, and suggest the appropriate ceiling and relative ranking of significant peers. A peer is any similar issuer or possible issuer.

2. Comparative statistics for the issuer and other similar entities. This must reflect the debt burden relative to resources, and debt service coverage with clearly identified sources of cash to repay the debt as well as income, asset, liability and cash flow numbers.

3. A draft COUNTRY RATINGS Credit Report explaining the basis for the rating. The commentary must be based on public information, whereas the rating recommendation can refer to any type of information.

4. The meeting memo describing the information presented by management and responses to questions posed during the management meeting. This should be as close to a verbatim record as possible. It should *not* include our opinion of what the answers should be.

5. Relevant issuer information that supports the analysis and is the basis for the analysis. This may include annual reports, municipal budgets, spending plans, industry statistics compiled by others, etc.

6. The analyst's preliminary agenda for the discussion specifying the order of discussion, and anticipated schedule for conclusion and publication of the rating.

RATING COMMITTEE DELIBERATIONS

This is the greatest challenge. When the analyst is ready, he presents the rating package to each member of the rating committee for individual review. The preliminary rating discussions take place on an individual basis between the Senior Analyst and the other members of the committee. The purpose of these discussions is to ensure each member is satisfied with the depth and quality of information provided, and that all the questions about the issuer, its strengths and prospects have been answered. Then, it is possible to convene the committee for formal consideration of the rating. The entire discussion process is repeated with all committee members present, and significant additional issues, if any, are discussed. The committee may ask the analyst to seek additional explanations from management.

At a minimum, the discussion must touch on

1. Issuer Background and History
2. The industries in which it operates - competition, RMS, new products and alternatives
3. Corporate details and structure
4. Ownership/control - *identify obligor and guarantees* (very important)
5. Define the business - preferably with numbers
6. Markets and products/segment
7. Customers/uses
8. DIFFERENTIAL ADVANTAGES - why do the business
9. Aggregate volumes/unit sales/competitors/alternative products
10. Distribution channels
11. Supply side - sources, cost drivers, labor as an input, unions
12. Explain the "asset conversion process" for segments i.e. what does the company do?
13. Relate the business to the accounts, the numbers should tell us what is going on

When the business is defined and enumerated, on to the financial analysis *Try to use audited statements*

1. First - reported and adjusted income statement, profits and CASH FLOW
2. Forecast, forecast, forecast - Look forward, extrapolate, trends
3. Based on actual performance, but analysis deals with drivers.
4. Balance sheet - *economic values*, anomalies
5. Now discuss the ratios and how they are likely to change over the next three years, most important:
6. Gross margin
7. Operating profit excluding special gains, but counting all expenses
8. Debt service requirements (ST is 100% due)
9. Net free cash flow after CAPEX requirements
10. Debt service capacity and margin of protection
11. Leverage and all the rest

Management capacity and predictability

- Does management clearly have a marketing orientation and *know* its customers and their needs.
- Appropriate CVs and experience
- Actual *PERFORMANCE* - five years or more managing the company
- Assess use of planning disciplines
- Status of MIS
- Regulatory or legal problems

Other issues

- SWOT implications for numbers, Porter threats and forecast of conditions
- Technology changes
- Product curve/life cycle
- Political interference and competition

Rating Committee Conclusions
When the committee as a whole is satisfied with its understanding of the outlook for the issuer and its relative strengths, consensus on the appropriate rating is sought. Only in very exceptional circumstances will a rating be assigned that does not reflect the consensus of the Rating Committee.

COUNTRY Ratings Co., Ltd - Possible Rating Definitions

COUNTRY RATINGS Long-term debt ratings

AAA
Bonds rated **AAA** are considered the best quality. They present the least investment risk and constitute "gilt edged" securities. Interest payments are assured with exceptionally large or stable margins. Principal is secure. While change can be anticipated in the credit profile, such changes as can be assessed are not likely to impair the fundamentally strong position of such issues.

AA
Bonds rated **AA** are considered high quality in all respects. Combined with the **AAA** bonds they constitute the high-grade group. The differentiating elements in the rating assignment are normally greater magnitude or range of fluctuation in elements that assure safety. Such elements for bonds in this category will not be as stable or predictable as for AAA bonds.

A
Bonds rated **A** are considered upper-medium-grade obligations possessing sound credit characteristics. Elements defining the safety of principal and interest reflect safe margins of protection at this time, but may be susceptible to change in the future due to industry or product characteristics.

BBB
Bonds rated **BBB** are considered medium-grade obligations normally possessing sound credit characteristics. Elements defining safety of principal and interest appear adequate for the present but certain factors may be marginal and predictability may be lacking as change can be forecast, but not accurately measured, over the intermediate term. Such bonds fail to reflect outstanding investment characteristics, and may show speculative characteristics from time-to-time.

BB
Bonds rated **BB** reflect significant speculative characteristics and important volatility in debt protection measurements. Typically, principal and interest is not well-assured even in positive economic times. It is difficult to ascertain the long term prospects for such investments.

B
Bonds rated **B** do not typically reflect characteristics of desirable investment. There is significant doubt that contractual interest and principal payments can be met, and maintenance of other terms of the issue over any period of time may be difficult.

CCC
Bonds rated **CCC** are poorly secured and protective elements are unpredictable. Such issues may be in default or reflect immediate challenges to the ability to make contractual principal and interest payments.

CC
Bonds rated **CC** constitute debt instruments which are speculative to a high degree. Such issues are often in default or reflect other limitations on repayment capacity. .

C
Bonds rated **C** are the lowest category of rated bonds. Issues rated in this category are unlikely to ever attain any real investment standing.

COUNTRY RATINGS bond ratings, where specifically noted, are applicable to senior bank obligations and insurance company senior policyholder and claims obligations with an original maturity exceeding one year. Obligations relying upon support mechanisms such as letters-of-credit and bonds of indemnity are excluded, unless explicitly rated by *COUNTRY RATINGS*.

Ratings for branch obligations of a bank are considered to be domiciled in the country in which the branch is located. Unless noted as an exception, *COUNTRY RATINGS*'s rating on a bank's ability to repay senior obligations extends only to branches located in specified countries as identified in the rating publications.

COUNTRY RATINGS makes no representation that rated bank obligations or insurance company obligations are issued in conformity with any applicable law or regulation. Nor does it represent any specific bank or insurance company obligation is legally enforceable or a valid senior obligation of a rated issuer.

COUNTRY RATINGS will assign ratings to all forms of debt and preferred stock.

COUNTRY RATINGS Issuer Ratings
Issuer ratings apply to companies and banks as issuers of fixed income instruments with maturities in excess of one year. These generic ratings will apply the same debt rating symbols as specific long term debt ratings, but are not to be construed as a rating for any particular obligation. To be eligible for an issuer rating, the company or bank must earn a rating opinion of A or better.

COUNTRY RATINGS Short-Term Debt Ratings
COUNTRY RATINGS's short-term debt ratings are opinions of the ability of commercial paper and deposit issuers to punctually repay senior short-term debt obligations. These obligations have an original maturity not exceeding one year, unless explicitly noted.
COUNTRY RATINGS utilizes the following designations, constituting investment grade ratings except **Unqualified**, to indicate the relative repayment ability of rated issuers:

* Issuers rated **CP-First** (or their supporting institutions) have a superior ability for repayment of senior short-term debt obligations. **CP-First** repayment ability will normally be evidenced by many of the following characteristics:
* Well-established products in predictable industries, leading market and R&D positions.
* High earnings rates with positive trends.
* Conservative capitalization, moderate reliance on debt and ample asset protection
* Strong and stable coverage margins
* High internal cash generation.
* Predictable access to multiple financial markets and assured sources of alternative liquidity.

- Issuers rated **CP-Second** (or their supporting institutions) have a strong ability to meet senior short-term debt obligations. Characteristics cited above will be present, but may differ in magnitude. Earnings and coverage ratios, although sound, may be subject to modest variation.

Capital relationships, while still appropriate, may be more affected by external market conditions. Ample alternative liquidity is maintained.

- Issuers rated **CP-Third** (or their supporting institutions) demonstrate an acceptable ability to repay senior short-term obligations. Industry variability and potential shifts in the financial profile render these issuers more susceptible to adverse market conditions and require careful management of financing programs. Adequate alternative liquidity is maintained to permit an orderly market exit.
- Issuers rated **Unqualified** do not fall within any of the eligible rating categories.

Ratings for branch obligations of a bank are considered to be domiciled in the country in which the branch is located. Unless noted as an exception, *COUNTRY RATINGS*'s rating on a bank's ability to repay senior obligations extends only to branches located in specified countries as identified in the rating publications.

COUNTRY RATINGS makes no representation that rated bank obligations or insurance company obligations are issued in conformity with any applicable law or regulation. Nor does it represent any specific bank or insurance company obligation is legally enforceable or a valid senior obligation of a rated issuer.

In cases where an issuer has documented the existence of a guarantee or other support arrangement from a third party, *COUNTRY RATINGS* will note the name or names of such supporting entity or entities in brackets adjacent to the name of the issuer. The ratings assigned to such issuers entail evaluation of the financial strength of the guarantor or supporting entity. This is one factor in the rating assessment. *COUNTRY RATINGS* makes no representation and gives no opinion on the legal validity or enforceability of any support arrangement.

COUNTRY RATINGS ratings are opinions, not recommendations to buy or sell securities of any type, and their accuracy is not guaranteed. A rating should be weighed solely as one factor in an investment decision and investors should make their own study and evaluation of any issuer whose securities or debt obligations they are planning to buy or sell.

Exhibit B

IOSCO CRA Principles

1. QUALITY AND INTEGRITY OF THE RATING PROCESS

A. Quality of the Rating Process

1.1 *The CRA should adopt, implement and enforce written procedures to ensure that the opinions it disseminates are based on a thorough analysis of all information known to the CRA that is relevant to its analysis according to the CRA's published rating methodology.*

1.2 *The CRA should use rating methodologies that are rigorous, systematic, and, where possible, result in ratings that can be subjected to some form of objective validation based on historical experience.*

1.3 *In assessing an issuer's creditworthiness, analysts involved in the preparation or review of any rating action should use methodologies established by the CRA. Analysts should apply a given methodology in a consistent manner, as determined by the CRA.*

1.4 *Credit ratings should be assigned by the CRA and not by any individual analyst employed by the CRA; ratings should reflect all information known, and believed to be relevant, to the CRA, consistent with its published methodology; and the CRA should use people who, individually or collectively have appropriate knowledge and experience in developing a rating opinion for the type of credit being applied.*

1.5 *The CRA should maintain internal records to support its credit opinions for a reasonable period of time or in accordance with applicable law.*

1.6 *The CRA and its analysts should take steps to avoid issuing any credit analyses or reports that contain misrepresentations or are otherwise misleading as to the general creditworthiness of an issuer or obligation.*

1.7 *The CRA should ensure that it has and devotes sufficient resources to carry out high-quality credit assessments of all obligations and issuers it rates. When deciding whether to rate or continue rating an obligation or issuer, it should assess whether it is able to devote sufficient personnel with sufficient skill sets to make a proper rating assessment, and whether its personnel likely will have access to sufficient information needed in order make such an assessment.*

1.8 *The CRA should structure its rating teams to promote continuity and avoid bias in the rating process.*

B. Monitoring and Updating

1.9 Except for ratings that clearly indicate they do not entail ongoing surveillance, once a rating is published the CRA should monitor on an ongoing basis and update the rating by:

a. regularly reviewing the issuer's creditworthiness;

b. initiating a review of the status of the rating upon becoming aware of any information that might reasonably be expected to result in a rating action (including termination of a rating), consistent with the applicable rating methodology; and,

c. updating on a timely basis the rating, as appropriate, based on the results of such review.

1.10 Where a CRA makes its ratings available to the public, the CRA should publicly announce if it discontinues rating an issuer or obligation. Where a CRA's ratings are provided only to its subscribers, the CRA should announce to its subscribers if it discontinues rating an issuer or obligation. In both cases, continuing publications by the CRA of the discontinued rating should indicate the date the rating was last updated and the fact that the rating is no longer being updated.

C. Integrity of the Rating Process

1.11 The CRA and its employees should comply with all applicable laws and regulations governing its activities in each jurisdiction in which it operates.

1.12 The CRA and its employees should deal fairly and honestly with issuers, investors, other market participants, and the public.

1.13 The CRA's analysts should be held to high standards of integrity, and the CRA should not employ individuals with demonstrably compromised integrity.

1.14 The CRA and its employees should not, either implicitly or explicitly, give any assurance or guarantee of a particular rating prior to a rating assessment. This does not preclude a CRA from developing prospective assessments used in structured finance and similar transactions.

1.15 The CRA should institute policies and procedures that clearly specify a person responsible for the CRA's and the CRA's employees' compliance with the provisions of the CRA's code of conduct and with applicable laws and regulations. This person's reporting lines and compensation should be independent of the CRA's rating operations.

1.16 Upon becoming aware that another employee or entity under common control with the CRA is or has engaged in conduct that is illegal, unethical or contrary to the CRA's code of conduct, a CRA employee should report such information immediately to the individual in charge of compliance or an officer of the CRA, as appropriate, so proper action may be taken. A CRA's employees are not necessarily expected to be experts in the law.

Nonetheless, its employees are expected to report the activities that a reasonable person would question. Any CRA officer who receives such a report from a CRA employee is obligated to take appropriate action, as determined by the laws and regulations of the jurisdiction and the rules and guidelines set forth by the CRA. CRA management should prohibit retaliation by other CRA staff or by the CRA itself against any employees who, in good faith, make such reports.

2. CRA INDEPENDENCE AND AVOIDANCE OF CONFLICTS OF INTEREST

A. General

2.1 *The CRA should not forbear or refrain from taking a rating action based on the potential effect (economic, political, or otherwise) of the action on the CRA, an issuer, an investor, or other market participant.*

2.2 *The CRA and its analysts should use care and professional judgment to maintain both the substance and appearance of independence and objectivity.*

2.3 *The determination of a credit rating should be influenced only by factors relevant to the credit assessment.*

2.4 *The credit rating a CRA assigns to an issuer or security should not be affected by the existence of or potential for a business relationship between the CRA (or its affiliates) and the issuer (or its affiliates) or any other party, or the non-existence of such a relationship.*

2.5 *The CRA should separate, operationally and legally, its credit rating business and CRA analysts from any other businesses of the CRA, including consulting businesses, that may present a conflict of interest. The CRA should ensure that ancillary business operations which do not necessarily present conflicts of interest with the CRA's rating business have in place procedures and mechanisms designed to minimize the likelihood that conflicts of interest will arise.*

B. CRA Procedures and Policies

2.6 *The CRA should adopt written internal procedures and mechanisms to (1) identify, and (2) eliminate, or manage and disclose, as appropriate, any actual or potential conflicts of interest that may influence the opinions and analyses the CRA makes or the judgment and analyses of the individuals the CRA employs who have an influence on ratings decisions. The CRA's code of conduct should also state that the CRA will disclose such conflict avoidance and management measures.*

2.7 *The CRA's disclosures of actual and potential conflicts of interest should be complete, timely, clear, concise, specific and prominent.*

2.8 The CRA should disclose the general nature of its compensation arrangements with rated entities. Where a CRA receives from a rated entity compensation unrelated to its ratings service, such as compensation for consulting services, the CRA should disclose the proportion such non-rating fees constitute against the fees the CRA receives from the entity for ratings services.

2.9 The CRA and its employees should not engage in any securities or derivatives trading presenting conflicts of interest with the CRA's rating activities.

2.10 In instances where rated entities (e.g., governments) have, or are simultaneously pursuing, oversight functions related to the CRA, the CRA should use different employees to conduct its rating actions than those employees involved in its oversight issues.

C. CRA Analyst and Employee Independence

2.11 Reporting lines for CRA employees and their compensation arrangements should be structured to eliminate or effectively manage actual and potential conflicts of interest. The CRA's code of conduct should also state that a CRA analyst will not be compensated or evaluated on the basis of the amount of revenue that the CRA derives from issuers that the analyst rates or with which the analyst regularly interacts.

2.12 The CRA should not have employees who are directly involved in the rating process initiate, or participate in, discussions regarding fees or payments with any entity they rate.

2.13 No CRA employee should participate in or otherwise influence the determination of the CRA's rating of any particular entity or obligation if the employee:

a. Owns securities or derivatives of the rated entity, other than holdings in diversified collective investment schemes;

b. Owns securities or derivatives of any entity related to a rated entity, the ownership of which may cause or may be perceived as causing a conflict of interest, other than holdings in diversified collective investment schemes;

c. Has had a recent employment or other significant business relationship with the rated entity that may cause or may be perceived as causing a conflict of interest;

d. Has an immediate relation (i.e., a spouse, partner, parent, child, or sibling) who currently works for the rated entity; or

e. Has, or had, any other relationship with the rated entity or any related entity thereof that may cause or may be perceived as causing a conflict of interest.

2.14 The CRA's analysts and anyone involved in the rating process (or their spouse, partner or minor children) should not buy or sell or engage in any transaction in any security or derivative based on a security issued, guaranteed, or otherwise supported by any entity within such analyst's area of primary analytical responsibility, other than holdings in diversified collective investment schemes.

2.15 CRA employees should be prohibited from soliciting money, gifts or favors from anyone with whom the CRA does business and should be prohibited from accepting gifts offered in the form of cash or any gifts exceeding a minimal monetary value.

2.16 Any CRA analyst who becomes involved in any personal relationship that creates the potential for any real or apparent conflict of interest (including, for example, any personal relationship with an employee of a rated entity or agent of such entity within his or her area of analytic responsibility), should be required to disclose such relationship to the appropriate manager or officer of the CRA, as determined by the CRA's compliance policies.

3. CRA RESPONSIBILITIES TO THE INVESTING PUBLIC AND ISSUERS

A. Transparency and Timeliness of Ratings Disclosure

3.1 The CRA should distribute in a timely manner its ratings decisions regarding the entities and securities it rates.

3.2 The CRA should publicly disclose its policies for distributing ratings, reports and updates.

3.3 The CRA should indicate with each of its ratings when the rating was last updated.

3.4. Except for "private ratings" provided only to the issuer, the CRA should disclose to the public, on a non-selective basis and free of charge, any rating regarding publicly issued securities, or public issuers themselves, as well as any subsequent decisions to discontinue such a rating, if the rating action is based in whole or in part on material non-public information.

3.5 The CRA should publish sufficient information about its procedures, methodologies and assumptions (including financial statement adjustments that deviate materially from those contained in the issuer's published financial statements) so that outside parties can understand how a rating was arrived at by the CRA. This information will include (but not be limited to) the meaning of each rating category and the definition of default or recovery, and the time horizon the CRA used when making a rating decision.

3.6 When issuing or revising a rating, the CRA should explain in its press releases and reports the key elements underlying the rating opinion.

3.7 *Where feasible and appropriate, prior to issuing or revising a rating, the CRA should inform the issuer of the critical information and principal considerations upon which a rating will be based and afford the issuer an opportunity to clarify any likely factual misperceptions or other matters that the CRA would wish to be made aware of in order to produce an accurate rating. The CRA will duly evaluate the response. Where in particular circumstances the CRA has not informed the issuer prior to issuing or revising a rating, the CRA should inform the issuer as soon as practical thereafter and, generally, should explain the reason for the delay.*

3.8 *In order to promote transparency and to enable the market to best judge the performance of the ratings, the CRA, where possible, should publish sufficient information about the historical default rates of CRA rating categories and whether the default rates of these categories have changed over time, so that interested parties can understand the historical performance of each category and if and how rating categories have changed, and be able to draw quality comparisons among ratings given by different CRAs. If the nature of the rating or other circumstances make a historical default rate inappropriate, statistically invalid, or otherwise likely to mislead the users of the rating, the CRA should explain this.*

3.9 *For each rating, the CRA should disclose whether the issuer participated in the rating process. Each rating not initiated at the request of the issuer should be identified as such. The CRA should also disclose its policies and procedures regarding unsolicited ratings.*

3.10 *Because users of credit ratings rely on an existing awareness of CRA methodologies, practices, procedures and processes, the CRA should fully and publicly disclose any material modification to its methodologies and significant practices, procedures, and processes. Where feasible and appropriate, disclosure of such material modifications should be made prior to their going into effect. The CRA should carefully consider the various uses of credit ratings before modifying its methodologies, practices, procedures and processes.*

B. The Treatment of Confidential Information

3.11 *The CRA should adopt procedures and mechanisms to protect the confidential nature of information shared with them by issuers under the terms of a confidentiality agreement or otherwise under a mutual understanding that the information is shared confidentially. Unless otherwise permitted by the confidentiality agreement and consistent with applicable laws or regulations, the CRA and its employees should not disclose confidential information in press releases, through research conferences, to future employers, or in conversations with investors, other issuers, other persons, or otherwise.*

3.12 *The CRA should use confidential information only for purposes related to its rating activities or otherwise in accordance with any confidentiality agreements with the issuer.*

3.13 CRA employees should take all reasonable measures to protect all property and records belonging to or in possession of the CRA from fraud, theft or misuse.

3.14 CRA employees should be prohibited from engaging in transactions in securities when they possess confidential information concerning the issuer of such security.

3.15 In preservation of confidential information, CRA employees should familiarize themselves with the internal securities trading policies maintained by their employer, and periodically certify their compliance as required by such policies.

3.16 CRA employees should not selectively disclose any non-public information about rating opinions or possible future rating actions of the CRA, except to the issuer or its designated agents.

3.17 CRA employees should not share confidential information entrusted to the CRA with employees of any affiliated entities that are not CRAs. CRA employees should not share confidential information within the CRA except on an "as needed" basis.

3.18 CRA employees should not use or share confidential information for the purpose of trading securities, or for any other purpose except the conduct of the CRA's business.

4. DISCLOSURE OF THE CODE OF CONDUCT AND COMMUNICATION WITH MARKET PARTICIPANTS

4.1 The CRA should disclose to the public its code of conduct and describe how the provisions of its code of conduct fully implement the provisions of the IOSCO Principles Regarding the Activities of Credit Rating Agencies and the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies. If a CRA's code of conduct deviates from the IOSCO provisions, the CRA should explain where and why these deviations exist, and how any deviations nonetheless achieve the objectives contained in the IOSCO provisions. The CRA should also describe generally how it intends to enforce its code of conduct and should disclose on a timely basis any changes to its code of conduct or how it is implemented and enforced.

4.2 The CRA should establish a function within its organization charged with communicating with market participants and the public about any questions, concerns or complaints that the CRA may receive. The objective of this function should be to help ensure that the CRA's officers and management are informed of those issues that the CRA's officers and management would want to be made aware of when setting the organization's policies.

Exhibit C Ukraine Laws and Regulations

***LAW 448/96* With language from Law 3701 inserted**
Not an Official Translation
Translation by Financial Markets International, Inc., with funding by USAID.
Consult the original text before relying on this translation.
Translation as of July 1999.

RESOLUTION OF THE VERKHOVNA RADA OF UKRAINE
On Procedure of Coming into Effect of the Law of Ukraine
“On State Regulation of the Securities Market in Ukraine”

The Verkhovna Rada hereby decrees:

1. To bring into force the Law of Ukraine “On State Regulation of the Securities Market in Ukraine” as of the day it is published.
2. To establish that prior to the date Ukrainian legislation is brought into line with the Law of Ukraine “On State Regulation of the Securities Market in Ukraine,” all effective laws shall be applied to the extent that they do not contradict this Law.
3. The Cabinet of Ministers of Ukraine shall:

- by December 1, 1996 execute and submit to the Verkhovna Rada proposals related to bringing legislation acts into accordance with the Law of Ukraine “On State Regulation of the Securities Market in Ukraine”;
- bring all decisions of the Government, ministries and sectors into accordance with this Law;
- ensure that functions related to securities market regulation are redeployed between the executive bodies and the Securities and Stock Market State Commission in accordance with this Law;
- give priority to provision of the necessary resources to the Securities and Stock Market State Commission with the aim of performing activities to establish and develop a stock market infrastructure pursuant to the “Concept of Functioning and Development of the Stock Market of Ukraine,” approved by the Resolution of the Verkhovna Rada of Ukraine, September 22, 1995;

4. The State Property Fund of Ukraine shall transfer state property to the Securities and Stock Market State Commission needed for establishment and development of stock market infrastructure pursuant to the “Concept of Functioning and Development of the Stock Market of Ukraine”.

Chairman of the Verkhovna Rada of Ukraine
O. Moroz

Kyiv, October 30, 1996

LAW OF UKRAINE
"ON STATE REGULATION OF SECURITIES MARKET IN UKRAINE"

(Bulletin of the Verkhovna Rada (BVR) 1996, #51, p.292)
(Enacted by the Resolution of the Verkhovna Rada # 475/96 - VR dated 10.30.96, BVR #51, p.293)
(With amendments made pursuant to the Law # 642/97 - VR dated 11.18.97, BVR #10. p.36)
(With amendments made pursuant to the Law # 938/XIV dated 07.14.99)

This law shall establish legal framework for executing state regulation of the securities market and state oversight of issuance and circulation of securities and their derivatives in Ukraine.

Article 1. Definition of Terms

For the purposes of this Law, the following terms shall have the following meanings:

- **state regulation of the securities market -** implementation by the state of a series of measures with regard to regulation, control and supervising the market of securities and their derivatives, as well as prevention of abuses and violations in this sphere;
- **investor in the securities market -** a physical person or legal entity, that purchases securities on behalf of his/her/its own and on his/her/its own account to make a profit from them or from the increase in their value, or to acquire the rights provided to a securities owner in accordance with the effective legislation;
- **circulation of securities -** conclusion and implementation of agreements with regard to securities that are not related to their issuance;
- **securities derivative -** securities whose issuance and circulation is related, during the term stipulated by agreement (contract), to the right to purchase or sell securities, or other financial instruments and/or commodities;
- **professional activity in the securities market -** entrepreneurial activity involving re-allocation of financial resources through the use of securities, as well as organizational, informational, technical, consulting, and other support of securities issuance and circulation. This type of activity shall be, as a rule, an exclusive or predominant one;
- **self-regulatory organization (SRO) -** a non-profit voluntary association of professional securities market participants, established to advocate interests of its members that own securities and other participants of the securities market. The association shall be registered with the Securities and Stock Market State Commission;
- **participants of the securities market -** issuers, investors and persons that carry out professional activity in the securities market.
- "Assessment of credit rating (rating) means services being rendered in a professional manner on the securities market with the aim to define the creditworthiness of a rated entity and may be performed by a rating agency as well;
- Credit rating means the conventional expression of creditworthiness for either the rated entity as whole and/or for its separate debt liability based on the national crediting rating scale;
- The National Rating Scale (hereinafter, the National Scale) means the scale grouped by levels along with such levels defining the borrower's capacity to promptly and in full extent repay the applicable interest rate and the principal debt under its debt liabilities and its paying capacity as well. The National Scale shall be used to assess the credit risk of the borrower i.e. a local government authority or a business entity, and of debt instruments i.e. bonds, mortgage-backed securities, loans.
- Issuer credit rating defines the level of a securities issuer's capacity to promptly and in full extent pay the applicable interest rate and the principal amount under its debt liabilities with regard to debt liabilities of any other borrowers.

- Issuer securities rating defines the borrower's (issuer's) capacity to promptly and in full extent serve liabilities under securities".
  (Article 1 has been added with the following paragraphs accoding to the LAW OF UKRAINE # 3201 "On Amending Certain Legislative Acts of Ukraine" from 15/12/2005)

Article 2. The Purpose of the Securities Market State Regulation

The goal of state regulation of the securities market are to:

- implement a unified state policy on the issuance and circulation of securities and their derivatives;
- facilitate effective mobilization and allocation by securities market participants of their finances with due regard to the interests of the society;
- connect information on conditions of securities issuance and circulation by securities market participants, the results of issuers' financial and business activities, the scope and character of securities transactions, and other information which affects price formation in the securities market;
- ensure equal opportunities for issuers, investors and intermediaries regarding access to the securities market;
- ensure securities ownership rights;
- protect securities market participants' rights;
- integrate with European and International stock markets;
- ensure compliance of securities market participants with legislation;
- prevent monopolization and develop a framework for fair competition in the securities market;
- ensure openness and transparency in the securities market.

Article 3. Forms of the Securities Market State Regulation

State regulation of the securities market shall be implemented through:

- adoption of the legislative and normative acts on issues related to the activities of the securities market participants;
- regulation of the issuance and circulation of securities, as well as rights and duties of the securities market participants;
- special permission (licenses) granted to engage in professional securities market activities and to provide for oversight of these activities;
- prohibition and suspension for a certain period (up to one year) of professional activity in the securities market in the event of engaging in said operations without the proper permission (license) for such activities, and this activity in conformity with the effective legislation;
- registration of both the securities issuance and information on the securities issuance;
- oversight over the reliability of the information submitted to regulatory bodies by issuers and entities engaged in professional activity in the securities market;
- establishment of a system for advocating investor's rights and ensuring compliance with those rights by securities issuers and professionals;
- exercising control over reliability of the information which is submitted to controlling bodies by issuers and entities engaged in professional activity in the securities market;
- promulgation of rules and standards for securities market transactions and oversight of compliance with them;
- oversight of compliance with antimonopoly legislation in the securities market;
- oversight of pricing system in the securities market;
- supervision of the activities of securities issuance and circulation service providers;
- other measures related to state regulation and control oversight of securities issuance and circulation.

Article 4. Professional Activity in the Securities Market

The following types of professional activities may be carried out in the securities market:

- **securities trading** - concluding civil-and-legal agreements regarding securities which stipulate payment for securities against their delivery to a new owner on the basis of agency or commission agreements either on account of clients (broker activities) or on its own behalf and on its own account with the purpose of re-selling the securities to third parties (dealer activities), unless otherwise specified by the legislation;
- **depository activities** - activities which render services with regard to securities safekeeping and/or maintenance of the securities ownership rights records, as well as servicing the securities transactions;
- **clearing-settlement activities** - determination of mutual commitments with regard to the securities transactions and settlements;
- **securities management** - activity entailing management of securities transferred to a person for execution by him of operations with them, for remuneration and on the basis of a relevant agreement with the owner, pursuant to a specified terms and in the owner's interest or in the interest of a third party indicated by the owner;
- **maintenance of a registry of registered securities owners** - collecting, registration, processing, safekeeping and submitting data which comprises the system of registry of registered securities owners regarding registered securities, their issuers and owners;
- **organization of trading in the securities market** - rendering services which directly facilitate conclusion of civil-and-legal agreements in securities on the stock exchange and over-the-counter market.

Professional activity in the securities market, including intermediary activities in connection with issuance and circulation of securities, shall be carried out by legal entities and physical persons exclusively on the basis of special permission (licenses) granted pursuant to procedures promulgated in accordance with the effective legislation.

While carrying out professional activities in the securities market, the entities shall comply with mandatory standards, established in accordance with this Law and other legislative and normative acts of Ukraine, concerning adequate amount of their equity capital, as well as other indicators and requirements that limit the securities transactions risks.

Article 4^1. Rating agencies and rating assessment

Rating, which shall be mandatory under the law, may be assessed by an authorized rating agency and/or an international rating agency (jointly, the rating agencies) only. International rating agencies shall be authorized by the State Commission for Securities and Stock Market thereto.

The agency shall acquire the right to assess rating on the date when such agency is issued a certificate of registration in the State Register of Authorized Rating Agencies.

The agency shall be registered in the State Register of Authorized Rating Agencies on a competitive basis (hereinafter, the competition).

More than one agency may win the competition.

The international rating agency shall acquire the right to provide rating assessments on the date when such international rating agency is entered into the list of rating agencies authorized by the State Commission for Securities and Stock Market.

The authorized rating agency shall use the National Scale for the purposes of rating assessment being mandatory under the law.

The National Scale shall comprise two groups of levels: the investment level and speculative level.

The National Scale along with the scale groupings by levels shall be approved by the Cabinet of Ministers of Ukraine.

An international rating agency shall use such scale as approved by such agency for the rating purposes.

The law shall list the events of compulsory rating of issuers and securities.

The following issuers shall be subject to compulsory rating assessment:

1) enterprises with a state share in the authorized capital;

2) enterprises which are strategically important for the national economy and security;

3) enterprises enjoying monopolistic (dominant) position.

The compulsory nature of the rating assessment shall not depend on the ownership pattern, legal accountability or any other features of the issuer.

Unless otherwise provided for by the law, rating shall be assessed for any type of equity securities which are not distributed among founders or pre-defined holders and may be distributed by subscription, or purchased or sold on the stock market or any other formal market except for:

1) public securities;

2) shares;

3) securities of non-diversified co-investment institutions;

4) securities issued by the State Mortgage Lending Agency.

The compulsory nature of securities rating assessment shall not depend on the issuer, type of issue, method of placing or any other properties";

3) shall be added with Paragraphs 31 – 37 in Article 7, Part Two as follows:

"31) shall issue the Certificate of Registration in the State Register of Authorized Rating Agencies to authorized rating agencies;

32) shall define the list of international rating agencies authorized to make mandatory rating assessments for issuers and securities;

33) shall define the record-keeping procedure for and shall keep the State Register of Authorized Rating Agencies;

34) shall prescribe rating assessment rules for authorized rating agencies based on the National Scale;

35) shall establish the procedure of submitting information by the rating agency to the State Commission for Securities and Stock Market;

36) shall define whether rating levels applied by the international rating agency comply with those of the National Scale;

37) summarize experience and practice of rating agencies and ensure rating publicity";

4) shall be added with Paragraphs 27 – 29 in Article 8 as follows:

27) shall determine marginal rates applicable to services rendered by rating agencies to be paid through the national and local budgetary funds;

28) shall audit financial and business operations of an authorized rating agency either independently or in cooperation with any other competent authority;

29) shall take any legal measure of influence including termination of registration of an authorized rating agency in the State Register of Authorized Rating Agencies, cancel the Certificate of Registration in the State Register of Authorized Rating Agencies, withdraw an international rating agency from the list of authorized agencies".
(**Article 4^1** has been added according to the LAW OF UKRAINE # 3201 "On Amending Certain Legislative Acts of Ukraine" from 15/12/2005).

Article 5. Bodies Exercising State Control over the Securities Market

The Securities and Stock Market State Commission shall be responsible for state regulation of the securities market. Other governmental bodies shall be responsible for oversight of the securities market within their jurisdiction, as stipulated by the effective legislation.
A Coordination Council shall be established to coordinate state bodies' activities related to the securities market.
The heads of the state bodies which, within their jurisdiction, regulate or manage functions related to the stock market and investment activities in Ukraine shall comprise the Coordination Council. The Chairman of the Securities and Stock Market State Commission shall head the Coordination Council. The Chairman of the Securities and Stock Market State Commission shall submit information on the Council's composition and a regulation on the Coordination Council to the President of Ukraine for approval.

Article 6. The Securities and Stock Market State Commission

The Securities and Stock Market State Commission shall be a state body subordinated to the President of Ukraine that reports to the Verkhovna Rada of Ukraine. The corresponding structure shall include the Securities and Stock Market State Commission, its central body, and its regional offices.

The Securities and Stock Market State Commission of Ukraine shall consist of the Chairman of the Commission, and six Commissioners.
The Chairman of the Commission and its members are appointed and dismissed by the President of Ukraine upon consent of the Verkhovna Rada.
The Chairman of the Securities and Stock Market State Commission and its members shall be entitled to represent the Commission in Court or Arbitration Court without special authorization.
The term of a Commissioner in office shall be seven years. No one may be a Commissioner for more than two terms in succession.
Termination of the tenure of the Commission Chairman and the Commissioners shall occur only at their request, or if they commit a crime or fail to carry out their responsibilities for health reasons.
Meetings shall be the main form of Commission operation. The meetings shall be called by the Chairman when necessary, but not less than once a month.
A meeting of the Commission shall be deemed authorized if at least five persons are present at the meeting.
Commission decision shall be approved by no less than five affirmative votes.
Regulation on the Securities and Stock Market State Commission shall be submitted to the President of Ukraine for approval. The regional offices shall operate on the basis of regulations approved by the

Commission, and coordinate their activities with the local state administrations and self-governing bodies.
The Securities and Stock Market State Commission shall develop and approve, on issues which are within its jurisdiction, legislative acts which are mandatory for central and local bodies of the state executive power, local self-governing bodies of Ukraine, the securities market participants, and their associations, and shall exercise oversight of implementation of this legislation.
The Consultative-Expert Council, as well as other organs and institutions, shall be established under auspices of the Securities and Stock Market State Commission.
The Consultative-Expert Council shall generate policy recommendations for the securities market and take part in drafting and discussing legislative acts elaborated and considered by the Commission.
The composition of the Consultative-Expert Council and the corresponding regulation shall be submitted to the Securities and Stock Market State Commission for approval.
Any suits (applications), related to violations of Ukrainian securities legislation, shall be addressed by the SSMSC to the General Courts and Arbitration Courts.

Article 7. Objectives of the Securities and Stock Market State Commission

The main objectives of the Securities and Stock Market State Commission shall be:

1) to formulate and ensure implementation of a unified state policy for development and operation of the securities and derivatives market in Ukraine, and encourage adaptation of the domestic securities market to international standards;
2) to coordinate state bodies' activities with regard to the securities market and derivatives market in Ukraine;
3) to execute state regulation of issuance and circulation of securities and their derivatives in Ukraine as well as compliance with legislation in this sphere;
4) to advocate investors' rights by implementing measures to prevent and eliminate infringements of legislation in the securities market, and to impose sanctions for violations of legislation within its jurisdiction;
5) to foster development of the securities market;
6) to generalize application of Ukrainian legislation to the issuance and circulation of securities in Ukraine, and to draft proposals on amendments to it.

The Securities and Stock Market State Commission, in accordance with its objectives, shall:

1) establish requirements for issuance (emission) and circulation of securities and their derivatives, requirements for prospectuses and information on placement, including the requirements for foreign issuers (taking into account requirements of Ukrainian currency legislation) that issue and place their securities in Ukraine, as well as develop a procedure for registration of securities issuance and their issue prospectuses;
2) with consent of the National Bank of Ukraine, set additional requirements concerning securities issued by commercial banks;
3) set standards for securities issuance, prospectuses for securities offered for open sale, including those of foreign issuers that issue their securities in Ukraine, and establish a procedure for registration of the securities issuance and information on their issuance;
4) grant permissions for circulation abroad of Ukrainian issuers' securities;
5) register securities issuance and prospectuses, including securities of foreign issuers that circulate in Ukraine;
6) set requirements with regard to access of foreign issuers' securities to the Ukrainian securities market and subsequent circulation of their securities there;
7) register rules for operation of organized securities markets;
8) set requirements and conditions for open sale (placement) of securities in Ukraine;
9) establish a procedure and grant permission for activities regarding issuance and circulation of securities, depository, registrar, clearing and settlement operations in securities, as well as grant other special permission (licenses) stipulated by the legislation to carry out separate kinds of

professional activities in the securities market; revoke this permissions (licenses) if violations the securities legislation occur;

10) establish reporting procedures for securities market participants pursuant to existing Ukrainian legislation;
11) with the consent with the National Bank of Ukraine, establish specific provisions for obtaining permission for depository clearing and settlement activities by commercial banks;
12) with the consent of the Ministry of Finance of Ukraine, and of the National Bank of Ukraine with respect to banks' activities in the securities market, develop specific provisions for keeping records of securities transactions;
13) establish procedures for registration and register stock exchanges and over-the-counter information and trading systems; and appoint state representatives to stock exchanges, depositories, and information and trading systems;
14) establish procedures for registration and register self-regulatory organizations established by persons engaged in professional activities;
15) establish requirements and standards with respect to mandatory information disclosure by the issuers and persons engaged in the professional securities market activities, ensure development of a data base for the securities market pursuant to existing legislation;
16) take part in drafting and submit, according to established procedures, drafts of legislative acts that regulate matters related to securities market development in Ukraine; take part in drafting relevant international agreements; and cooperate with state bodies and non-governmental organizations of foreign countries and international organizations on issues that fall under its jurisdiction;
17) coordinate training of stock market specialists, grant permissions, set qualification requirements for securities market professionals, and certify specialists;
18) elaborate and implement measures aimed at prevention of violations of Ukrainian securities legislation;
19) organize research on issues related to Ukrainian stock market operations;
20) inform the general public of its activities and of progress with respect to securities market development;
21) establish procedures for carrying out professional activities in the securities market by foreign legal entities and enterprises with foreign investments;
22) grant permissions, establish standards and rules for activities, and register issuance and issue prospectuses of investment funds' and investment companies' investment certificates;
23) define procedures for effective securities legislation enforcement.

While executing the tasks entrusted to it, the Commission shall cooperate with other central bodies of the state executive power, the Autonomous Republic of the Crimea, and regional and local executive authorities and regional and local legislative authorities.

Article 8. Powers of Securities and Stock Market State Commission

The Securities and Stock Market State Commission shall be entitled to:

1) classify securities into categories specified by the existing legislation;
2) establish mandatory standards for sufficiency of an entity's operating capital and other indicators and requirements that reduce risks of securities transactions in the sphere of activities on securities issue and circulation, as well as other professional activities in the securities market (except for banking operations);
3) set fees, with the consent of the Cabinet of Ministers of Ukraine, for granting special permissions (licenses), registering documents, providing with the information requested by legal and physical entities and transferring the derived funds to the state budget;
4) establish restrictions on combining professional activities in the securities market;
5) issue warnings, suspend (for a term up to one year) placement (sale) and circulation of securities of an issuer, grant permissions (licenses) of the Securities and Stock Market State Commission, and void such permissions (licenses) if the securities legislation or normative acts of the Securities and Stock Market State Commission are violated;
6) terminate all operations in the bank accounts of the corresponding legal entity until the Court passes a decision on imposition of a fine (except for payment of state court fees for appeals and

complaints lodged in the Court), should signs of infringements (in the form of issuing or placing securities without due registration under existing legislation, or activities in the securities market without special permission (license)) be revealed;

7) terminate trading at a stock exchange until violations are eliminated if a stock exchange violate securities legislation, or its statute and the corresponding rules;
8) review the reliability of information released by issuers and securities market professionals as well as its conformity with the established standards;
9) conduct, independently or jointly with other appropriate agencies, inspections and spot checks of business operations of issuers and securities market professionals, stock exchanges, and self-regulatory organizations;
10) issue mandatory orders on elimination of violations of securities legislation to issuers and professionals, stock exchanges, and self-regulatory organizations, as well as demand submission of necessary documents pursuant to existing legislation;
11) forward materials to law enforcement bodies with regard to violations that entail administrative and criminal liabilities which do not fall under the SSMSC's jurisdiction;
12) forward materials to the Antimonopoly Committee of Ukraine, should violations of the antimonopoly legislation be found;
13) elaborate and approve obligatory normative acts with respect to issues within its jurisdiction;
14) impose administrative reprimands, fines and other sanctions for infringement of existing legislation on legal entities and their employees including revocations of professional activities in the securities market;
15) in order to protect the interests of investors and individuals - raise matters concerning dismissal of Heads of stock exchanges, and other institutions of stock market infrastructure, should they fail to comply with existing Ukrainian legislation;
16) appoint temporarily (for a term up to two months) heads of stock exchanges, depositories, terminate or suspend trading in securities on any stock exchanges, terminate clearing and buy-sell transactions for a certain term in order to protect interests of citizens and the Sate;
17) regulate, jointly with other executive agencies, printing facilities for securities;
18) monitor the flow of investments realized through the stock market in Ukraine and abroad;
19) elaborate and implement models of stock market infrastructure;
20) certify software and establish requirements for software used in the securities market;
21) while conducting inspections, confiscate (for a term of up to three days) documents confirming violations of securities legislation.

Article 9. Authorized Persons of the Securities and Stock Market State Commission

The following shall be authorized persons of the Securities and Stock Market State Commission:

- the Chairman of the Securities and Stock Market State Commission and the commissioners;
- heads of the regional representative offices of the Securities and Stock State Market Commission;
- officers of the central office by written order of the Chairman or Commissioner;
- officers of the regional representative offices of the Securities and Stock Market State Commission - by written order of the Head of the regional office.

Authorized persons of the Securities and Stock Market State Commission shall have the right to:

- have free access to enterprises, institutions, and organizations as well as materials necessary for inspection on the grounds of his/her office identification card;
- require for inspection all necessary documents and other information related to exercising of his/her authorities;
- engage (under agreement with the relevant central and local bodies of state executive power, local power and self-governance, enterprises and associations) their employees, deputies of local Councils of People Deputies, upon their consent, in carrying out inspections and spot checks;
- in accordance with distributed duties or written assignment, to examine, within its jurisdiction, violations of the effective legislation concerning the issuance and circulation of the securities, including the cases related to the infringements of standards, norms, and rules established by the

Securities and Stock Market State Commission's normative acts; and to raise questions with the Ukrainian public prosecution bodies and the Ministry of Internal Affairs related to investigations or other measures in conformity with existing legislation.

Should approval of the Securities and Stock Market State Commission not be granted, its authorized persons shall not be permitted to become members of commissions, committees, and other bodies formed by central and local state executive bodies or by bodies of local self-governance.

Article 10. Relations between the Securities and Stock Market State Commission and Law Enforcement Bodies and Other Bodies of State Executive Power

Officers of law enforcement agencies shall assist authorized persons of the Securities and Stock Market State Commission in carrying out their official duties. Upon request of Securities and Stock Market State Commission officials, law enforcement agencies shall provide them with available information necessary for effective oversight of the securities market.

The law enforcement agencies may refuse to submit relevant information, if disclosure would affect criminal investigation or legitimate executive searching operations.

Should the officials of the Securities and Stock Market State Commission be obstructed from carrying out their inspections pursuant to this Law, law enforcement agencies shall, on the request of officials of the Securities and Stock Market State Commission's, take immediate measures to carry out a compulsory inspection.

The privatization agencies shall forward to the Securities and Stock Market State Commission all necessary documents about objects of state property being privatized, if, during privatization of these objects, the securities are to be issued in line with existing legislation.

Pursuant to the existing legislative requirements, the state executive bodies shall forward to the Securities and Stock Market State Commission the necessary documents and information on issues that are within its jurisdiction.

Article 11. Responsibility of the Legal Entities for Violations of Legislation in the Securities Market

The Securities and Stock Market State Commission may impose the following fines on legal entities:

- should issued and placed securities be unregistered pursuant to existing legislation, fine shall be up to 10,000 subsistence tax-free incomes, or 150 per cent of the profit (revenue) derived as a result of those actions;
- should the securities market activity be performed without special permission (license) as stipulated in the existing legislation, the fine shall be up to 5,000 citizens' subsistence tax-free incomes;
- should failure to submit information, delayed submission, or submission of misleading information take place, the fine shall total up to 1,000 of citizens' subsistence tax-free incomes;
- should evasion from compliance or delayed compliance with orders, resolutions or removal of violations concerning securities take place, the fine shall total up to 500 of citizens' subsistence tax-free incomes.

A decision of the Securities and Stock Market State Commission's to impose fines may be appealed in Court.

Fines imposed by the Securities and Stock Market State Commission shall be exacted pursuant to judicial procedures. (Clause 3, Article 11 in the wording of the Law # 642/79-VR dated 11.18.97)

The Securities and Stock Market State Commission shall inform the National Bank of Ukraine when it imposes fines on commercial banks within three days.

Article 12. Procedure for Imposing Fines for Violation of Legislation in the Securities Market by the Legal Entities

Fines stipulated in Article 11 of this Law shall be imposed by the Chairman of the Securities and Stock Market State Commission, Commissioners, or by the Head of the relevant regional office upon consideration of materials revealing the violation.

A formal document indicating the violation stipulated by Article 11 shall be generated by the Securities and Stock Market State Commission's official who uncovered the violation. This formal document, jointly with an explanation by the manager, or other responsible official, and relevant documents, shall be forwarded within three days to an official who is authorized to impose fines.

Should withdrawal of documents evidencing the violation take place while the Securities and Stock Market State Commission's official conducts the inspection, copies of these documents and a copy of the withdrawal protocol shall be attached to the violation protocol.

A three-day withdrawal of documents evidencing a violation may be conducted with a mandatory generation of a protocol containing the date of its execution, the full name and position of the official who is executing the withdrawal, as well as the complete list of the withdrawn documents and the day the documents should be returned , in accordance with this Law. This protocol shall be signed by the official who executed the withdrawal. Upon completion of the inspection and documents withdrawal, a copy of the withdrawal protocol shall be forwarded to representative of the legal entity whose documents were withdrawn.

A Securities and Stock Market State Commission's official shall make a decision on imposition of a fine within 10 days after the documents specified in the second part of this article received.

A resolution on imposition of the a fine may be appealed to the Arbitration Court. Moreover, an appeal to Arbitration Court within a 10-day period after receiving the resolution, shall suspend levying of the fine until the case is resolved by the Arbitration Court.

Article 13. Responsibility for Administrative Violations Related to the Securities Market Activities

Should issuance or placement of securities which were not registered in accordance with the existing legislation take place, the fine imposed on individuals or officials shall be 50 to 100 of citizens' subsistence tax-free incomes.

Should securities market activity take place without special permission (a license) pursuant to the existing legislation, the fine imposed on the individuals or officials shall be 20 to 50 subsistence tax-free incomes.

Should a failure to submit information, delayed submission, or submission of misleading information to the Securities and Stock Market State Commission take place, when submission of the requested information is stipulated by existing legislation, the fine imposed on the individuals or officials shall be 50 to 100 of citizens' subsistence tax-free incomes.

Should evasion from compliance, or delayed compliance with orders of the Securities and Stock Market State Commission, or delayed compliance with them take place, the fine imposed on the individuals or officials shall total 20 to 50 of citizens' subsistence tax-free incomes.

Should these violations be found, a protocol shall be drawn up by the officials of the Securities and Stock State Market Commission.

The administrative sanctions for violations stipulated by Clauses 1-4 of this article shall be imposed by the Securities and Stock Market State Commission or its regional offices. The Chairman of the Commission, Commissioners, or head of the relevant regional body of the Commission shall be authorized, on behalf of the aforementioned bodies, to consider cases on administrative violations and impose sanctions.

The procedures for administrative violation cases stipulated by clauses 1-4 of this Article shall be in accordance with the Code of Ukraine on Administrative Violations.

Article 14. Criminal and Property Liability for Violation of Securities Legislation

Officials who fail to comply with securities legislation shall bear criminal and property liability, as stipulated by relevant Ukrainian legislation.

Article 15. Responsibilities of the Securities and Stock Market State Commission and its Officials

Securities and Stock Market State Commission officials shall bear responsibility, as established by Ukrainian legislation, for improperly performing out their office duties, or for failure to perform them.

Losses inflicted on securities market participants through the improper actions of the Securities and Stock Market State Commission while exercising its regulatory and educational powers, shall be redressed in full by the State pursuant to the existing legislation.

Article 16. Procedure for Settling of Disputes

Disputes arising in the process of application of this Law shall be settled according to established procedures by the General Courts or by the Arbitration Courts.

Article 17. Self-Regulatory Organization Authorities with Respect to Oversight and Regulating of Securities Market

Self-regulatory organizations (SRO) shall acquire SRO status and the status of a legal entity once they have been registered with the Securities and Stock Market State Commission.

The procedure and terms for registration and cancellation of registration shall be established by the Securities and Stock Market State Commission.

The Securities and Stock Market State Commission shall establish a sample of certificate and grant certificate on an association's registration as a self-regulatory organization.

Pursuant to existing legislation, self-regulatory organizations shall establish for their members standard requirements related to securities market operations, qualification requirements for experts, as well as execute control over their members' compliance with these rules, standards, and securities legislation requirements.

The Securities and Stock Market State Commission and other state bodies that regulate stock market activity may delegate the following powers to the self-regulatory organizations:

- elaboration and implementation of rules, standards, and requirements for the stock market operations;
- certification of stock market specialists;
- granting of permission (licenses) to the stock market professional participants;
- collection, processing, and analysis of the statistical information on the professional the stock market activity.

The Securities and Stock Market State Commission may establish other requirements and delegate other powers to self-regulatory organizations as long as they do not contradict the existing legislation.

Article 18. Funding, Material and Technical Support for the Securities and Stock Market State Commission

Funding shall be provided from the State budget of Ukraine for the Securities and Stock Market State Commission, its regional representative offices, and other bodies established by the State Securities and Stock Market Commission in accordance with its aims and objectives.

The President of Ukraine L. Kuchma
Kyiv, October 30, 1996
448/96-VR

Law 3480-IV

Not an Official Translation
Consult the original text before relying on this translation.

LAW OF UKRAINE
On Securities and the Stock Market

This Law shall regulate the relations that arise during placement and circulation of securities and conduct of professional activities in the stock market, in order to ensure transparency and effectiveness of the stock market functioning.

This Law stipulates definitions and forms of business associations, the regulations governing their establishment and activities and the rights and obligations of their members and founders.

SECTION I. GENERAL PRINCIPLES

Article 1. Definition of Terms

1. Terms shall be used in the Law in the following meaning:

securities issue – a set of issuable securities of a certain kind of the same issuer, same nominal value, same form of issue and same international identification number that grant to their owners same rights, regardless of the time of purchasing and placement in the stock market;

delisting – a procedure of excluding securities from the register of a trade organizer for failure to meet the trade organizer rules, followed by termination of trading on the trade organizer or moving them to the category of securities admitted for trading without including them into the trade organizer's register;

issuance – a law-established sequence of the issuer's actions with regard to issue and placement of issuable securities;

endorsement – the signature on an order security that certifies the transfer of rights under the security to another person/entity;

endorser – an individual or legal entity which is the owner of the security and which endorses;

quoting – a mechanism of determining and/or fixing the market value of a security;

listing – a set of procedures to include securities into a trade organizer register and to ensure the securities and the issuer meeting the terms and requirements set forth in the trade organizer rules;

international identification number of securities – a number (code) permitting to identify securities or other financial instruments, which assignment is envisaged by Ukrainian laws;

securities circulation – execution of transactions relating to transfer of ownership rights to securities and rights under securities, except for agreements concluded at the time of securities placement;

primary owner – a person/entity which obtained ownership of securities directly from the issuer (or the person/entity which issued the securities) or the underwriter during placement of securities;

securities prospectus – a document that contains information on open (public) securities placement;

securities placement – alienation of securities by the issuer or the underwriter by way of conclusion of a civil and legal agreement with a primary owner;

financial instruments – securities, futures contracts, cash instruments, forward contracts, interest rate swaps, currency swaps or index swaps, options that grant the right to purchase or sell any of the above financial instruments, including cash instruments (currency options and interest rate options).

Article 2. Stock Market

1. Stock market (securities market) shall be a totality of stock market participants and their legal relations with regard to the placement, transference and record keeping of securities and derivatives.

2. Stock market participants shall be issuers, investors, self-regulatory organizations and professional stock market participants.

An issuer shall be a legal entity, the Autonomous Republic of Crimea or municipalities, as well as the State in the person of GOU-authorized bodies of State power that, on its behalf, places issuable securities and undertakes obligations thereunder to their owners.

Investors in securities shall be physical persons and legal entities, resident and non-resident, which have acquired ownership rights to securities for the purpose of getting a return on the invested funds and/or on the acquired rights assigned to securities' owners under legislation. Institutional investors shall be collective investment institutions (unit and corporate investment funds), investment funds, mutual funds of investment companies, non-State pension funds, insurance companies, and other financial institutions that perform transactions with financial assets in the interest of third parties at own cost or at the cost of said persons, and, in cases envisaged by legislation, at the cost of financial assets of other persons for the purpose of making a return or preserving the real value of said financial assets.

A self-regulatory organization of professional stock market participants shall be a non-for-profit association of professional stock market participants engaged in professional activities on the stock market insecurities trading, asset management of institutional investor assets, depositary activities (registrar and custodian activities), created according to the criteria and requirements set by Securities and Stock Market State Commission and approved by the Antimonopoly Committee of Ukraine.

Professional stock market participants shall be legal entities that, on the basis of licenses issued by Securities and Stock Market State Commission, carry out professional stock market activities, whose types are defined by this Law.

3. The stock market shall be divided into primary and secondary market.

The primary market of securities shall be a totality of legal relations related to securities placement.

The secondary market of securities shall be a totality of legal relations related to the circulation of securities.

Article 3. Securities and Their Classification

1. Securities shall be documents of the established form with relevant requisites that testify to the money and other property rights, determine interrelationships between the entity that has placed (issued) them and the owner and envisage carrying out obligations under the terms of their placement, and to the possibility of transfer to other persons of rights following from said documents.

2. According to the terms of placement (issue), securities shall be divided into issuable and non-issuable securities.

Issuable securities shall be securities that testify to equal rights of their owners within one issue with regard the person that undertakes respective obligations (issuer).

Issuable securities shall include:

- shares;
- corporate bonds;
- municipal bonds;
- government bonds of Ukraine;
- mortgage certificates;
- mortgage bonds;
- certificates of Funds of Real Estate Operations (hereinafter, FREO certificates);
- investment certificates; and
- treasury bills of Ukraine.

Securities that do not fall under the definition of issuable securities under this Law may be recognized as such by Securities and Stock Market State Commission if this does not conflict with special laws on these groups and/or types of securities.

3. By the form of existence securities shall fall into documentary and non-documentary.

4. According to the form of issue securities may be bearer, registered or order.

Rights certified by a security shall belong to the following:

- bearer of the security (bearer security);
- person indicated in the security (registered security); or
- person indicated in the security, which can independently exercise these rights or appoint by its instruction (order) another authorized person (order security).

5. In Ukraine the following groups of securities shall be in civil circulation:

1) Equity securities shall be securities, which testify to participation of their owners in the statutory capital (except for investment certificates) that entitle their owners to participate in the issuer governance and receive a portion of profit in the form of dividends, and a portion of property in case of the issuer's liquidation. The following securities shall refer to equity securities:

- shares;
- investment certificates

2) Debt securities shall be securities that testify to the relations of borrowing and envisage the issuer's obligation to pay funds at a definite time in accordance with the obligation. The following securities shall refer to debt securities:

- corporate bonds;
- government bonds of Ukraine;
- municipal bonds;
- treasury bills of Ukraine;

- savings (deposit) certificates;
- promissory notes

3) Mortgage securities shall be securities with a mortgage coverage (pool of mortgages), which testify to the right of their owners to receive from the issuer their due funds. The following securities shall refer to mortgage securities:

- mortgage bonds;
- mortgage certificates;
- mortgage letters (zastavni);
- FREO certificates.

4) Privatization securities shall be securities, which testify to the right of their owners to obtain free of charge a share of state enterprises, state housing stock and land resources in the process of privatization.

5) Derivatives shall be securities, whose framework of issue and circulation is linked with the right to purchase or sell securities, other financial and/or commodity resources within the term established by an agreement.

6) Securities of title to goods shall be securities, which entitle their holder to dispose of goods specified in these documents.

Article 4. Transfer of Rights under Securities

1. All rights certified by a security shall transfer to the person who acquired ownership of the security.

A restriction on circulation of and/or exercise of rights under securities may be set forth only in cases and according to the procedure envisaged by law.

2. In order to transfer to another person the rights certified by a bearer security, it shall be enough to hand the security over to this person.

3. Rights certified by a registered security shall be transferred according to the procedure established by the laws of Ukraine.

4. Rights certified with an order security shall be transferred by way of endorsement. The endorser shall be responsible for the availability and exercise of this right.

Under an endorsement, all rights certified with a security shall transfer to the person to whom these rights are transferred (endorsee). The endorsement may be in the blank form (without indicating the person with regard to whom obligations shall be performed) or in the order form (with the indication of such a person).

5. Specific features of record keeping and transfer of ownership rights to securities shall be established by the legislation.

Article 5. Performance of Obligations under a Security

1. A person, who placed (issued) a security, and persons, who endorsed it, shall bear joint liability to its lawful owner. Should a claim be satisfied of the lawful owner of an order security with regard to performance of an obligation certified by this security by one or several persons of those who have such obligations, persons who endorsed this security shall acquire the right of recourse with regard to other persons, who have obligations under the security.

2. Refusal to perform obligations certified by a security for lack of grounds for the obligation or for its invalidity shall be prohibited.

SECTION II . TYPES OF SECURITIES

Article 6. Shares

1. A share shall be a registered security that certifies property rights of its owner (shareholder) that relate to the joint stock company, including the right to receive a portion of profit of the joint stock company in the form of dividends and the right to receive a portion of property of the joint stock company in case of its liquidation, the right to manage the joint stock company as well as non-property rights envisaged by the Civil Code of Ukraine and the law that regulates establishment, operation and termination of joint stock companies.

2. An issuer of shares shall be only a joint stock company. The procedure for making a decision by the relevant body of the joint stock company with regard to placement of shares shall be established by the law that regulates establishment, operation and termination of joint stock companies.

3. A share shall have a nominal value set in the national currency. Minimal nominal value of a share may not be less than one kopeck.

4. A joint stock company shall place only registered shares.

A share certificate shall indicate the security type, the name and location of the joint stock company, the series and number of the certificate, the number and date of issue, the international identification number of the security, the type and nominal value of the share, the name of the owner, the number of shares issued.

5. A joint stock company shall place shares of two types — common and preferred.

6. Common shares shall grant to their owners the right to receive a portion of the joint stock company's profit in the form of dividends, to participate in management of the joint stock company, to receive a portion of property of the joint stock company in case of its liquidation and other rights as envisaged by the law that regulates establishment, operation and termination of joint stock companies. Common shares shall grant equal rights to their owners.

Common shares shall not be convertible into preferred shares or other securities of a joint stock company.

7. Preferred shares shall grant to their owners preemptive rights versus owners of common shares to receive a portion of the joint stock company's profit in the form of dividends and to receive a portion of property of the joint stock company in case of its liquidation as well as the right to participate in governance of the joint stock company in cases envisaged by the charter and the law that regulates establishment, operation and termination of joint stock companies.

8. A joint stock company shall place preferred shares of different classes (with a different scope of rights) if envisaged by its charter. In this case, terms of their placement shall define the succession of receiving dividends and payments from property of the liquidated company per each class of preferred shares placed by the joint stock company and shall be set forth in the company's charter. Depending on the terms of placement, preferred shares of certain classes may be convertible into common shares or preferred shares of other classes.

The percentage of preferred shares in the statutory capital of a joint stock company may not exceed 25%.

9. Registration of a share issue shall be conducted by the Securities and Stock Market State Commission according to the procedure set by the Commission. Shares circulation shall be allowed

after registration of a report on the results of shares placement and issue of a registration certificate of shares issue by the Securities and Stock Market State Commission.

10. Specifics of issuance, circulation and redemption of corporate investment fund's shares shall be defined by legislation.

Article 7. Bonds

1. A bond shall be a security that certifies a contribution of cash by its owner, determines the relations of borrowing between the bondholder and the issuer, confirms the issuer's obligation to return to the bondholder the nominal value of the bond, within the period envisaged by the terms of placement, and to pay return on the bond, unless otherwise envisaged by the terms of placement.

2. Bonds shall be placed in a documentary or non-documentary form.

3. An issuer may place according to the procedure established by Securities and Stock Market State Commission interest bearing, special purpose and discount bonds.

Interest bearing bonds shall be bonds that provide for payment of interest income.

Special purpose bonds shall be bonds, obligations under which may be met with goods and/or services in compliance with the requirements established by the terms of placement of such obligations.

Discount bonds shall be bonds that are placed at a price that is lower than their nominal value. The difference between the purchase price and the nominal value of a bond shall be payable to the bondholder at bond repayment and shall represent return (discount) on the bond.

4. Bonds may be placed with a fixed maturity, same for the whole issue. Early redemption of bonds on the request of their holders shall be permitted if this is envisaged by the terms of bond placement that determine the procedure of setting the price of the early redemption and the time period within which bonds may be presented for early redemption.

5. Bonds may be redeemed by cash or property, depending on the terms of the bond placement.

6. A bond shall have a nominal value, set in the national currency and, if envisaged by the terms of the bond placement, in foreign currency. Minimal nominal value of a bond may not be less than one kopeck.

7. The issuer may place registered bonds and bearer bonds. Bonds circulation shall be allowed after registration by Securities and Stock Market State Commission of a report about results of bonds placement and issuance of a registration certificate of bonds issue.

8. A bond certificate shall indicate the security type, the name and location of the issuer, the international identification number of the security, the nominal value of the bond, the total amount of the issue, the maturity, the amount and terms of interest payment (for interest bearing bonds), the date when the decision on bond placement was made, the series and number of the bond certificate, the signature of the issuer's manager or other authorized person, certified with the issuer's stamp.

Additional features of bond certificate may be established by Securities and Stock Market State Commission.

A registered bond certificate shall indicate the name of the holder.

A coupon (coupon sheet) shall be attached to a certificate of bearer interest bearing bonds. The coupon (coupon sheet) shall indicate the series and number of the certificate of the bond on which interest is payable, the name and location of the issuer, and the period of interest payment. A series number shall be indicated on each coupon (coupon sheet).

9. Bonds shall be sold for national currency and, if envisaged by the law and the terms of placement, for foreign currency.

Article 8. Corporate Bonds

1. Corporate bonds shall be placed by legal entities only after their statutory capital has been paid in full.

Corporate bonds shall confirm the issuer's obligations thereunder and shall not grant the right to participate in governance of the issuer.

2. Corporate bonds shall not be placed for the purpose of formation and replenishment of the issuing company statutory capital and to cover the operating losses by recording proceeds from sale of bonds as a result of current business activities.

3. A legal entity shall have the right to place bonds for the amount that does not exceed the amount of three-fold equity capital or the amount of the guarantee that is provided to it by third parties for this purpose.

4. The placement terms of bonds that are placed by a joint-stock company may provide for their conversion into shares of joint stock company (convertible bonds).

5. A decision on corporate bonds placement shall be made by the relevant management body of the issuer in accordance with the provisions of the laws that regulate the procedure of establishment, operation and termination of legal entities of a relevant organizational and legal form.

6. Registration of a corporate bond issue shall be conducted by Securities and Stock Market State Commission according to the procedure set by the Commission.

Article 9. Municipal Bonds

1. Municipal bonds shall include internal and external municipal bonds.

A decision on placement of municipal bonds shall be made by the Verkhovna Rada of the Autonomous Republic of Crimea or a municipal council, in accordance with the requirements set by the budget legislation.

2. Registration of an issue of municipal bonds shall be conducted by Securities and Stock Market State Commission according to the procedure set by it.

3. Specific features of repayment of and exercise of rights under municipal bonds shall be defined in the terms of placement thereof.

Article 10. Government Bonds of Ukraine

1. Government bonds of Ukraine may be:

- long-term – over 5 years;
- medium-term – from 1 to 5 years; and
- short-term – up to 1 year.

2. Government bonds of Ukraine shall be divided into bonds of internal government borrowings of Ukraine, bonds of external government borrowings of Ukraine and special-purpose bonds of internal government borrowings of Ukraine.

3. Bonds of internal government borrowings of Ukraine shall be government securities that are placed solely in the internal stock market and certify Ukraine's obligations to repay to the holders of these bonds the nominal value thereof and income, according to the terms of bond placement.

4. Special-purpose bonds of internal government borrowings of Ukraine shall be bonds of internal government borrowings, whose issuance is the source of financing the deficit of the government budget within the amount envisaged for this purpose by the Law "On the State Budget of Ukraine" for the relevant year and within the ultimate amount of government debt.

The major feature of special-purpose bonds of internal government borrowings of Ukraine shall be identification of the direction for the use of funds raised as a result of placement of such bonds, as envisaged by the Law "On the State Budget of Ukraine" for the relevant year.

Funds raised to the State Budget of Ukraine as a result of placement of special-purpose bonds of internal government borrowings of Ukraine shall be used solely to finance government or regional programs and projects on a pay-back basis within the scope envisaged by the Law "On the State Budget of Ukraine" for the relevant year. Financing shall be in compliance with the loan agreements concluded between the State, represented by the Ministry of Finance of Ukraine, and the recipient of funds. The terms of loan agreements shall correspond to the terms of issue of special-purpose bonds of internal government borrowings of Ukraine, with a mandatory indication of the date of servicing and repaying the loan as 5 days before the date of servicing and repaying special-purpose bonds of internal government borrowings of Ukraine.

5. Bonds of external government borrowings of Ukraine shall be government debt securities that are placed in the international stock markets and testify to Ukraine's obligations to repay to the holders of such bonds their nominal value and return, according to the terms of bond issue.

6. Issuance of government bonds of Ukraine shall be a part of the budgetary process and shall not be regulated by Securities and Stock Market State Commission.

7. Issuance of government bonds of Ukraine shall be regulated by the Law "On the State Budget of Ukraine" for the relevant year, which shall set the ultimate amounts of the government external and internal debt.

A decision to place bonds of external and internal government borrowings of Ukraine and the terms of issue thereof shall be made in accordance with the Budget Code of Ukraine.

Government bonds of Ukraine shall be placed in case of observance, at the end of the year, of the ultimate amounts of the government external and internal debt, as envisaged by the Verkhovna Rada of Ukraine in the Law "On the State Budget of Ukraine" for the relevant year.

8. The terms of placement and repayment of bonds of internal government borrowings of Ukraine and special-purpose bonds of internal government borrowings of Ukraine that are not envisaged by the terms of placement shall be set by the Ministry of Finance of Ukraine in accordance with the law.

9. The National Bank of Ukraine shall carry out operations on servicing the government debt in connection with placement of bonds of internal government borrowings and special-purpose bonds of internal government borrowings of Ukraine, repayment thereof and payment of return thereon as well as depository activities with regard thereto. The procedure of carrying out operations related to placement of these bonds shall be set by the National Bank of Ukraine with approval of the Ministry of Finance of Ukraine. Specific features of carrying out depository activities with regard to government bonds of Ukraine shall be set by Securities and Stock Market State Commission together with the National Bank of Ukraine.

10. Bonds of external government borrowings of Ukraine shall be placed, serviced and repaid by the Ministry of Finance of Ukraine, which may engage in this activity banks, investment companies, etc.

The relations between the Ministry of Finance of Ukraine and these organizations shall be regulated by relevant agreements.

11. Expenses on preparation for placement as well as placement and repayment of government bonds of Ukraine and payment of return thereon shall be covered in accordance with the terms of the government bonds of Ukraine placement at the cost of the funds envisaged in the State Budget of Ukraine for such purposes.

12. Government bonds of Ukraine may be registered or bearer.

Government bonds of Ukraine shall be placed in a documentary or non-documentary form.

13. Bonds of internal government borrowings shall be sold for national currency, and bonds of external government borrowings shall be sold for currency of their nomination.

14. Return shall be payable and government bonds of Ukraine shall be repaid in cash or with government bonds of Ukraine of other types, as agreed upon by the parties.

Article 11. Treasury Bills of Ukraine

1. A treasury bill of Ukraine shall be a government security that is placed solely on a voluntary basis among individuals, that testifies to the debt of the State Budget of Ukraine to the holder of the treasury bill of Ukraine, grants to the holders the right to receive cash income and is repayable according to the terms of placement of treasury bills of Ukraine.

The amount of issue of treasury bills of Ukraine together with the amount of issue of bonds of internal government borrowings of Ukraine may not exceed the ultimate amount of internal government debt and the amount of expenses associated with servicing of government debt, as determined by the Law “On the State Budget of Ukraine” for the relevant year.

Issuance of treasury bills of Ukraine shall be a part of the budgetary process and shall not be regulated by Securities and Stock Market State Commission.

Repayment of and payment of return on treasury bills of Ukraine shall be guaranteed with the revenue of the State Budget of Ukraine.

2. Treasury bills of Ukraine may be:

- long-term – over 5 years;
- medium-term – from 1 to 5 years; and
- short-term – up to 1 year.

3. The issuer of treasury bills of Ukraine shall be the State, represented by the Ministry of Finance of Ukraine by instruction of the Cabinet of Ministers of Ukraine.

4. Treasury bills of Ukraine may be registered and bearer.

Treasury bills of Ukraine shall be placed in a documentary or non-documentary form.

In case of placement of treasury bills of Ukraine in a documentary form, a certificate is issued.

A certificate of treasury bill of Ukraine shall indicate the security type, the name and location of the issuer, the amount of payment, the date of payment of cash return, the date of repayment, the venue of repayment, the date and venue of issue of the treasury bill of Ukraine, the series and number of the certificate of the treasury bill of Ukraine, the signature of the issuer’s managers or other authorized person, certified with the issuer’s stamp. A certificate of a registered treasury bill of Ukraine shall also indicate the holder’s name.

Specific features of repayment of and exercise of rights under treasury bills of Ukraine shall be determined by the terms of placement thereof.

5. Decisions on placement of treasury bills of Ukraine shall be made in accordance with the Budget Code of Ukraine. The decision shall identify the terms of placement and repayment of treasury bills of Ukraine.

6. The terms of placement of treasury bills of Ukraine may provide for repayment thereof by way of reducing liabilities of the holder of the treasury bill of Ukraine to the State Budget of Ukraine by the value of this bill.

7. The procedure for determining the sale price of treasury bills of Ukraine at the time of placement thereof shall be set by the Ministry of Finance of Ukraine.

8. Specific features of depository activities with treasury bills of Ukraine shall be determined by Securities and Stock Market State Commission together with the National Bank of Ukraine.

Article 12. Investment Certificates

1. An investment certificate shall be a security that is placed by an investment fund, an investment company, an asset management company of a unit investment fund and testifies to the investor's ownership right to a stake in an investment fund, a mutual fund of an investment company, and a unit investment fund.

2. An issuer of investment certificates shall be an investment fund, an investment company or an asset management company of a unit investment fund.

3. The number of declared investment certificates of a unit investment find shall be indicated in the securities prospectus.

The period of placement of investment certificates of an open-end and interval unit investment funds shall not be limited.

4. Investment certificates may grant to their holders the right to receive income in the form of dividends. Dividends on investment certificates of an open-end and interval unit investment funds shall not be accruable or payable.

5. Placement of derivative securities, whose underlying asset is the right to receive investment certificates, shall not be allowed.

6. Specific features of issuance, placement, circulation, record-keeping and redemption of investment certificates shall be determined by respective legislation.

Article 13. Savings (Deposit) Certificates

1. A savings (deposit) certificate shall be a security that certifies the amount of deposit with a bank and the rights of the depositor (certificate owner) to receive, after the end of a definite period, the deposited amount and interest, indicated in the certificate, from the issuer bank.

2. Savings (deposit) certificates shall be placed for a definite period (at interest envisaged by the terms of placement). Savings (deposit) certificates may be registered or bearer. Registered savings (deposit) certificates shall be placed in a non-documentary form and bearer ones – in a documentary form.

3. A savings (deposit) certificate in a documentary form shall indicate the security type, the name and location of the issuer bank, the series and number of the certificate, the date of issue, the deposited amount, the interest rate, the period of deposit, the signature of the bank's manager or other authorized person, certified with the bank's signature.

4. A savings (deposit) certificate shall be ceded by way of concluding an agreement between the person who cedes rights under the certificate and the person who obtains these rights.

5. Income on savings (deposit) certificates shall be payable at the time they are presented to the bank that placed these certificates.

In case of early presentation of a savings (deposit) certificate, the bank shall repay the deposited amount and interest (on deposit, at request), unless the terms of the certificate issue provide for other interest rate.

Article 14. Promissory Note

1. A promissory note shall be a security that testifies to an absolute pecuniary obligation of the maker or his order to a third party to pay, after the maturity, a definite amount to the owner of the promissory note (note holder).

2. Promissory notes may be common or transfer, and shall exist exceptionally in a documentary form.

3. Specific features of issuance and circulation of promissory notes, operations with promissory notes, repayment of obligations under promissory notes and enforce payment under promissory notes shall be determined by the law.

Article 15. Mortgage Securities, Privatization Securities, Derivative Securities and Securities of Title to Goods

1. Specific features of issuance, circulation and record-keeping of mortgage letters, mortgage certificates, mortgage bonds, FREO certificates, privatization securities, derivatives, securities of title to goods and the procedure for information disclosure regarding them shall be determined by legislation.

SECTION III. PROFESSIONAL STOCK MARKET ACTIVITIES

Article 16. Types of Professional Stock Market Activities

1. Professional stock market activities shall be activities of legal entities on provision of financial and other services with regard to placement and circulation of securities, keeping records of rights under securities, management of institutional investors assets in compliance with the requirements set to such activities by the present Law and other laws.

It shall not be allowed to combine professional stock market activities with other types of professional activities, except for banking activities, unless otherwise envisaged by the law.

2. In the stock market, the following types of professional activities shall be conducted:

- activities on securities trading;
- activities on management of assets of institutional investors;
- depository activities; and
- activities on organization of trading in the stock market.

3. Professional stock market activities shall be conducted solely on the basis of a license issued by Securities and Stock Market State Commission. The list of documents necessary to receive a license, the procedure for its issuance and termination shall be established by the Securities and Stock Market State Commission.

4. Professional activity of stock market participants, except for depositaries and stock exchanges, shall be conducted on condition of membership in at least one self-regulatory organization (SRO).

Article 17. Activities on Securities Trading

1. Professional activities on securities trading in the stock market shall be conducted by securities traders – business associations for which operations with securities are an exclusive type of activities, and also by banks.

Professional activities on securities trading shall include:

- brokerage;
- dealing;
- underwriting; and
- securities management.

A securities trader may conduct dealing activities if it has the statutory capital, paid in cash, of at least 120,000 hryvnyas, brokerage activities and activities on securities management – if it has at least 300,000 hryvnyas, and activities on underwriting – if it has at least 600,000 hryvnyas.

The stake of another trader in the statutory capital of a securities trader may not exceed 10%.

A securities trader shall be prohibited from re-selling (exchanging) securities issued by it.

2. Brokerage shall be conclusion by a securities trader of civil and legal agreements (in particular commission agreement and agency agreement) with regard to securities on his own behalf (on behalf of another person), on the instruction and for the account of another person. The securities trader may become the security or guarantor to the third parties with regard to meeting the obligations under the contracts that concluded on behalf of clients of such a trader, for which the trader receives fee specified in the agreement of a securities trader with a client.

3. Dealing shall be conclusion by a securities trader of civil and legal agreements with regard to securities on his own behalf and for his own account with an objective of reselling them, except in cases envisaged by the law.

4. Underwriting shall be placement (subscription, sale) of securities by a securities trader on the instruction, on behalf and for the account of the issuer.

In case of public securities placement, an underwriter may undertaking an obligation, as agreed upon by the issuer, to guarantee sale of all or a portion of securities of the issuer to be placed. If a securities issue is publicly placed not in full, the underwriter may redeem unsold securities fully or partially at a fixed price indicated in the agreement on the basis of commercial representation according to the undertaken obligations.

In order to organize public securities placement, underwriters may conclude between themselves an agreement on joint activities.

5. Securities management shall be activities conducted by a securities trader on his own behalf for a fee during a definite period on the basis of an agreement on management of entrusted securities and cash funds intended for investment in securities as well as securities and funds owned by management initiator (settlor) and obtained in the process of such management, in the interests in this settlor or third parties determined by him/her.

A securities trader shall have the right to conclude agreements on securities management with natural persons and legal entities. The agreement value on securities management with one client that is a natural person shall amount at least 100 minimum wages.

The essential terms of an agreement on securities management shall be set by law and as agreed by parties.

A securities trader shall not conclude an agreement on securities management with an asset management company.

A securities trader shall manage securities according to the requirements of the Civil Code of Ukraine, the present Law, other laws, and regulations of Securities and Stock Market State Commission.

6. An agency agreement, a commission agreement or an agreement on securities management shall be concluded with a securities trader in writing. The rights and obligations of a securities trader with regard to his client, the terms of conclusion of agreements regarding securities, the procedure of reporting by the trader to the client as well as the procedure and terms of paying a fee to the trader shall be determined in the agreement concluded between them.

A securities trader shall perform orders of clients under agency agreements, commission agreements and agreements on securities management on the most client-friendly conditions. Orders of clients shall be performed by a securities trader on the first-come first-served basis, unless otherwise envisaged by the agreement or order of the clients. Should a securities trader conclude agreements for his own account simultaneously with conclusion by him of agreements for the client's account execution of agreements for a client shall be a priority.

7. A securities trader shall keep records of securities and cash separately per each client and separately from his own securities, cash and property, according to the requirements set by Securities and Stock Market State Commission by approval of the Ministry of Finance of Ukraine and, in cases set by the law, also of the National Bank of Ukraine. Cash and securities of clients entrusted to securities traders may not be forfeited with regard to securities traders' liabilities, which are not connected with trader's execution of manager functions.

In order to conduct activities on securities management, a client's money shall be deposited on a separate current bank account of the securities trader separately from the securities trader own funds and other clients' funds according to the terms of the securities management agreement. A securities trader shall report to the clients about the use of their cash funds.

A securities trader shall have the right to use the clients' cash if envisaged by the agreement on securities management. An agreement on securities management may provide for division of profit from use of the client's cash, received by the securities trader, between the parties. A securities trader shall be bound to submit the information about all his securities transactions to the selected stock exchange within the terms and according to the procedure established by the stock exchange regulations.

8. The following shall not be deemed professional activities on securities trading:

- placement by the issuer of its own securities;

- redemption by the issuer of its own securities;

- making settlements with promissory notes and/or mortgage letters by legal entities and physical persons entrepreneurs;

- purchase and sale (swap) of securities by legal entities on the basis of commission agreements or agency agreements through a securities trader licensed to conduct brokerage activities, as well as on the basis of agreements of sale and purchase, or exchange concluded directly with the securities trader.

- securities contribution to the statutory capital of legal entities.

9. The following operations may be carried out without participation of a securities trader:

- gift and inheritance of securities;

- operations related to execution of court decisions; and

- purchase of shares according to the privatization law.

10. Specific features of conclusion of agreements related to transfer of ownership right to shares issued
by banks shall be determined by the law.

Article 18. Activities on Management of Assets of Institutional Investors

1. Activities on management of assets of institutional investors shall be professional activities of a stock market participant – an asset management company, which it conducts for a fee on its own behalf or on the basis of the relevant agreement on management of assets owned by institutional investors.

2. Activities on management of assets of institutional investors shall be regulated by a special legislation.

Article 19. Depository Activities

1. Depository activities shall be conducted by stock market participants according to the law on the Depository System of Ukraine.

Article 20. Activities of Trade Organizers in the Stock Market

1. Activities on organization of trading in the stock market shall be activities of a professional stock market participant (trade organizer) on creation of organizational, technological, informational, legal and other conditions for collection and dissemination of information on ask and bid prices, conduct of regular trades in financial instruments according to established rules, centralized conclusion and performance of agreements with regard to financial instruments, including clearing and settlements on them and resolution of disputes between members of the trade organizer.

2. Trade organizers shall be stock exchanges that comply with requirements of the present law. In order to perform their activities stock exchanges shall maintain an equity capital not less than 3 Mio hryvnyas, and for stock exchanges that conduct clearing and settlements – not less than 6 Mio hryvnyas.

Article 21. Establishment of a Stock Exchange and Rights of Its Members

1. A stock exchange shall be established and operate in the organizational and legal form of a company (except for full partnership, limited partnership and additional liability company) or a subsidiary of an association of securities traders and conducts its activities according to the Civil Code of Ukraine and laws that regulate establishment, operation and termination of legal entities, taking into account specific features determined by the present Law. A stock exchange profit shall be directed for its development and is not a subject for distribution between its founders (members).

2. A stock exchange shall be established by at least 20 founders – securities traders that are licensed to conduct professional stock market activities or an association thereof that unites at least 20 securities traders. A share of one securities trader may not exceed 5% of the stock exchange statutory capital.

3. A stock exchange shall obtain a status of a legal entity from the moment of state registration. A state registration of a stock exchange shall be conducted according to the procedure established by the Law of Ukraine “About State Registration of Legal Entities and Natural Persons-Entrepreneurs”. A stock exchange shall have the right to conduct activities on organization of trading in the stock market from the moment of receiving a license from Securities and Stock Market State Commission.

Only legal entities that were created and operate in compliance with the requirements of the present Law shall be allowed to use the word “stock exchange” and its derivatives.

4. Activities of a stock exchange as a trade organizer shall be temporarily suspended by Securities and Stock Market State Commission if the number of its members is less than 20 and if a stock exchange is established in the form of a subsidiary of an association of securities traders, when the number of members of such association is less than 20. If within 6 months no new members joined, the stock exchange’s activities shall be terminated.

5. Members of a stock exchange may be solely securities traders that are licensed to conduct professional stock market activities and undertook an obligation to meet all rules, regulations and standards of the stock exchange.

In case of termination of a securities trader’s license to conduct professional stock market activities its membership in the stock exchange shall be temporary suspended till it renews the license or submits a letter to the stock exchange to exclude him from the stock exchange membership. Other grounds for termination or suspension of membership in a stock exchange shall be determined by its rules. Membership in a stock exchange shall be terminated in case of termination of the license to conduct professional stock market activities issued to the securities trader.

6. All members of a stock exchange shall have equal rights with regard to organization of activities of the stock exchange as a trade organizer.

Article 22. Stock Exchange Charter

1. The charter of a stock exchange shall be approved by the highest body of the stock exchange.

2. The charter of a stock exchange shall indicate the name and location of the stock exchange, the procedure for management and creation of its bodies and their authorities, the objective of activities, grounds and procedure for termination of operation of the stock exchange, and division of property of the stock exchange in case of its liquidation.

Article 23. Requirements to a Stock Exchange

1. A stock exchange shall disclose and submit to Securities and Stock Market State Commission information on the following:

- the list of securities traders admitted to conclusion of agreements on securities sale and purchase on the stock exchange;

- the list of listed securities;

- the volume of trading in securities (the number of securities, the total value of concluded transactions,
  the price of securities per each issuer separately) for the period set by Securities and Stock Market State Commission.

2. Securities and Stock Market State Commission shall determine the procedure and forms of submission of information indicated in Part 1 of the present Article and shall control the disclosure of information by stock exchanges.

Article 24. Organization of Trading on a Stock Exchange

1. A stock exchange shall create organizational conditions for conclusion of securities transactions by way of quoting of securities on the basis of data on ask and bid received from the participants of stock exchange trades.

Stock exchange members and other persons, as envisaged by the law, shall be entitled to participate in stock exchange trades.

2. Stock exchange trades shall be conducted according to the stock exchange rules, which shall be approved by the stock exchange board and registered by Securities and Stock Market State Commission.

Article 25. Stock Exchange Rules

1. Stock exchange rules shall include procedure for the following:

- organization and conduct of stock exchange trades;
- listing and delisting of securities;
- admittance of the stock exchange members and other persons, as envisaged by the law, to stock exchange trades;
- quoting of securities and disclosure of their stock exchange price;
- disclosure of information on activities of the stock exchange and making this information public;
- resolution of disputes between the stock exchange members and other persons, which are entitled to participate in stock exchange trades according to the law; and
- control over observance by the stock exchange members and other persons, which are entitled to participate in stock exchange trades according to the law and the stock exchange rules;
- imposing sanctions for violation of stock exchange rules.

Article 26. Combining Certain Types of Professional Stock Market Activities

1. Combining certain types of professional stock market activities shall not be allowed, except in cases envisaged by the present Law and other legal acts that regulate the procedure for conducting specific types of professional stock market activities.

2. Trade organizers shall not conduct types of professional stock market activities other than activities on organization of trades in the stock market, unless otherwise provided by law. Trade organizers may execute clearing and settlement operations under the agreements with regard to derivatives concluded on such trade organizer.

3. Activities of a securities trader may be combined with activities of a securities custodian. Should a securities custodian be licensed to conduct activities on maintenance of registries of registered securities owners, the custodian shall be prohibited from carrying out any operations with securities the registry of the owners of which it maintains, except for operations of the registrar under the agreement with the issuer.

4. Activities on maintenance of registries of registered securities owners shall be an exclusive type of activities, which may be combined with activities of a securities custodian and a securities trader (taking into account the requirements of Part 3 of the present Article) as well as with activities of an asset management company in cases envisaged by law.

5. Combining activities on management of assets of institutional investors with other types of professional stock market activities shall be prohibited, except for activities on maintenance of registries of registered securities owners of collective investment institutions in cases envisaged by law.

Article 27. Requirements to Professional Stock Market Participants

1. Licensing requirements, including those to the amount of the statutory capital and owners' equity, the procedure to determine it, liquidity, qualification requirements to specialists of a professional stock market participant, the essential terms of agreements concluded in the process of professional stock market activities, other requirements and indicators that limit risks of professional stock market activities shall be set by the present Law, other laws of Ukraine that regulate specific types of professional stock market activities, and regulations of Securities and Stock Market State Commission.

SECTION IV. ISSUANCE OF SECURITIES IN CASE OF OPEN (PUBLIC) AND CLOSED (PRIVATE) PLACEMENT

Article 28. Stages of Issuance of Securities in Case of Open (Public) and Closed (Private) Placement

1. Public (open) securities placement shall be their alienation on the basis of publicizing in mass media or advertising in some other way information about securities sale addressed to an indefinite number of persons.

In case of open (public) placement of securities among a circle of persons, which was not defined in advance, the issuance shall have the following stages:

1) making a decision on open (public) securities placement by the issuer's authorized body;

2) in case of refusal of the shares owner to use his preemptive right to purchase shares, if this envisaged by the terms of open (public) securities placement, receiving a written confirmation of refusal from him;

3) submission of the application and all the documents necessary for registration of securities issue and securities prospectus;

4) registration of the securities issue and the securities prospectus with Securities and Stock Market State Commission;

5) if necessary, making a decision on involving an underwriter for securities placement;

6) assigning an international identification number to securities;

7) concluding an agreement with a depository regarding servicing of the securities issue or with a registrar regarding maintenance of the registry of registered securities owners, except when the issuer independently keeps records of rights under securities, in accordance with the law, or in case of bearer securities;

8) manufacturing of securities certificates in case of documentary securities;

9) disclosure of the information contained in the securities prospectus;

10) open (public) securities placement;

11) approval of the securities placement results by the issuer's body authorized to make such decision;

12) approval of amendments to the charter with regard to increase of the statutory capital of a joint-stock company taking into account the shares placement results;

13) registration of amendments to the charter with the state registration authorities;

14) submission of the report on the results of open (public) securities placement;

15) registration of the report on the results of open (public) securities placement by Securities and Stock Market State Commission;

16) receiving a certificate on registration of the securities issue;

17) disclosure of the information contained in the report on the results of open (public) securities placement.

2. Private (closed) securities placement shall be securities placement by means of direct securities proposal to a predetermined circle of persons.

In case of closed (private) securities placement among a predetermined circle of persons the issuance shall have the following stages:

1) making a decision on closed (private) securities placement by the issuer's authorized body;

2) in case of refusal of the share owner to use his preemptive right to purchase shares, if this envisaged by the terms of closed (private) securities placement, receiving a written confirmation of refusal from him;

3) submission of the application and all the documents necessary for registration of securities issue;

4) registration of the securities issue with Securities and Stock market State Commission;

5) assigning an international identification number to securities;

6) concluding an agreement with a depository regarding servicing of the securities issue or with a registrar regarding maintenance of the registry of registered securities owners, except when the issuer independently keeps records of rights under securities, in accordance with the law, or in case of bearer securities;

7) manufacturing of securities certificates in case of documentary securities;

8) closed (private) securities placement;

9) approval of the securities placement results by the issuer's body authorized to make such decision;

10) approval of amendments to the charter related to increase of the statutory capital of a joint-stock company taking into account the shares placement results;

11) registration of amendments to the charter with the state registration authorities;

12) submission to Securities and Stock Market State Commission of the report on the results of closed (private) securities placement;

13) registration of the report on the results of closed (private) securities placement by Securities and Stock Market State Commission;

14) receiving a registration certificate of securities issue.

3. Per each securities placement, the issuer shall make a decision, which shall be formalized with a protocol. The requirements to the content of the protocol shall be set by Securities and Stock Market

State Commission. The issuer shall have no right to change the decision on securities placement with regard to the scope of rights under securities, the terms of placement and the number of securities of one issue, except when envisaged by laws and regulations of Securities and Stock Market State Commission.

It shall be prohibited to restrict access of securities owners to the original of the decision on securities placement, which shall be kept by the issuer.

4. Primary placement of shares of an open joint stock company shall be solely closed (private), among the founders.

Article 29. Registration of a Securities Issue and a Securities Prospectus

1. Securities and Stock Market State Commission, within 30 days after receiving an application and all necessary documents for registration of the issue and the securities prospectus, shall conduct registration of the issue and the securities prospectus simultaneously, or refuse in registration.

2. Registration by Securities and Stock Market State Commission of the issue and the securities prospectus shall not be viewed as a guarantee of the value of securities. Securities and Stock Market State Commission shall be liable only for the completeness of the information contained in the documents which it registered and for its compliance with the requirements of the law. Persons who signed documents submitted for registration of the issue and the securities prospectus shall be liable for the authenticity of the data contained in the documents.

3. The list of documents required for registration of the issue and the securities prospectus as well as the procedure of registration thereof shall be set by Securities and Stock Market State Commission.

Additional requirements to registration of the issue and the securities prospectus of banks shall be set by Securities and Stock Market State Commission with approval of the National Bank of Ukraine.

Article 30. Requirements to a Securities Prospectus

1. A securities prospectus shall contain information on the issuer, its financial and business position and the securities with regard to which the decision on open (public) placement was made.

2. Requirements to disclosure of information on the issuer and its financial and business position shall be set by Securities and Stock Market State Commission.

3. Information on securities shall include the following information:

- the kind, form of issue, type, number and nominal value of securities with regard to which the decision on open (public) placement was made;

- the date when the decision on open (public) placement was made;

- the dates of the beginning and the end of open (public) placement; and

- the procedure and forms of payment of income on securities.

4. A securities prospectus shall contain other data envisaged by this Law and other laws that determine specific features of open (public) placement of specific types of securities and/or regulations of Securities and Stock Market State Commission.

5. A securities prospectus shall be signed by the issuer's manager (chairman of the executive body) and the auditor and shall be certified with the issuer's stamp. Persons who signed the securities prospectus shall thereby confirm the authenticity of the data contained therein, and the auditor shall confirm the authenticity of the data he audited.

Should the issuer use services of an underwriter with regard to open (public) placement of a securities issue, the securities prospectus shall be subject to approval by the underwriter.

Persons guilty of submission of inauthentic data in the securities prospectus shall be liable according to laws of Ukraine.

6. The securities prospectus shall be registered with Securities and Stock Market State Commission simultaneously with registration of the securities issue.

7. Upon registration, the issuer shall have the securities prospectus published in full in an official publication of Securities and Stock Market State Commission at least 10 days before the beginning of open (public) securities placement.

8. In case of changes in the securities prospectus, the issuer shall have them registered and have information on these changes published within 30 days after the securities prospectus was published, but at least 10 days before the beginning of open (public) securities placement. Should it be impossible to do within the established period, the changes shall also include information on extension of open (public) securities placement. A ground for refusal in registration of changes in the securities prospectus shall be non-compliance of the documents with the requirements of the law or violation of the procedure for making a decision on changes set by Securities and Stock Market State Commission.

9. Until registration and publishing of the information on changes in the securities prospectus, an issuer shall have no right to conduct open (public) securities placement.

Article 31. Keeping Records of Registered Securities Issues

1. Securities and Stock Market State Commission shall maintain the State Registry of Securities Issues according to the procedure set by the Commission.

2. Securities and Stock Market State Commission shall establish the procedure and ensure open and free access of the securities market participants to the information contained in the Register.

Article 32. Requirements to Closed (Private) Securities Placement

1. Specific features of closed (private) share placement shall be determined by the law that regulates establishment, operation and termination of joint stock companies and the law on collective investment institutions.

2. The issuer shall complete closed (private) securities placement within the period envisaged by the decision on closed (private) securities placement, but not later than within 2 months from the date of the beginning of placement.

3. During closed (private) placement, unit securities shall not be sold at a price that is less than their nominal value.

4. It shall be prohibited to establish a preemptive right to purchase securities for some investors versus other investors, except when envisaged by the law.

5. The actual number of placed securities shall be indicated in the report on the results of closed (private) securities placement, which shall be approved by the issuer's body authorized to make such decision and shall be submitted to Securities and Stock Market State Commission.

Article 34. Open (Public) Securities Placement with Participation of an Underwriter

1. During open (public) securities placement, the issuer shall have the right to use services of an underwriter.

2. Requirements to operations of an underwriter shall be set by Securities and Stock Market State Commission.

Article 35. Report on the Results of Securities Placement

1. The issuer shall file with Securities and Stock Market State Commission, within 15 days after registration of amendments to its charter with the State registration bodies, a report on the results of open (public) securities placement as well as other documents defined by Securities and Stock Market State Commission required for registration of the report. Securities and Stock Market State Commission shall set requirements to disclosure of the information contained in the report on the results of open (public) securities placement.

2. Securities and Stock Market State Commission, within 15 days after receiving the required documents from the issuer, shall make a decision on registration of the report or refusal in registration.

3. A ground for refusal in registration of the report on the results of open (public) securities placement shall be violation of the requirements of the law connected with securities placement.

4. Securities and Stock Market State Commission within two weeks after registration of the report on the results of open (public) securities placement shall give a certificate on registration of the securities issue to the issuer.

5. In case of open (public) placement of bonds, within 15 days after the end of bond repayment the issuer shall submit to Securities and Stock Market State Commission a report on the results of bond repayment.

6. In case of closed (private) placement of securities, the issuer shall submit to Securities and Stock Market State Commission, within the period set by the Commission, a report on the results of closed (private) placement.

Within two weeks after the issuer submitted the report on the results of closed (private) securities placement, the issuer is given a certificate on registration of the securities issue.

Article 36. Unfair Securities Issuance

1. Unfair securities issuance shall mean actions that violate the issuance procedure set by this Law and represent a ground for making a decision on refusal in registration of securities prospectus and securities issue, suspension of open (public) securities placement.

2. Grounds for recognizing securities issuance unfair shall include:

- violation by the issuer of the requirements of this Law, non-compliance of the documents submitted by the issuer or data contain therein with the requirements of the law and/or the list set by Securities and Stock Market State Commission;
- violation of the procedure of making a decision on open (public) securities placement;
- including inauthentic data in the securities prospectus and documents submitted for registration of the securities issue and the securities prospectus; and
- regular or gross violation of investor rights by the issuer.

3. The procedure of making a decision on refusal in registration of the securities prospectus and issue, suspension of open (public) placement shall be set by Securities and Stock Market State Commission.

4. In case of unfair issuance, Securities and Stock Market State Commission shall have the right to temporarily suspend open (public) securities placement.

5. Suspended open (public) securities placement shall be renewed by decision of Securities and Stock Market State Commission only until the end of the period of securities placement, set in the securities prospectus, if the violations that caused suspension of open (public) placement have been eliminated.

6. Should the violations that caused suspension of open (public) placement have not been eliminated within 15 days after Securities and Stock Market State Commission made the corresponding decision, or documents that confirm elimination of the violations have not been sent to Securities and Stock Market State Commission, the Commission shall decide to invalidate securities issuance.

Article 37. Placement of Securities of Foreign Issuers on the Territory of Ukraine and Those of Ukrainian Issuers Outside Ukraine

1. Specific features of placement and circulation of securities of foreign issuers on the territory of Ukraine shall be determined by Securities and Stock Market State Commission according to the legislation of Ukraine.

2. Ukrainian issuers may place securities outside Ukraine only by permission of Securities and Stock Market State Commission, except for bonds of external government borrowings of Ukraine.

A permission to place securities of Ukrainian issuers outside Ukraine shall be granted if the following conditions are met:

- the securities issue is registered;
- the securities are admitted to trades on one of the Ukrainian stock exchanges;
- the number of securities to be placed outside Ukraine is within the limit set by Securities and Stock Market State Commission.

Article 38. Issuance of Securities of Collective Investment Institutions in Case of Open (Public) and Closed (Private) Placement

1. Specific features of issuance, placement, circulation and redemption of securities of collective investment institutions in case of open (public) and closed (private) placement thereof shall be determined by a special legislation.

SECTION V. INFORMATION DISCLOSURE IN THE STOCK MARKET

Article 39. Requirements to Information Disclosure by Issuers

1. Issuers that have conducted open (public) placement shall timely and fully disclose information on the following:

- the issuer’s financial and business position and performance within the period established by the law;
- any actions that may affect the issuer’s financial and business position and cause a significant change of the price of its securities; and
- owners of large blocks of shares (10% and more).

2. Information on owners of large blocks of shares (10% and more) shall be filed with Securities and Stock Market State Commission by the person who keeps records of ownership rights to the issuer’s shares in the National Depository System of Ukraine within the period, under the procedure and in the form set forth by Securities and Stock Market State Commission.

Information on owners of large blocks of shares (10% and more) shall be public and Securities and Stock Market State Commission shall make this information public by way of displaying it in the free-access SSMSC information database on the securities market.

Article 40. Regular Information on the Issuer

1. Regular information on the issuer shall be annual and quarterly reporting on the results of the issuer's financial and business activities to be filed with Securities and Stock Market State Commission (including reporting in the electronic form).

2. A reporting period for compiling annual information on the issuer shall be a calendar year.

The issuer's first reporting year may be less than 12 months and shall be calculated:

- for joint stock companies, from the date of state registration of the company until December 31 of the reporting year inclusive; and

- for bond issuers, from the date of registration of the bond issue until December 31 of the reporting year inclusive.

3. Annual information on the issuer must contain the following data:

- the name and location of the issuer, the amount of its statutory capital;

- the issuer's management body, its officials and founders;

- the issuer's business and financial activities;

- the issuer's securities (kind, category, type, number), placement and listing of securities;

- annual financial statements; and

- the auditor's opinion.

The issuer shall have the right to additionally submit other information.

4. Annual information on the issuer shall be public and shall be disclosed by the issuer no later than by 30 April of the year following the reporting year, by way of publishing it in one of the official publications of the Verkhovna Rada of Ukraine, the Cabinet of Ministers of Ukraine or Securities and Stock Market State Commission and by way of displaying it in the free-access SSMSC information database on the securities market.

The issuer shall send a copy of the official publication in which annual information about him (issuer) was published to Securities and Stock Market State Commission.

5. A reporting period for compiling quarterly information on the issuer is quarters of the current year.

Quarterly information on the issuer must contain the following data:

- the name and location of the issuer, the amount of its statutory capital;

- the issuer's management body, its officials and founders;

- the issuer's business and financial activities;

- the issuer's securities (kind, form of issue, type, and amount);

- quarterly financial statements; and

- the issuer's participation in creation of other companies, institutions and organizations.

The issuer shall have the right to additionally submit other information.

6. The period, procedure and forms of submission of regular information on the issuer (annual and quarterly) shall be set by Securities and Stock Market State Commission.

Securities and Stock Market State Commission shall set additional requirements to disclosure of regular information on the issuer and shall take measures to ensure its disclosure.

7. Special features of filing and making public the regular information by collective investment institutions shall be established by legislation.

Article 41. Ad Hoc Information on the Issuer

1. Ad hoc information on the issuer shall be information on any events that may affect the issuer's financial and business position and cause a significant change of the value of its securities.

Ad hoc information shall include data on the following:

- a decision on placement of securities for the amount that exceeds 25% of the statutory capital;
- a decision on redemption of the issuer's own shares;
- listing/delisting of securities on a stock exchange;
- receiving a loan or credit for the amount that exceeds 25% of the issuer's assets;
- change of the composition of the issuer's officials;
- change of owners of shares which own 10% and more of voting shares;
- the issuer's decision on creation, termination of its branches, representative offices;
- a decision of the issuer's highest body on decrease of the statutory capital;
- initiation of bankruptcy proceedings against the issuer and court's decision about its sanation;
- a decision of the issuer's highest body or the court on termination or bankruptcy of the issuer.

2. The period, the procedure and the filing forms of ad hoc information about the issuer shall be set by Securities and Stock Market State Commission.

3. Ad hoc information on the issuer shall be public and shall be made public by way of publishing it in one of the official publications of the Verkhovna Rada of Ukraine, the Cabinet of Ministers of Ukraine or Securities and Stock Market State Commission and by way of displaying it in the free-access SSMSC information database on the securities market.

4. Securities and Stock Market State Commission shall set forth additional requirements to disclosure of ad hoc information on the issuer and shall take measures to ensure its disclosure.

Article 42. Procedure of Disclosure of Information on the Record Keeping of Registered Securities by Participants of the Depository System of Ukraine

1. Information on keeping records of registered securities shall be disclosed by the participants of the National Depository System:

- at a written request of the owner of the information or by his written permission, except in cases envisaged by paragraphs 3 and 4 of this Part;
- in compliance with a court decision; and

- upon a written request of the Prosecutor's office, the security service, internal affairs bodies, Securities and Stock Market State Commission and the Antimonopoly Committee of Ukraine, and other governmental agencies in conformity with legislation, with regard to operations within systems of records of registered securities that are carried out by a specific legal entity or individual within a specific period.

2. A participant of the National Depository System shall be prohibited from providing information on the clients of another participant of the National Depository System, even if their data is indicated in the documents and agreements of the client.

3. Persons guilty of violation of the procedure of disclosure and use of information on keeping records of registered securities shall be liable according to the law.

Article 43. Disclosure of Information on Professional Stock Market Participants

1. Securities and Stock Market State Commission shall provide for making information on professional stock market participants public (the number, the date of issuance and the validity period of the license, powers under the license, the manager and the authorized person who acts on his behalf).

Article 44. Insider Information and Insiders

1. Insider information shall be any information on the issuer, its securities or transactions therein that is not made public and, if made public, may significantly affect the value of securities.

2. Information on valuation of securities and/or the issuer's financial and business position, if received solely on the basis of information that was made public or information from other public sources not prohibited by the law shall not be insider information.

3. Insiders shall be persons who have insider information because they are:

(1) owners of the issuer's voting shares or stakes (units) in the issuer's statutory capital;

(2) the issuer's officials; or

(3) persons who have access to insider information due to performance of labor (official) duties or contractual obligations, regardless of their relations with the issuer, in particular:

- legal entities that have contractual relations, or direct or indirect relations of control with the issuer;

- individuals who have labor or contractual relations, or direct or indirect relations of control with the issuer, or legal entities or individuals which have contractual relations or relations of control with the issuer; and

- government officials.

The issuer or professional stock market participants performing operations with securities of this issuer shall keep records of persons who have access to insider information.

4. Securities and Stock Market State Commission shall determine which information is considered insider information.

Article 45. Prohibition on Use of Insider Information

1. An insider shall be prohibited from the following:

- concluding, with the use of insider information, for his own benefit or for the benefit of other persons/entities, agreements on purchase or alienation of securities to which insider information relates until this information is made public;

- transferring insider information or providing access thereto to other persons, except in case of disclosure of information within the limits of performance of professional, labor or official duties and in other cases envisaged by the law; and

- giving recommendations to any person with regard to purchase or alienation of securities with regard to which he/she has insider information until this information is made public.

2. The procedure for disclosure of insider information shall be set by regulations of Securities and Stock Market State Commission.

Professional stock market participants shall inform Securities and Stock Market State Commission of securities transactions that are suspected to be involving or be able to involve insider information.

3. Clause 1 of this Article shall also apply to persons who are not insiders, but have insider information and know or should know that this information was received from an insider.

4. Liability for unlawful use of insider information shall be established by law.

Article 46. Advertising Information in the Stock Market

1. Advertising information in the stock market shall be advertising:

- of the issuer or securities being placed by the issuer or outstanding securities;

- a professional stock market participant and its activities; and

- securities transactions.

2. Advertising in the stock market shall not include information that under the requirements of this Law and of other regulatory acts is subject to mandatory disclosure.

3. Government agencies shall not engager in advertising in the stock market, except for advertising related to placement and circulation of government securities.

SECTION VI. REGULATION OF THE SECURITIES MARKET

Article 47. Securities Market Regulation

1. Stock market regulation shall be performed by the State and by self-regulatory organizations.

2. State regulation of the securities market shall be performed by Securities and Stock Market State Commission, as well as by other governmental organizations within their jurisdiction as established by law.

Article 48. Self-Regulatory Organizations of Professional Stock Market Participants

1. Self-regulatory organizations of professional stock market participants shall be formed in conformity with the principle “one self-regulatory organization per each type of professional securities market activities.”.

Such a self-regulatory organization shall unite over 50% of professional stock market participants in one of the types of professional activities.

2. The association shall acquire the status of a self-regulatory organization from the day of its registration by Securities and Stock Market State Commission. The procedure for and the terms of the

registration of the professional stock market participants SRO and the termination of the registration shall be set forth by Securities and Stock Market State Commission.

The objective of activities of self-regulatory organizations of professional stock market participants shall be to provide for activities of professional stock market participants, which are members of the self-regulatory organization, as well as to develop and approve rules, and standards of professional behavior and conduct of the relevant type of professional activities.

3. Self-regulatory organization of stock market participants shall acquire the powers delegated to it by Securities and Stock Market State Commission from the day of promulgation of the decision of Securities and Stock Market State Commission on the delegation of respective powers to a self-regulatory organization in an official printed organ of Securities and Stock Market State Commission.

4. The terms of making a decision on delegation of Securities and Stock Market State Commission powers on the stock market regulation to an organization-candidate of professional stock market participants shall be as follows:

- rules and standards of professional activities in the stock market in place that shall be mandatory for all members of the self-regulatory organization to comply with;

- the organization have a not-for-profit status; and

- the organization shall have assets worth at least UAH 600,000 at its disposal to ensure its statutory activities.

Article 49. Delegation of Powers on Stock Market Regulation to Self-Regulatory Organizations

1. With regard to each type of professional activities, Securities and Stock Market State Commission may delegate to a self-regulatory organization the following powers:

- collection, summarization and analytical processing of data on conduct of the relevant type of professional activities;

- inspections of the performance of the relevant type of professional activities, compliance with the requirements of the securities law, and rules and standards of professional conduct;

- submission to it of a request, mandatory for review, on the termination (suspension) of the license to perform a certain type of activities by a professional stock market participant; and

- certification of stock market specialists;

- issuance of licenses to persons that perform professional activities in the stock market.

Securities and Stock Market State Commission, in line with the procedure established by same, may delegate other powers to self-regulatory organizations.

2. Securities and Stock Market State Commission shall delegate to a self-regulatory organization powers on stock market regulation according to the procedure set by the Commission in response to the application of this organization.

Within one month after receiving an application from a self-regulatory organization, Securities and Stock Market State Commission shall make a decision on delegation or refusal in delegation of powers to the self-regulatory organization.

3. A decision on delegation of powers to a self-regulatory organization shall indicate the following:

- the name of the self-regulatory organization to which the powers are being delegated;

- the powers being delegated;

- the period for which the powers are being delegated; and

- the procedure of state control over execution of the delegated powers.

4. A decision on delegation of powers to a self-regulatory organization shall be subject to state registration with the Ministry of Justice of Ukraine, as a normative and legal act, and shall be made public according to the law.

5. The period of powers delegated to a self-regulatory organization shall be extended according to the same procedure as the one that is set for obtaining them.

6. A self-regulatory organization shall have the right to submit an application on delegation of additional powers thereto only upon the condition of satisfactory execution of powers that were previously delegated.

SECTION VII. FINAL PROVISIONS

1. This Law shall come into effect in 30 days from the day of its promulgation, excepting:

clause 3 of article 8, which shall come into force within two years from the day of promulgation of this Law;

paragraph 2, Subitem 4 of Item 3, Section VII "Final Provisions", which shall come into force within two years from the day of promulgation of the present Law;

clause 1 of article 48, which shall come into force within three years after the day of promulgation of this Law.

2. After this Law comes into effect, the following laws shall become ineffective:

(1) the Law of Ukraine "On Securities and Stock Exchange" (The Bulletin of the Verkhovna Rada of Ukraine, 1991 No. 38, p. 508; 1992 No. 47, p. 645; 1995 No. 14, p. 90, p. 93; 1996 No. 40, p. 185; 1997 No. 45, p. 285; 1999 No. 26, p.213, No. 31, p. 252; 2003 No. 30, p. 247, No. 38, p.313; 2004 No. 13, p. 181, No. 19, p. 271; 2005 No.42, p.465; with amendments made by the Law of Ukraine dated December 15, 2005 No.3201-IV);

Resolution of the Verkhovna Rada of Ukrainian Soviet Socialist Republic dated June18, 1991 "On Making Effective the Law of Ukrainian SSR "About Securities and Stock Exchange" (The Bulletin of the Verkhovna Rada, 1991, No.38, p.509).

3. The following legal acts of Ukraine shall be amended:

1) the Commercial Code of Ukraine (The Bulletin of the Verkhovna Rada of Ukraine, 2001 No. 25-26, pg. 131; 2005 No. 5, pg. 119)) shall be amended with Article 232-1 reading as follows:

"Article 232-1. Disclosure or Usage of Information About the Issuer or Its Securities That Have Not Been Made Public"

Purposeful disclosure or other usage of unpublished or undisclosed in any other way information on the issuer, its securities or transactions therein (insider information) by a person who learnt this information through professional or official activities, in case this has caused a significant material loss to the State interests or the interests of legal entities or physical persons, -

shall carry restraint of liberty for up to three years or imprisonment for up to three years with deprivation of the right to occupy certain positions or engage in certain activities for up to three years".

2) Part 2 of Article 112 of the Criminal and Procedural Code of Ukraine after number “232” shall be supplemented with numbers “232-1”;

3) the Commercial Code of Ukraine (The Bulletin of the Verkhovna Rada of Ukraine, 2003 No. 18-22, p. 144; with amendments made by the Law of Ukraine dated December 15, 2005 No.3201-IV):

- in the second sentence of clause 2 of article 163, the words “savings certificates’ shall be replaced with the words “savings (deposit) certificates”;

- clauses 4, 5, and 7 of article 164 shall be worded as following:

4. Business entities the exclusive activity of which is activity on management of assets of collective investment institutions shall have the rights to issue investment certificates.

5. Banking institutions depositing funds of legal entities and individuals shall furnish them with written certificates to confirm the depositors’ right of depositors to get back the deposit principal and interest at the expiry of the established term (savings [deposit] certificates).

7. Business subjects shall have the right to issue, according to the procedure set by the law, promissory notes – debt securities that certify an absolute monetary obligation of the maker or his order to a third party to pay after the maturity period a definite amount to the owner of the promissory note (note holder).

- clause 2 of article 356 shall be omitted;

- clause 1 of article 360 shall read as follows:

1. In order to ensure the functioning of the securities market, a stock exchange shall be created. The procedure of creating and performing the stock exchange operations shall be determined by law.

4) in the Civil Code of Ukraine (The Bulletin of the Verkhovna Rada of Ukraine, 2003 No. 40-44, p. 356):

- clause 2 of article 158 shall be omitted;

- in clause 1 of article 194, the words “issued” and “issue” shall be replaced with the words “placed” and “placement” correspondingly;

- in item 3 of clause 1 of article 195 and of clause 2 of article 197, the word “issue” shall be replaced with the word “placement”;

- in clause 3 of article 195, the word “to be issued” shall be replaced with the word “to exist”;

- in clause 1 of article 198:

- in the first sentence, the word “issued” shall be replaced with the word “placed”;

- in the second sentence the word “owner” shall be supplemented with the word “order”;

5) in the Law of Ukraine “On State Regulation of the Securities Market in Ukraine” (The Bulletin of the Verkhovna Rada of Ukraine, 1996 No. 51, pg. 292; 1999 No. 38, pg. 339; 2001 No. 21, pg. 103; 2002 No.16, pg.114, No.17, pg.117, No.29, pg.194; 2004 No.13, pg.181; 2005 No.42, pg.465, 466; No.48, pg.481; with amendments made by laws of Ukraine dated December 15, 2005 No.3201-IV and December 22, 2005 No.3273-IV):

- paragraphs 3, 4, and 6 – 8 of article 1 shall be omitted;

- the title of article 4 and parts 1 and 2 of this article shall read as follows:

"Article 4. Securities Market Activities That Shall Be Subject to Licensing. Securities and Stock Market State Commission, under the procedure established by same, shall grant licenses to engage in the following types of activities:

1) brokerage activity – entering by a securities broker into civil law contracts (particularly commission and agency agreements) on securities on his/its behalf (or on behalf of another person), on the order of and at the cost of another person;

2) dealership activity - entering by a securities broker into civil law securities contracts on his/its behalf and at its/his cost for resale purposes, except for cases envisaged by law;

3) underwriting – placement (subscription, sale) of securities by the broker of these securities on the order of, on behalf of and at the cost of the issuer;

4) securities management activity – activity performed by the securities broker on its/his behalf for a fee for the duration of a specified period based on an agreement to manage the securities given and, upon consent of the principal, the cash funds to invest in securities, as well as the securities and cash funds earned in the process of managing owned by management initiator (settlor), in his interests or in the interests of third persons specified by him;

5) asset management activity – professional activity of a stock market participant – an asset management company, - performed by it for a fee on its behalf or based on a corresponding asset management agreement to manage assets owned by institutional investors;

6) mortgage coverage management activity – activity performed foe a fee by a bank or by another financial institution under a respective mortgage coverage management agreement;

7) depositary activity of a securities depositary – activity to provide services such as security safekeeping, servicing securities transactions on the accounts of securities custodians, as well as issuers' operations with their securities;

8) depositary activity of a securities custodian - activity to provide services such as securities custody and servicing securities transactions on the accounts of securities owners;

9) registered securities owners registers keeping activity – collecting, recording, processing, safekeeping, and giving access to data that make up the register system of registered securities owners on registered securities, their issuers, and owners;

10) stock market trading organization activity – activity of a professional stock market participant (trade organizer) with regard to providing organizational, technological, informational, legal, and other conditions to collect and disseminate ask and bid information, to conduct regular trading of financial instruments by established rules, to centralize conclusion and execution of financial instruments contracts, including clearing and settlement of same; and to resolve disputes between trade organizer members;

11) clearing and settlement activity – activities to determine mutual obligations under securities contracts and to settle same.

Securities and Stock Market State Commission, under the procedure established by same, in the event of professional securities market participants engaging in several types of activities envisaged by clause 1 of this article, shall issue one form of license for such activities.

In clause 2 of article 7:

Item 13 shall read as follows:

13) shall exercise control over compliance with legislation and shall appoint government representatives on stock exchanges, at depositaries, and trade-and-information systems;";

item 14-1 shall be added to read as follows:

14-1) shall set forth a standard sample and issue certificate of registration of the association of professional stock market participants as a self-regulatory organization";

article 17 shall be omitted;

6) in the Law of Ukraine "On Advertising" (The Bulletin of the Verkhovna Rada of Ukraine, 2004 No. 8, pg. 62):

- to add the following paragraph to clause 4 of article 25:

to use information on income on securities or the amount of profit received by the issuer in the past without indication that this profit does not guarantee receiving income in the future";

- to add the following paragraphs to clause 1 of article 26:

the Ministry of Finance of Ukraine – with regard to advertising of government securities;

Securities and Stock Market State Commission – with regard to advertising in the stock market."

7) Paragraph 2, clause 1 of article 27 of the Law of Ukraine dated December 22, 2005 "About Mortgage Bonds" words "activity of mortgage coverage manager and mortgage coverage" shall be added following the words "circulation of mortgage bonds";

8) in sub-item "ô" of clause 3, article 3 of the Cabinet of Ministers Decree 7-93 "On State Duty" dated 1/21/93 (The Bulletin of the Verkhovna Rada of Ukraine, 1993 No. 13, pg. 113; 1995 No. 30, pg. 229; 2004 No. 2, pg.6 with amendments made by the Law of Ukraine dated December 22, 2005 No. 3273-IV), the word "concession" shall be added after the words "as well as for notarization of agreements".

4. Stock market participants, within 3 years after this Law comes into effect, shall bring their activities in compliance with this Law.

Stock market participants that are licensed to conduct professional stock market activities shall conduct their activities in accordance with the issued licensed within 3 years after this Law comes into effect. Stock market participants that are licensed to conduct activities on organization of securities market trading shall conduct activities on organization of trading in the stock market as trade organizers.

After the license expires, conduct of the relevant type of professional activities shall be allowed if a new license is obtained in accordance with this Law.

5. The Cabinet of Ministers of Ukraine, together with the National Bank of Ukraine, within 3 months from the date of promulgation of the present Law shall prepare and submit to the Verkhovna Rada of Ukraine a draft law of Ukraine on amendments to the Law of Ukraine "On Payments Systems and Money Transfer in Ukraine" with regard to opening an account by a securities trader for his client with the purpose to conduct activities on securities management.

6. This Law shall not apply to securities issues, decisions on which had been approved prior to this Law coming into force.

President of Ukraine Victor Yushchenko
City of Kyiv
February 23, 2006
No.3480-IV

DRAFT Cabinet Decree - 208 Amended

CABINET OF MINISTERS OF UKRAINE

DECREE

dd. #

Kyiv

On Amending and Supplementing the Decree # 208-p dd. April 01, 2004 of the Cabinet of Ministers of Ukraine
On Approval of the Concept of Development of the Rating System for Regions, Sectors of the National Economy, and Business Entities

In pursuance of the Law of Ukraine # 3201-IV dd. December 15, 2005 *On Amending Certain Legislative Acts of Ukraine*, Part 7,

the Cabinet of Ministers of Ukraine
does hereby decree:

1. The Decree # 208-p dd. April 01, 2004 of the Cabinet of Ministers of Ukraine *On Approval of the Concept for Development of the Rating System for Regions, Sectors of the National Economy, and Business Entities* shall be amended and supplemented (as attached).

2. This Decree shall enter into force on the date of publishing.

Interim Prime Minister of Ukraine Y.Yekhanurov

Appendix 2
To the Draft Decree of the Cabinet of Ministers of Ukraine *On Amending and Supplementing the Decree # 208-p dd. April 01, 2004 of the Cabinet of Ministers of Ukraine 'On Approval of the Concept for Development of the Rating System for Regions, Sectors of the National Economy, and Business Entities'*

NATIONAL RATING SCALE

Long-term credit ratings (more than one year)

Investment levels

uaAAA Under **uaAAA** rating, a borrower or a debt instrument features the highest creditworthiness as compared with any other Ukrainian borrowers or debt instruments.

uaAA Under **uaAA** rating, a borrower or a debt instrument features very high creditworthiness as compared with any other Ukrainian borrowers or debt instruments.

uaA Under **uaA** rating, a borrower or a debt instrument features high creditworthiness as compared with any other Ukrainian borrowers or debt instruments. Such creditworthiness appears to be sensitive to any unfavorable changes in business, financial, or economic environment.

uaBBB Under **uaBBB** rating, a borrower or a debt instrument features sufficient creditworthiness as compared with any other Ukrainian borrowers or debt instruments. Such creditworthiness appears to be affected by any unfavorable changes in business, financial, or economic environment.

Speculative levels

uaBB Under **uaBB** rating, a borrower or a debt instrument features insufficient creditworthiness as compared with any other Ukrainian borrowers or debt instruments. Such creditworthiness appears to be much affected by any unfavorable changes in business, financial, or economic environment.

uaB Under **uaB** rating, a borrower or a debt instrument features low creditworthiness as compared with any other Ukrainian borrowers or debt instruments. Such creditworthiness appears to be very much affected by any unfavorable changes in business, financial, or economic environment.

uaCCC Under **uaCCC** rating, a borrower or a debt instrument features very low creditworthiness as compared with any other Ukrainian borrowers or debt instruments. Default is quite probable.

uaCC Under **uaCC** rating, default of a borrower or a debt instrument is highly probable.

uaC A borrower is expected to default under its debt liabilities.

uaD Default. A borrower has stopped paying back the principal debt under its debt liabilities and an interest thereon and has not made any arrangements with its creditors to reschedule debt before the payment date.

Short-term credit ratings (up to one year)

Investment levels

uaK1 The highest creditworthiness as compared with any other Ukrainian borrowers or debt instruments. With such financial standing, the borrower is able to prevent any predictable risks within a short-term perspective.

uaK2 High creditworthiness as compared with any other Ukrainian borrowers or debt instruments. Financial standing of such borrower is sufficiently high to prevent any predictable risks within a short-term perspective.

uaK3 Sufficient creditworthiness as compared with any other Ukrainian borrowers or debt instruments. Financial standing of such borrower is satisfactory to prevent any predictable risks within a short-term perspective.

Speculative levels

uaK4 Low creditworthiness as compared with any other Ukrainian borrowers or debt instruments. Financial standing of such borrower is insufficient to prevent any predictable risks within a short-term perspective.

uaK5 Very low creditworthiness as compared with any other Ukrainian borrowers or debt instruments. With such financial standing, the borrower is unable to prevent any predictable risks within a short-term perspective.

uaKD The borrower has declared default under its debt liabilities.

The following additional designations and forecasts shall be used with credit ratings.

Additional designations:

ua Ratings assigned under the Ukrainian National Rating Scale.

- or + Intermediate rating categories assigned within basic categories.

(pi) Ratings based on public information only.

withdrawn The assigned rating may be withdrawn if the borrower fails to provide any information as may be required to update its rating or for any other reasons.

suspended The assigned rating may be suspended as an intermediate measure before possible (but not necessary) withdrawal when the borrower fails to provide any information as may be required to update its rating or for any other reasons.

Credit rating forecasts comment any prevailing trends that affect the assigned credit rating in terms of further changes that may (but not necessarily) occur.

Forecasts:

positive	'Positive' forecast indicates that the credit rating may be upgraded provided that available positive trends will remain while current risk exposure will be declined.
stable	'Stable' forecast means that credit rating will unlikely be changed.
negative	'Negative' forecast indicates that the credit rating may be downgraded provided that negative trends and current risks will remain.
progressive	'Progressive' indicates that credit rating would likely be changed.

Executive Summary

To the Draft Decree of the Cabinet of Ministers
On Amending and Supplementing the Decree # 208-p dd. April 01, 2004 of the Cabinet of Ministers '*On Approval of the Concept for Development of the Rating System for Regions, Sectors of the National Economy, and Business Entities'*

1. Rationale for the need to adopt the Decree

The Draft Decree of the Cabinet of Ministers *On Amending and Supplementing the Decree # 208-p dd. April 01, 2004 of the Cabinet of Ministers* '*On Approval of the Concept of for Development of the Rating System for Regions, Sectors of the National Economy, and Business Entities'* has been devised in pursuance of the Law of Ukraine dd. 3201-IV dd. December 15, 2005 *On Amending Certain Legislative Acts of Ukraine*, Part 7, to the extent applicable to rating services and rating assignments.

Under Part 7, Paragraph 2, Subparagraphs 9 – 10 of this Law and the Law of Ukraine *On Government Regulation of Securities Market in Ukraine*, Article 7, Paragraph 7, the State Commission for Securities and Stock Market shall develop and implement the National Rating Scale for assigning credit ratings for borrowers i.e. local governments, business entities and for debt instruments (hereinafter, the National Rating Scale) and identify authorized rating agencies eligible to assign ratings for issuers and securities on a mandatory basis.

National Rating Scale.

The National Rating Scale shall be used to assign a credit rating for a borrower i.e. a local government, a business entity, and for debt instruments i.e. bonds, mortgage-backed securities, loans.
The National Rating Scale shall cover all credit ratings, in particular:
rating assigned to issuer's securities which identifies the borrower's (issuer's) capacity to promptly and in full serve its liabilities under securities;
rating assigned to issuer which identifies the issuer's capacity to promptly and in full pay back the principal debt under its debt liabilities and any interest thereon against debt liabilities of any other borrowers;
The National Rating Scale shall comprise two levels: the investment level and speculative level.
The National Rating Scale shall have groups of levels and levels which shall define the borrower's capacity to promptly and in full pay back the principal debt under its debt liabilities and any interest thereon and its paying capacity as well.

Credit ratings may be assigned for a short term (identifying credit risks in terms of short-term perspective i.e. up to one year) and for a long term (identifying credit risks in terms of long-term perspective i.e. more than one year).
Credit rating shall vary from "uaAAA" (the highest creditworthiness) to "uaD" (default) for long-term credit ratings; and from "uaK1" (the highest creditworthiness) to "uaKD" (default) for short-term credit ratings.
Credit rating forecasts (either positive, stable, negative, or progressive) shall comment on prevailing trends that affect the credit rating as far as any changes may (but not necessary) occur in the future.
Such rating may be withdrawn when the borrower fails to supply information required for the authorized agency to update the assigned rating or for any other reasons.

Competitive selection of authorized rating agencies

Competitive selection of authorized rating agencies eligible to assign ratings for issuers and securities on a mandatory basis under the law as well as criteria to be met by such authorized rating agencies allow to strengthen competitive environment and involve as much stockholders as possible in the development of the rating system for regions, sectors of the national economy, and business entities.

2. Purpose and objectives of the Decree

Adoption of this Draft Decree shall address the following purposes and objectives:

improvement of the National Rating Scale;

development of the national rating system for local governments, business entities, stock market operators and instruments;

competitive selection of authorized rating agencies eligible to assign ratings for issuers and securities on a mandatory basis under the law;

building of competitive environment in which authorized rating agencies will operate;

improvement and compliance of the national rating system with current laws for the purposes of identifying investment attractiveness of local governments, business entities, stock market operators and instruments;

application of the national rating results for the purposes of identifying investment attractiveness of local governments, business entities, stock market operators and instruments etc.

3. Background information and general provisions

The Draft Decree implies:

improvement and implementation of the National Rating Scale;

identification of criteria for competitive selection of authorized rating agencies eligible to assign ratings for issuers and securities on a mandatory basis under the law.

The National Rating Scale, as presented by the Draft Decree, is divided into groups of levels and levels and covers all credit ratings including both ratings assigned to issuers and ratings assigned to debt instruments.

The best international standards and best world practice have been taken as a basis for the development of the National Rating Scale.

The identified criteria for competitive selection of authorized rating agencies will eventually allow to strengthen competitive environment and engage as much stakeholders as possible to the development of the national rating system for regions, sectors of the national economy, and business entities.

4. Legal and regulatory framework

Applicable legal framework is outlined below:

Law of Ukraine *On Amending Certain Legislative Acts of Ukraine* # 3201-IV dd. December 15, 2005;

Law of Ukraine *On Government Regulation of Securities Market of Ukraine* # 142/97 dd. February 14, 1997 (as amended and supplemented);

Actions to be taken to implement the Concept for the Development of the Rating System for Regions, Sectors of the National Economy, and Business Entities and the Regulation on the Terms and Conditions of Competitive Tender to Identify Agencies Eligible to Assign Ratings as approved by the Resolution # 236 dd. June 01, 2004 by the State Commission for Securities and Stock Market and registered on July 27, 2004 by the Ministry of Justice of Ukraine, # 945/9544.

5. Financial and economic rationale

The adoption of this Draft Decree shall entail no additional expenses to the State Budget of Ukraine.

6. Forecast for social and economic impact of adopting this decree

Adoption of this draft decree will promote:

improving the national rating system for local governments, business entities, stock market operators and instruments;

strengthening competitive environment for authorized rating agencies;

implementing rating methods in Ukraine in line with the best world rating practice of international rating agencies which are applied by investors on international financial markets;

applying national rating results to identify the investment attractiveness of local governments, stock market operators and instruments etc.

Appendix 1

To the Draft Decree of the Cabinet of Ministers
On Amending and Supplementing the Decree # 208-p dd. April 01, 2004 of the Cabinet of Ministers of Ukraine 'On Approval of the Concept for Development of the Rating System for Regions, Sectors of the National Economy, and Business Entities'

Amendments and Additions
to the Decree # 208-p dd. April 01, 2004 of the Cabinet of Ministers of Ukraine
On Approval of the Concept for Development of the Rating System for Regions, Sectors of the National Economy, and Business Entities

1. Section 1, Paragraph 5, Subparagraphs 1 – 5 shall be restated as follows:

"An agency authorized by the State Commission for Securities and Stock Market to assign ratings (hereinafter, an authorized agency), shall meet the following criteria:

to be a Ukrainian resident;

to render services in a professional manner and to specialize on assigning credit ratings (assigning ratings) or on rendering the related information and research services in support of such credit ratings only;

to apply the National Rating Scale for rating purposes;

to follow in its work the rating procedure which is in line with rating rules applicable for an authorized rating agency as approved by the State Commission for Securities and Stock Market;

to have an infrastructure in place to provide for efficient data collection, processing and review along with tools to disclose such credit ratings to public;

to have at least 2 year related experience;

to have its registered share capital of at least UAH 3,000 thousand paid by cash only;

to have no individuals operating on the financial services market, having proprietary rights or any interest with any operators of the financial services market, or otherwise affiliated with any operators of the financial services market among its founders and/or members;

to have no individuals who are officials in operators of the financial services market and/or officials in any affiliated structures of such operators of the financial services market among its management body;

to assign no credit ratings for its founders and affiliated (related) entities".

2. Paragraph 6 in Section 1 shall be deleted.

3. Section 2 shall be restated as follows

National Rating Scale

The National Rating Scale shall be used to assign a credit rating for a borrower i.e. a local government, a business entity, and for debt instruments i.e. bonds, mortgage-backed securities, loans.

The National Rating Scale shall cover all credit ratings, in particular:

rating assigned to issuer's securities which identifies the borrower's (issuer's) capacity to promptly and in full serve its liabilities under securities;

rating assigned to issuer which identifies the issuer's capacity to promptly and in full pay back the principal debt under its debt liabilities and any interest thereon against debt liabilities of any other borrowers;

The National Rating Scale shall comprise two levels: the investment level and speculative level.

The National Rating Scale shall have groups of levels and levels which shall define the borrower's capacity to promptly and in full pay back the principal debt under its debt liabilities and any interest thereon and its paying capacity as well.

Credit ratings may be assigned for a short term (identifying credit risks in terms of short-term perspective i.e. up to one year) and for a long term (identifying credit risks in terms of long-term perspective i.e. more than one year).

Credit rating shall vary from "uaAAA" (the highest creditworthiness) to "uaD" (default) for long-term credit ratings; and from "uaK1" (the highest creditworthiness) to "uaKD" (default) for short-term credit ratings.

Credit rating forecasts (either positive, stable, negative, or progressive) shall comment on prevailing trends that affect the credit rating as far as any changes may (but not necessary) occur in the future.

Such rating may be withdrawn when the borrower fails to supply information required for the authorized agency to update the assigned rating or for any other reasons."

STATE COMMISSION
FOR SECURITIES AND STOCK MARKET

RESOLUTION

___ ______ 2006 Kyiv # ____

On Making Amendments and Additions to the Regulation on Conditions of the Tender for Identifying Authorized Rating Agencies (revised by the Resolution of the State Commission for Securities and Stock Market # 236 of June 1, 2004 registered with the Ministry of Justice of Ukraine on July 29, 2004, # 945/9544).

Under the Law of Ukraine *On Amending Certain Legislative Acts of Ukraine* # 3201-IV of December 15, 2005, Part 7, and under the Law of Ukraine *On Government Regulation of Securities Market of Ukraine* # 142/97 of February 14, 1997, Article 7, Paragraph 15,

The State Commission for Securities and Stock Market

HEREBY RESOLVES:

1. The Regulation on Conditions of the Tender for Identifying Agencies Eligible to Assign Ratings as approved by Resolution # 236 of June 1, 2004 of the State Commission for Securities and Stock Market and registered on July 29, 2004 with the Ministry of Justice of Ukraine, # 945/9544, shall be amended and supplemented and shall be presented in the revised version (as attached).

2. Mr. M. Nepran, Chief of Staff of the State Commission for Securities and Stock Market, shall ensure that:

this Resolution is registered by the Ministry of Justice of Ukraine;

this Resolution is duly published as required by applicable laws.

3. Mr. M. Nepran, Chief of Staff of the State Commission for Securities and Stock Market, shall control the execution of this Resolution.

Commission Chairman **A. Balyuk**

APPROVED
by Resolution of the State Commission for Securities and Stock Market
____________ 200__, # ______

1. General Provisions

1.1. Devised in pursuance of the Law of Ukraine On *Amending Certain Legislative Acts of Ukraine*, this Regulation shall define the conditions and the procedure for arranging and holding the tender to identify authorized rating agencies (hereinafter, the tender) **eligible to assign ratings for issuers and securities on a mandatory basis under the law**.

2. Grounds and Timeframe for the Tender

2.1. Rating agencies that do not have the status of an authorized rating agencies and are interested to receive it shall have the right to send to the State Securities and Stock Market Commission (hereinafter referred to as "the Commission") a written request to hold the tender.

2.2. The tender shall be initiated by the Commission.

In the event at least two written requests to hold the tender are received from rating agencies, the tender shall be held regardless of the schedule. Scheduled tenders shall be held at least once a year.

2.3. Within 10 business days of its establishment the Tender Committee shall approve the text of the Tender Notice (announcement).

2.4. The Tender Notice (announcement) shall be published in Ukrainian in official publications of the Commission and posted on its website not later than 30 days prior to the tender date.

2.5. The Tender Notice (announcement) shall include:

2.5.1. obligatory requirements to participants of the tender;

2.5.2. date, time and place of the tender;

2.5.3. address to which tender documents shall be submitted;

2.5.4. deadline for the submission of tender documents;

2.5.5. contact telephone and fax numbers, email addresses for requesting information about the tender.

2.6. Participants shall submit to the Tender Committee tender documents indicated in 4.2. of this Regulation not later than the deadline for the submission of tender documents indicates in the Tender Notice (announcement).

3. Tender Committee

3.1. The tender shall be held by the Tender Committee. The Tender Committee shall be established upon the Commission's decision with **the purpose to organize and hold the tender.**

3.2. The membership of the Commission and any changes therein shall be subject to the Commission's approval. The Tender Committee shall comprise at least 7 members.

3.3. The Tender Committee shall follow applicable laws of Ukraine, in particular this Regulation and any decisions made by the Tender Committee.

3.4. A meeting held by the Tender Committee shall be deemed lawful provided it is attended by at least two thirds of its membership. Should a member of the Tender Committee, whose appointment has been approved by the Commission's order, be unable to attend a meeting of the Tender Committee (due to his/her illness, business trip, vacation etc.), a representative of such member whose powers and authorities are legally certified under Ukrainian law shall be assigned to attend such meeting.

3.5. The Committee Chairman shall manage and organize the work of the Tender Committee. The Committee Chairman is appointed by the Commission's decision from among the Commission's membership. The Chairman of the Committee shall have the following powers:

To convene meetings of the Tender Committee;

To chair the meetings;

Organize preparation for considering materials identified in this Regulation;

Secure the involvement of experts and consultants in the work of the Tender Committee, if necessary,

3.6. The Tender Committee shall have the following powers:
3.6.1. define tender timeframes;
3.6.2. approve the Tender Notice (announcement);
3.6.3. study tender applications;
3.6.4. identify eligible bidders;
3.6.5. study and assess tender documents submitted by bidders;
3.6.6. identify tender winners from among bidders;
3.6.7. keep and approve minutes on tender results;
3.6.8. exercise any other functions as provided for by Ukrainian law.

4. Procedure and Conditions for Participation in the Tender

4.1. To be eligible to take part in the tender, a bidder shall confirm its intention to participate in the tender in writing, submit tender documents and meet the following **criteria**:
4.1.1. To be a Ukrainian resident;
4.1.2. To apply the National Rating Scale for rating purposes;
4.1.3. To follow in its work the rating procedure which is in line with the rating rules applicable for an authorized rating agency as approved by the State Commission for Securities and Stock Market;
4.1.4. To have no individuals participating in the financial services market, having proprietary rights or any interest with any participants of the financial services market, or otherwise affiliated with any participants of the financial services market among its founders and/or members and/or shareholders;
4.1.5. To have no individuals who hold official positions in organizations that participate in the financial services market and/or official positions in any affiliated structures of such participants of the financial services market among its managers;

4.1.6. To assign no credit ratings for its founders and affiliated (related) entities.
4.1.7. To have an infrastructure sufficient for efficient data collection, processing and analysis, namely:
Telephone lines – at least 10
Computers – for each employee but not less that 15, minimum technical requirements – processor CPU 1 GHz, memory RAM 128 MB;
Fax machine;
Access to Internet and an electronic mail address.
4.1.8. To have and to maintain an official website for disclosure of information about assigned credit ratings;
4.1.9. To have enough employees with necessary qualification for fulfilling rating procedures and processing the full volume of mandatory rating assessment, namely:
At least 15 employees having a degree not lower than Specialist in finance and/or economy and at least 2 years of work experience in the respective field.
4.2. Before the deadline indicated in 2.7 of this Regulation, bidders shall submit the following **documents** to the Tender Committee:
4.2.1. tender application (Appendix 1);
4.2.2. duly certified copies of the Charter and the Certificate of State Registration of the Legal Entity;
4.2.3. a duly certified copy of the certificate confirming that the legal entity has been registered in the Uniform State Register of Legal Entities and Individual Business Entities kept by the State Statistics Committee of Ukraine;
4.2.4. an auditor's report of the financial standing of such legal entity for the last four quarters preceding the quarter in which the tender is held;
4.2.5. a certificate of no budget arrears issued by a tax administration;
4.2.6. a registration card (Appendix 2);
4.2.7. information about branch and representative offices of the legal entity (Appendix 3);
4.2.8. information about membership of the legal entity in any corporate association (Appendix 4);
4.2.9. information about officials within management bodies of the legal entity including the number and value of shares (stock, equity interest) they hold (Appendix 5);
4.2.10. information about founders and/or members of the legal entity including the number and value of shares (stock, equity interest) they hold in the entity (Appendix 6);
4.2.11. information about business entities in which the legal entity holds or manages (uses) any shares (stock, equity interest) (Appendix 7);
4.2.12. information about the staff (incl. both in-house and freelance staff) of the legal entity (Appendix 8) and documents confirming their qualification and work experience: copies of the degree certificate and the labor book of each employee;
4.2.13. information about founders, shareholders, members of the legal entities holding more than 10% in the authorized capital of the bidder (specifying professional participants of the securities market) (Appendix 9);
4.2.14. a certificate proving that there are no persons among the managers of the legal entity who are participants of the securities market and/or hold official in structures affiliated with participants of the securities market;
4.2.15. documents that confirm having an information infrastructure and tools that are sufficient for efficient data collection, processing and analysis as well as for making information about assigned credit ratings available to public (the number of phone lines, computers, fax machines, modem connections, e-mail address, own mass media, etc.): copies of contracts with telephone connection providers, copies of contracts with Internet service and the official website providers, documents confirming the availability of the required quantity of computers in a proper condition (Appendix 10).

4.3. Tender documents shall be submitted (sent) in written form in a sealed envelope marked *Tender documents*. If necessary and upon request by the Tender Committee, the bidder shall submit tender documents in electronic form on electronic media (diskette, CD).

The envelopes shall be addressed to the Tender Committee and shall specify the tender date and time and shall be clearly marked: DO NOT OPEN BEFORE _________.
In addition to this inscription, envelopes with tender documents shall clearly indicate:
address and details of the Tender Committee;
bidder's address and name.
Tender documents shall be signed by the bidder's CEO or its authorized representative and sealed with the bidder's seal.
4.4. Tender documents shall be registered in a special registration log by the Tender Committee's secretary either at the date of their registration in the Commission's secretariat or, if delivered with a messenger, at the date when such documents are delivered to the Tender Committee's secretary in witness whereof the secretary shall put his/her signature in the registration log.
4.5. The Tender Committee shall receive tender documents not later than the date and time indicated in the Tender Notice (announcement). Tender documents received by the Tender Committee after the deadline shall not be opened and shall be returned to the respective bidders.
4.6. The tender documents submitted by the participants shall meet applicable requirements if they include all necessary documents and information required in 4.2. of this Regulation.

5. Tender Procedure

5.1. The tender shall be held if at least one eligible legal entity (hereinafter "the bidder (bidders) is available from among the tender applications submitted within the designated deadline after the tender notice (announcement) is published.
5.2. The tender shall be held in two stages. For each meeting at each stage of the tender, separate minutes shall be taken and signed by the Chairman and the secretary of the Tender Committee.
5.2.1. At the first stage, the Tender Committee shall hold a public meeting. Any bidder who submitted tender documents for the tender shall attend such meeting.
At the first stage, the Tender Committee shall review bidders' tender applications and keep records of the documents submitted by the bidders.
Any envelope with tender documents shall be opened in the presence of bidders (or their authorized representatives) if they desire so to do and members of the Tender Committee.
Each bidder's full name and address shall be announced when envelopes with tender documents are opened.
Should any further information be needed with regard to the bidder, the Tender Committee has the right to hear the bidder at its meeting.
5.2.2. For the purposes of making decision in regard to the compliance of the tender documents submitted by the bidders with the terms and conditions of the tender and the bidder registration procedure (bidders are denied registration when tender documents fail to meet tender requirements), tender documents shall be submitted to the Tender Committee which shall handle them within 10 days.
5.2.3. Based on the results of reviewed tender documents submitted by bidders, the Tender Committee shall identify eligible tender participants.
5.3. The Tender Committee may reject the bidder's tender application in the following cases:
the bidder's tender application and/or the documents attached thereto are not properly filled or prepared;
at least one of the documents from the list in 4.2. of this Regulation is missing among the attachments to the application;
the bidder has withdrawn its application.
5.4. At the second stage, the Tender Committee shall identify the winners. The meeting of the Tender Committee on the second stage shall not be open to public.
5.5. The Tender Committee shall identify the tender winner (winners) based on the results of reviewing and discussing of the tender documents submitted by the participants.
The tender may have more than one winner.

The decision identifying the winners of the tender shall be adopted by the simple majority. When votes of members of the Tender Committee are equally divided, the Chairman shall give a casting vote.
5.6. The decision of the Tender Committee identifying the tender winners shall be documented in the tender protocol including;
information about tender participants;
voting results;
reasoning behind the decision to identify the winners.
The tender protocol shall be signed by all the members of the Tender Committee who participated in the voting.
5.7. The decision awarding the tender winners shall be subject to Commission's approval at its meeting within 10 business days after the last meeting of the Tender Committee.
Such approval shall empower the rating agency to accept the status of the authorized rating agency entitled to assign ratings for issuers and securities, which are mandatory under the law.
The rating agency has the right not to accept the status of an authorized rating agency.
5.8. The Commission's decision awarding the tender winners shall be either sent to all tender participants by registered mail or delivered by hand to their duly authorized participants within 10 days of the decision's date.

6. Dispute settlement

6.1. Should any tender participant disagree with the tender results, the participant has the right to file a claim with the State Commission for Securities and Stock Market within 10 business days of the date of the Tender Committee's decision to award the winner. The claim shall be discussed by the Tender Committee at its meeting with the participation of the Tender Committee members and the claimant if he decides to do so and such claim shall be considered by the Tender Committee at its meeting.
6.2. If claims are received, the Commission shall hold a meeting with the participation of the Tender Committee members within 30 days of the date of the last claim. The claimant shall be notified of the meeting not later than 5 business days in advance.
The notice to the claimant shall indicate the date and time of the Commission' meeting and the invitation to take part in the meeting.
The claimant shall notify the Commission of his intention to take part in the Commission's meeting not later than 3 business days before the meeting.
6.3. Upon consideration of claims from the tender participants, a decision shall be made and signed by the members of the Commission and the Tender Committee. The decision must include information about taking account of the claimant's objections in regard to fairness and legitimacy of the tender results stated in the claim or reasons to disregard the objections.
If the objections stated in the claim are deemed reasonable, the Commission and the Tender Committee shall decide to acknowledge the participant as the winner of the tender. The claimant shall be notified of this decision within 10 calendar days.
6.4. If the tender participant disagrees with the Tender Committee's decision he has the right to challenge this decision in accordance with Ukrainian law.

O. Petrashko

Director,
Corporate Relations Department

Translation of Law 3201 Dated 15 December 2004, Chapter headings only except for Section 7 imposing ratings.

LAW OF UKRAINE

On Amending Some Legislative Acts of Ukraine

With amendments introduced by the Law of Ukraine of February 23, 2006 No. 3480-IV

The Verkhovna Rada of Ukraine hereby **resolves**:

I. To introduce changes to the following legal acts of Ukraine:

1. Administrative Violations Code of Ukraine
2. Economic Code of Ukraine
3. Civil Code of Ukraine
4. Paragraph 4, part I shall be considered void

(in connection with the fact that the Law of Ukraine of June 18, 1991 # 1201-XII pursuant to the Law of Ukraine of February 23, 2006 # 3480-IV was superseded and extinguished)

5. The Law of Ukraine "On Notary Services"
6. Article 7 of the Law of Ukraine "On Privatization of Small State Owned Enterprises (Small Scale Privatization)"

7. The Law of Ukraine "On State Regulation of the Securities Market in Ukraine"

1) shall be added with the following paragraphs in Article 1, Part One:

"Assessment of credit rating (rating) means services being rendered in a professional manner on the securities market with the aim to define the creditworthiness of a rated entity and may be performed by a rating agency as well;

Credit rating means the conventional expression of creditworthiness for either the rated entity as whole and/or for its separate debt liability based on the national crediting rating scale;

The National Rating Scale (hereinafter, the National Scale) means the scale grouped by levels along with such levels defining the borrower's capacity to promptly and in full extent repay the applicable interest rate and the principal debt under its debt liabilities and its paying capacity as well. The National Scale shall be used to assess the credit risk of the borrower i.e. a local government authority or a business entity, and of debt instruments i.e. bonds, mortgage-backed securities, loans.

Issuer credit rating defines the level of a securities issuer's capacity to promptly and in full extent pay the applicable interest rate and the principal amount under its debt liabilities with regard to debt liabilities of any other borrowers.

Issuer securities rating defines the borrower's (issuer's) capacity to promptly and in full extent serve liabilities under securities";

2) shall be added with Article 4.1 as follows:

" **Article 4[1]. Rating agencies and rating assessment**

Rating, which shall be mandatory under the law, may be assessed by an authorized rating agency and/or an international rating agency (jointly, the rating agencies) only. International rating agencies shall be authorized by the State Commission for Securities and Stock Market thereto.

The agency shall acquire the right to assess rating on the date when such agency is issued a certificate of registration in the State Register of Authorized Rating Agencies.

The agency shall be registered in the State Register of Authorized Rating Agencies on a competitive basis (hereinafter, the competition).

More than one agency may win the competition.

The international rating agency shall acquire the right to provide rating assessments on the date when such international rating agency is entered into the list of rating agencies authorized by the State Commission for Securities and Stock Market.

The authorized rating agency shall use the National Scale for the purposes of rating assessment being mandatory under the law.

The National Scale shall comprise two groups of levels: the investment level and speculative level.

The National Scale along with the scale groupings by levels shall be approved by the Cabinet of Ministers of Ukraine.

An international rating agency shall use such scale as approved by such agency for the rating purposes.

The law shall list the events of compulsory rating of issuers and securities.

The following issuers shall be subject to compulsory rating assessment:

1) enterprises with a state share in the authorized capital;

2) enterprises which are strategically important for the national economy and security;

3) enterprises enjoying monopolistic (dominant) position.

The compulsory nature of the rating assessment shall not depend on the ownership pattern, legal accountability or any other features of the issuer.

Unless otherwise provided for by the law, rating shall be assessed for any type of equity securities which are not distributed among founders or pre-defined holders and may be distributed by subscription, or purchased or sold on the stock market or any other formal market except for:

1) public securities;

2) shares;

3) securities of non-diversified co-investment institutions;

4) securities issued by the State Mortgage Lending Agency.

The compulsory nature of securities rating assessment shall not depend on the issuer, type of issue, method of placing or any other properties";

3) shall be added with Paragraphs 31 – 37 in Article 7, Part Two as follows:

"31) shall issue the Certificate of Registration in the State Register of Authorized Rating Agencies to authorized rating agencies;

32) shall define the list of international rating agencies authorized to make mandatory rating assessments for issuers and securities;

33) shall define the record-keeping procedure for and shall keep the State Register of Authorized Rating Agencies;

34) shall prescribe rating assessment rules for authorized rating agencies based on the National Scale;

35) shall establish the procedure of submitting information by the rating agency to the State Commission for Securities and Stock Market;

36) shall define whether rating levels applied by the international rating agency comply with those of the National Scale;

37) summarize experience and practice of rating agencies and ensure rating publicity";

4) shall be added with Paragraphs 27 – 29 in Article 8 as follows:

"27) shall determine marginal rates applicable to services rendered by rating agencies to be paid through the national and local budgetary funds;

28) shall audit financial and business operations of an authorized rating agency either independently or in cooperation with any other competent authority;

29) shall take any legal measure of influence including termination of registration of an authorized rating agency in the State Register of Authorized Rating Agencies, cancel the Certificate of Registration in the State Register of Authorized Rating Agencies, withdraw an international rating agency from the list of authorized agencies";

14. The Law of Ukraine *On Insurance*:

2) shall be added with the following provisions in Article 31:

"The credit rating of a banking institution holding insurance reserve funds shall match the investment level under the national scale as defined by the laws of Ukraine.

The credit rating of securities issued in Ukraine and accumulating insurance reserve funds shall match the investment level under the national scale as defined by the laws of Ukraine."

24. The Law of Ukraine *On Non-public Pension Insurance* shall be added with Paragraphs 17, 18 and 19 in Article 49, Part One:

"17) to purchase securities which credit rating has not been assessed by the rating agency but has met the speculative level under the National Scale as defined by the laws of Ukraine;

18) to purchase any securities of any issuer which credit rating has not been assessed by the authorized Rating Agency but has met the speculative level under the National Scale as defined by the laws of Ukraine;

19) to hold funds at any bank deposit account or in any savings certificate of banks which credit rating has not been assessed by the authorized rating agency but has met the speculative level under the National Scale as defined by the laws of Ukraine."

FINAL PROVISIONS

1. This Law shall enter into force on the date of publishing.

2. The Cabinet of Ministers of Ukraine shall:

prepare and submit the draft **Law of Ukraine governing the national rating system in Ukraine** to Verkhovna Rada for approval within a six-month period upon the effective date of this Law.

December 15, 2005
N 3201-IV

Exhibit D. Sample Business Plan Outline

Plan Outline

1) **Executive Summary**
    i) *Market Development*
    ii) Management
    iii) Shareholder Group
    iv) Investment Required
    v) Use of Proceeds
    vi) Forecast and Valuation

2) **Key Investment Considerations**

3) **Overview**
    i) Mission Statement
    ii) Objectives
    iii) Corporate Form

4) **Markets, Products and Services**
    i) Identification and Segmentation
    ii) Data Bases
    iii) *Introduction to products*

5) **Product Descriptions**
    i) Rating - Introduction
    ii) Municipal Ratings
    iii) Corporate/Bank Ratings
    iv) Commercial Paper/Deposit Ratings
    v) Bulletin/CP Report
    vi) Reports/Sector Studies
    vii) Bank Risk Handbook/Statistics
    viii) Agency Analytical Seminars

6) **Management**
    i) General Management
    ii) Analytical Staff

7) **Financial Summary**

8) **Table of Exhibits**

    i) *A: Financial Forecasts, Revenue Models*
        (a) Compensation Table
        (b) Expenses
        (c) Purchases
        (d) Revenue Model (Base)
        (e) Income Statement (Base)
        (f) Net Working Capital
        (g) Cash Flow
        (h) Projected Balance Sheet Accounts
        (i) Revenue Model 1 (10% Case)
        (j) Income Statement 1
        (k) Revenue Model 2 (20% Case)
        (l) Income Statement 2
        (m) Summary Statistics
    ii) B: Marketing Survey Summary

Exhibit E. List of persons interviewed

Name	Organization	Date
Alexander Ginzburg	Credit-Ratings	8 September 2006
Stanislav Dubko	Credit-Ratings	8 September 2006
Eugen N. Grigorenko	Ukr Assoc. of Invest. Business	11 September 2006
Victor A. Kolbun	Ukr Assoc. of Invest. Business	11 September 2006
Volodimir V. Feschenko	Ukr Agency of Fin. Development	11 September 2006
Sergiy Prilipko	Stock Market Agency Ltd	12 September 2006
Vitaliy Granovskiji	PrivatBank	13 September 2006
Martin Raiser	IBRD	14 September 2006
Vitaliy Bigdai	IBRD	14 September 2006
Yuriy Kamenetskiy	Ukrgasbank	14 September 2006
Ramon Jachovski	Ministry of Economy	15 September 2006
Ann D. Wallace	USAID CMDP	18 September 2006
Victor Stetsenko	USAID CMDP	18 September 206
Volodymyr V. Vysotskyi	Ministry of Finance	18 September 2006
Kateryna Beradze	Ministry of Finance	18 September 2006
Valeriy B. Alyoshin	SCRFMS	18 September 2006
Tetyana Mosiychuk	SCRFMS	18 September 2006
Roksolana I. Malyy	SCRFMS	18 September 2006
Olena Kalinivska	SCRFMS	18 September 2006
Mariya Polishuk	SCRFMS	18 September 2006
Nikolay Kruglyakov	IBI Rating Agency	19 September 2006
Viktor P. Lisovyi	Assoc. of Ukrainian Registrars	20 September 2006
Alexei Petrashko	SSMSC	20 September 2006
Antonina B. Palamarchuk	Assoc of Ukrainian Banks	22 September 2006
Volodymyr I. Kucheruk	Assoc of Ukrainian Banks	22 September 2006
Oleksandr Kirieiev	National Bank of Ukraine	29 September 2006
Olena Chernilevska	Ukr State Anti Monopoly Com.	2 October 2006
Mykola Barash	Ukr State Anti Monopoly Com.	2 October 2006
Lyudmyla Zhornyk	Ukr State Anti Monopoly Com.	2 October 2006
Olena Zhuravel	Ukr State Anti Monopoly Com.	2 October 2006

John Michael McMullen

A veteran of 20 years at the MOODY'S INVESTORS SERVICE, Mr. McMullen has participated in a wide range of assignments and projects for banks, financial institutions, and NGO, such as USAID, World Bank, Thomson BankWatch in more than 20 countries in Europe, Asia, and the United States. Mr. McMullen has published numerous articles and columns for Moody's weekly publications; and articles and columns on ratings and analysis for market magazines such as *Euromoney* and *Market* (Warsaw).

MOLDOVA
ATTACHMENTS

ATTACHMENT 1

Report of the Visit in Chisinau, Moldova

November 27 – December 1, 2006

Prepared by Mr. A. Kopeikin and Ms. N. Rogojina

Purpose of the visit: to study the situation of the residential mortgage lending market in the Republic of Moldova for the purpose of adapting the program "Certified Mortgage Lender".

During the visit, there were held meetings with the specialists of a number of Moldovan banks (Mobiasbanca, Agroindbank, Investprivatbank, Moldincombank, Saving bank, Victoriabank) and the non bank credit organization Prime Capital, the representatives of the National Bank of Moldova, Banks Association, National Commission for Securities, State enterprise "Cadastre", European Bank for Reconstruction and Development.

The residential mortgage lending market of Moldova is characterized by the following features:

1. The residential mortgage lending market began its formation during the last one year and a half. The majority of banks began the mortgage lending in 2006. The Saving Bank is preparing to launch its mortgage lending program. In general, the market of mortgage lending is in its initial stage of development. Its volume is evaluated by the experts on the level of $30 million.

2. The legislative mortgage lending basis is in the process of improvement. The adopted Civil Code permits to develop mortgage activities. According to the opinion of many participants of the mortgage market, in order to regulate the mortgage system it is necessary to adopt the Law on mortgage lending, which, at present, is under development. The bankers and specialists of the securities market consider that it is necessary to adopt a law on mortgage securities so that there is a perspective to involve long term resources of institutionalized investors in the mortgage.

3. The problems for mortgage development:

    a. lack of long term resources – 3-6 months deposits prevail;
    b. population low income;
    c. prevalence of income, non confirmed by official documents.

4. Types of residential lending:

    a. Classic mortgage lending for buying housing space pledging the purchased space;
    b. Lending for improving the living conditions – intermediary lending;
    c. Lending for participation in construction of multi storied buildings (share participation) pledging the rights on future housing space and providing additional collateral in the form of other real estate property or property guarantees on behalf of third parties;

    d. Municipal mortgage program (Agroindbank) – attraction of mortgage deposits (accumulation of resources during the period of housing construction) for further offering to citizens mortgage lending on beneficial conditions for purchasing the ready constructed housing space.

5. Problem: there is considerable share of lending based on citizens participation in housing building (investments in housing building) – this fact increases the lending risk, as the usual bank risks are amplified by building risks.

6. Lending conditions:
    a. Lending terms – up to 10 years (there is demand for up to 20 years);
    b. Lending currency – lei (prevail), there is also lending in lei correlated with Dollars;
    c. LTV – 70-80%, can be 100% upon condition of additional collateral in the form of property guarantee on behalf of third parties;
    d. Interest rates type – fixed interest rates prevail, floating interest rates are widely used (some banks don't include in the lending agreement provisions on changing the interest rate; other banks' agreements include conditions on changing the interest rate: the 3-6 months deposits rate or the inflation level is regarded as an indicator);
    e. The level of interest rates for lending in lei is 12-16%; for lending correlated with dollars is 13-17%;
    f. Evaluation of lenders creditworthiness: officially confirmed income is taken into account as well as the unofficial income; the share of the lending payment in total income constitutes from 50-70%;
    g. Insurance – as a rule, is not obligatory in order to make the lending product cheaper; some banks practice only the insurance of immovable property, others require life and work capability insurance, one bank is using an insurance package, including title insurance;
    h. Methods of lending redemption: annuity; equal redemption of the principal debt and application of respective interest on the remaining debt; flexible forms of redemption.

7. In our opinion the main problems are the insufficient development of the insurance on mortgage lending; high share of payment on lending in the total income; low level of standardization in mortgage lending.

ATTACHMENT 2

Mortgage Lending Training Course Adaptation

Sent by Natalia Rogojina

During the process of Certified Mortgage Lender Program adaptation the following changes are to be made: new courses on the legislation of Moldova in mortgage lending area, on mortgage lending legal aspects, on issues related with problematic loans, on particularities of mortgage transactions registration have been prepared. The number of sessions in computer classes, dedicated to preliminary qualification of lender and mortgage lending underwriting will be increased. The training material will take into account the practice of banks and non banks lending institutions of Moldova acting on the mortgage lending market. In particular, the specific features of potential lenders creditworthiness evaluation in situations when the unofficial revenues prevail will be taken into account while adapting the courses and practical sessions referring to underwriting. Different approaches to the evaluation of creditworthiness and the experience of other countries with similar conditions will be considered.

The particularities of Moldova will be taken into account while preparing the list of documents necessary for underwriting. The courses on mortgage lending risks management will be completed keeping in mind the specifics of the Moldovan market and applied mortgage lending schemes. The courses will include practical materials and examples reflecting the particularities and experience of mortgage lending development in Moldova. The course on residential construction mortgage lending will be completed with materials regarding the evaluation of lending risks related with co-participation of citizens in financing residential construction (taking into account the increasing volume of such lending in Moldova).

The courses will be adapted taking into account the social and economic situation and specific features of banks’ practice. The information obtained during the meetings with the specialists of the mortgage market participants and from other sources will also be used for that purpose. The business game on granting and servicing mortgage loans will be updated taking into consideration the particularities of the Moldovan residential and mortgage lending market. Besides that, the sessions on foreign mortgage lending experience will include new information derived from foreign sources.

ATTACHMENT 3

Report Re: Leasing Activities
December 3 – 7, 2006
Prepared by
Robert Homans

From December 3rd through 7th I visited Moldova, for the purpose of conducting an assessment of the leasing companies in Moldova and the prospects of offering advisory services to these companies. An additional purpose of the trip was to assess the opportunities, and challenges, of offering a Certified Leasing Specialist Program in Moldova.

During the course of my trip I met with 6 of the 7 largest leasing companies in Moldova. The only major leasing company I did not meet with, East-Auto-Lada & Iveco Leasing, is a "niche" auto lessor and I understand is not likely to change their strategy in the near future. I also met with a major insurance company offering insurance products to local lessors, whose General Director formerly worked with one of the major lessors. He gave us valuable perspective on the Industry. I also met with representatives from "Dina Cociuc," a large vendor of food manufacturing and foodservice equipment in Moldova, who has a strong relationship with one of the lessors we met with. Finally, I met with Corneliu Rusnac, Project Manager for USAID/Moldova, as well as Eugenia Stancu and Doina Nistor of the Competitiveness Enhancement and Enterprise Development ("CEED") Project.

In all my meetings I was accompanied by Mr. Vlad Railean, Financial Leasing Advisor attached to ATCI's Program Office in Chisinau. In addition to Mr. Railean, Mr. Rick Dvorin joined us for the meeting with Mr. Rusnac of USAID. I found Mr. Railean to be extremely knowledgeable and helpful. Mr. Railean's notes of each one of our meetings, including the names and Titles of those with whom we met, are attached to this Report. In his notes Mr. Railean provides detailed data about each company with which we met. Therefore, I will not repeat the data in my Report, except in general terms.

Overall Conclusions/Leasing Market:

1. **High Level of Knowledge and Professionalism –** Almost without exception, I found high level of knowledge and professionalism among the leasing company representatives I met with. Underwriting conditions in Moldova are probably more difficult than they are in Ukraine. Therefore, as a leasing company, in order to make money it is important to have extremely strong credit and underwriting skills.
2. **Moldovan Leasing Industry is Very Small, but Growing Fast –** Presently, the two largest lessors in Moldova, each with approximately 40% of the market, have outstanding portfolios of approximately $17 million. This puts the overall annual volume, all the lessors in Moldova, at around $42.5 million. One of these two,

IMC, stated that they have a current monthly “run rate” of around $1 million. This indicates, at least for IMC that their business is growing substantially.

3. **Lack of Capital –** All the leasing companies we met with said that lack of capital was limiting their ability to offer “new” products, especially more leasing of capital equipment. One of the 2 largest lessors, MAIB, has accessed the Moldovan capital market, having completed 1 bond issue, for approximately 5.6 million Moldovan Lei (approximately $427,000.00), and are about to register another for 20 million Lei (approximately $1.5 million). Therefore, encouragement leasing companies needing capital to issue bonds seems appropriate.
4. **The Moldovan Leasing Market is a “Duopoly” –** As mentioned in No. 2, above there are two lessors, MAIB and IMC, that together have approximately 80% of the local leasing market. Additionally 2 other companies, EuroLeasing and BS Leasing, together have approximately 15% of the market. Of these 4 only 1, IMC, is not owned by a Moldovan commercial bank. IMC has backing from a US private equity fund based in Kyiv. Therefore, need to expand number of leasing companies as well as expand diversification of assets for leasing; plant seeds; provide leasees’ needs.
5. **More Innovation Coming from Smaller Players –** As might be expected, the smallest of the 6 leasing companies with which we met, appear to be the most innovative, especially with respect to the desire to lease more capital equipment. This is especially true for BS Leasing and Electro Systems Leasing.
6. **Significant Potential Demand from Equipment Vendors –** If our meeting with “Dina Cociuc” (the distributor of food Manufacturing and foodservice equipment) was any indication, there is a significant unmet demand for capital equipment leasing, along with a history and willingness to use leasing as part of vendors’ marketing programs.
7. **Few Problems with Legal or Regulatory Conditions –** At only 1 of our meetings, with IMC, was there any mention made of existing legal or regulatory problems. IMC raised issues having to do with accounting treatment of leasing. They promised to provide us with more details on this issue. In addition, MAIB Leasing mentioned problems associated with the requirement of having to register vehicles with the Ministry of Defense.

Overall Conclusions/CLS-Training:

1. **Significant Desire for Training and the CLS Program –** Every leasing company we met with expressed a strong desire for training of the type that is offered in connection with the CLS Program. They all asked the same question, “when do you plan to start?”
2. **Strong Desire for the Training and CLS to be “Moldovan” –** Most every company we met with expressed the strong desire that the Training and CLS Program be adapted to Moldovan conditions, as it was in Ukraine, and that the Program must be run by Moldovan institutions. I agree with both these sentiments, but it must be understood that meeting them will put significant demands on the ATCI Program Offices in both Chisinau and Kyiv.

3. **No "Local Counterpart" –** Presently there is no leasing association, similar to either "UKRLEASING" or the Union of Ukrainian Lessors, which could serve as a local counterpart in a Moldovan CLS Program. The existence of a local counterpart would appear to be essential, for the continued success of a CLS Program in Moldova as an independent entity. At our meetings it was revealed that there is informal communication among Moldovan lessors, but no great desire for an actual Association. A Moldovan association is also a pre-requisite for eventual membership in LeasEurope, which itself is an organization made up of national leasing associations. The representatives of the CEED Program, with whom we met, have offered to be of assistance in setting up a Moldovan Leasing Association.
4. **Danger of Co-Option –** Care should be taken that the CLS Program in Moldova does not end up being controlled by one, or both, of the 2 largest lessors. This is especially important because it appears that at least 2 of the smaller lessors appear to be the most innovative and thus may be the biggest beneficiaries of the training program included in CLS.
5. **Timing –** Development of CLS/Moldova should begin in earnest in the 1st Quarter of 2007, but not until after the protocols with the Ukraine training providers are executed and training sessions begin in Ukraine. The reasons for this recommendation are as follows: 1. I believe it is important that the Ukraine CLS Program be fully operational, at least with respect to the on-going training, before work is begun setting up a similar program in Moldova; 2. Developing a CLS Program that is "Moldovan" is going to place significant demand on the ATCI Program Office in Chisinau, not to mention Kyiv, if the body of knowledge is to be adapted to Moldovan conditions, Moldovan institutions to be set up, etc.

Opportunities/Advisory Services –

From the meetings I had I believe there are several advisory opportunities. In addition to the specific opportunities I will mention in this report, I think that most companies we met with could use assistance. I think additional advisory opportunities will arise as a result of continued discussions between the companies and the Program Office in Chisinau, with assistance from Kyiv.

Here the specific opportunities that I would suggest pursuing initially:

1. **Electro-Systems Leasing –** Electro-Systems Leasing is a subsidiary of a Moldovan bank called Energbank. Electro Systems Leasing is the only lessor I have met with, in either Ukraine or Moldova, who is utilizing their Parent's branch network to generate business. Energbank has 29 branches throughout Moldova. Electro-Systems Leasing, along with MAIB and IMC uses radio ads. No leasing company in Ukraine, that I am aware of, uses radio ads, especially to advertise the financing of capital equipment (Electro Systems' portfolio is 50% capital equipment). When I asked Ms. Semionova, the Vice Director, if the radio advertising has been effective, she answered in the affirmative.

As far as I am aware no bank-owned leasing company, in either Ukraine or Moldova, is using their Parent's branch network, to generate business, they way Electro-Systems is using their Parent's branch network. This has significant for increasing the volume of agricultural leasing in Moldova, among other industries. For example Reiffeisen/Aval Leasing has the potential of using Aval's network of branches throughout Ukraine. However I understand that most, or all, of Raiffeisen/Aval's lease volume is generated from Kyiv.

The advisory services for Electro-Systems might include advice on marketing and credit, with the idea on better utilizing their Parent's branch network and more aggressively going after business is certain industries, including agriculture. Electro-Systems is not one of the 4 largest lessors in Moldova, so their portfolio is currently very small. In addition Electro-Systems' current portfolio is 50% capital equipment, a far higher percentage than any other company we met with, including furniture, pharmaceutical and medical equipment. In other words, Electro-Systems has already diversified their portfolio, at a time when others are only talking about it.

2. **BS Leasing** – BS Leasing is a subsidiary of the Moldovan bank, Bank Socialia. When we met with Mr. Oleg Kovaliov, the General Director, he observed that he wanted to move the company's portfolio over to capital equipment as fast as possible.

   BS Leasing's current portfolio is 70% titled vehicles and 30% equipment. Mr. Kovaliov expressed a desire to shift the portfolio to 50% capital equipment within 2 years and, eventually, to 70% capital equipment. Mr. Kovaliov stated that local leasing companies who continue to rely on titled vehicles for future growth are going to run the risk of having to compete with better-capitalized Western Europe car lessors (Sixt, First Lease, etc.) who are beginning to enter the Moldovan market and can offer much lower rates and better term structure.

   Advisory services for BS Leasing would include areas in marketing and credit that would facilitate their stated desire to increase the volume of capital equipment leasing. This would be consistent with the stated goals of the Leasing Component of ATCI.

3. **IMC Leasing –** IMC Leasing, one of the 2 largest lessors in Moldova, expressed a desire for advisory services to develop marketing programs directed at certain industries. Such advisory services, if offered, would have to be coordinated with the CEED Program, who is already assisting IMC develop programs for companies in the wine, garment and IT industries.

4. **"Dina Cociuc" –** As mentioned earlier this company sells food manufacturing and foodservice equipment, and is aggressively using leasing in their sales program. They currently have a leasing relationship with MAIB Leasing that,

interestingly, did not mention much of a desire to increase financing of capital equipment. Nevertheless, Dina expressed strong satisfaction with their relationship with MAIB.

The representatives with Dina that we met with stated that they take an active role with customers, making sure that the customers have all the financial information required for MAIB to make a decision. In addition they offer training to their inside sales force on how to use leasing to increase sales volume.

My company, Norden Capital, specializes in leasing food manufacturing equipment. In addition to Norden's web site, I gave them the web sites of two vendors Norden works with extensively, both of whom carry equipment similar to that sold by Dina. Because of my industry experience, through Norden Capital, I believe the Project can offer extremely useful advisory services to Dina.

Advisory services might include marketing strategies on how to increase the use of leasing. A portion of these services might be offered jointly to Dina and MAIB. In addition similar advisory work could be offered to other equipment vendors, in other industries.

5. **MAIB Leasing** – In addition to a possible joint program with Dina, and as mentioned earlier MAIB Leasing has successfully accessed the Moldovan capital markets, with 1 bond issue. They are in the processing of registering their 2nd issue. Possible advisory services for MAIB might be connected with raising capital, including the bond issue.

6. **Targeted Marketing** – I have suggested in the past drafting a business plan, or prospectus, covering the opportunities associated with leasing "small ticket" medical equipment in Ukraine. I would seriously consider extending this strategy to the furniture industry and do the same in Moldova. These prospectuses could be shared with existing leasing companies, as well as other financial institutions considering entering the market. Moldovan companies seem to be going after certain industry to a greater degree than their Ukrainian counterparts who appear to be more generalists.

   The CEED Program is essentially offering targeted marketing programs in Moldova, with the garment industry, the wine industry and the IT Industry. I see our work in this area as complimenting CEED, but taking a broader focus. In addition the AMACO Finance Business Plan can be seen as a proxy for leasing of agricultural equipment in Ukraine, in addition to its utility for AMACO itself.

Cooperation with CEED:

CEED has requested my assistance in finding a US specialist who could help them, and IMC, develop a leasing program targeted at the garment industry. I know an individual, who I have known and worked with in the leasing industry for the past 15 years, who may be interested. He runs a leasing company in the US that specializes in financing garment manufacturing equipment. CEED has agreed to provide me with the TOR for this position.

In addition CEED has asked our help in finding a consultant to help install and updated IT system for IMC. I have agreed to see if such a person is available, for a 10 day engagement in Moldova.

ATTACHMENT 4

Report by Vlad Railean, Senior Financial Leasing Advisor, ATCI/Moldova

The main Moldovan Financial Leasing Companies are (*):

1. **IMC Leasing*** (NCH Holdings)
2. **MAIB Leasing*** (Agroindbank)
3. **Euro-leasing*** (insurance Co& others)
4. **BS leasing*** (Banca Sociala)
5. **East-Auto-Lada & Iveco Leasing***
6. **Electro-Systems Leasing*** (Energbank)
7. **Status Leasing*** (Moldinconbank)
8. Teh-agro Leasing (state owned)
9. Gallas Leasing (closed operation)
10. Top Leasing - newcomer
11. Total Leasing - newcomer
12. Eurobus Leasing – very small
13. Excelent Leasing – very small
14. Sixt Optima Leasing (car rentals)

MINI – REPORT
(About the Moldovan Financial Leasing Companies)

4-th of December 2006, Monday

1. **10.00 a.m.** - **Euro-Leasing,** Vladimir Tsopa, General Director, str. 33 Izmail, tel: 27-27-09, mob: 069104520
   - Portfolio – 200 mln. Lei; ratio: 60%/40% legal entities/physical entities; 85% - vehicles and 15% - equipment & agricultural technique;
   - Created in 2002, owners – 2 private companies (one of these is an insurance company) & one entrepreneur;
   - Conditions: up to 3 years, 20% - down payment, 16% - interest rate ($/Euro)
   - Risk coverage: CASCO, financial Risk insurance, mandatory buy-back agreements with the equipment suppliers;

2. **03.00 a.m.** - **MAIB Leasing,** Mariana Solomon, Finance Director, str. 49/4 Tighina, 4-th floor, tel: 20-36-16, mob: 069750848
   - Portfolio – 220 mln. Lei, ratio: 70% legal entities/30% physical (implemented about 200 big projects), 20 employees;
   - Diversification: 50% vehicles, 6% trucks, 18% real estate (they require Life insurance), 1% agriculture, 1% IT equip.
   - Corporate bonds issuance – 5.6 mln. MDL for 18 months, with quarterly paid coupons at 10% annually;
   - They plan to issue new 20 mln. MDL corporate bonds with 3 years maturity, paid semiannually;
   - Expecting soon to get another 40-60 mln.MDL – additional investment;

- New strategy is going to change their portfolio as follows: cars 35%, equipment 35%, real estate 35%;
- They attend ACAP – local training program for the MAIB credit managers, it's about Financial Statement Analysis and accounting;
- Risk coverage: CASCO, financial risk insurance, buy-back contract with the equipment vendors;
- Problems encountered: car registration at the Defense Department, court decisions are executed very slow in regards to the defaulted clients;
- They would like to have kind of "Guarantee Fund" or an institution which could provide advisory services in terms of International Financing;

5-th of December 2006, Tuesday

3. **11.00 a.m. - <u>BS Leasing,</u>** Kovaliov Oleg, General Director, str. 21 Moscova, tel: 44-10-44, mob: 069110237

- Portfolio diversification – 70% vehicles, 30% equipment, but untill the end of 2008 they intend to make it vice-versa: like 70% equipment and 30% other;
- Conditions: 20% down payment, up to 5 years, 15-17% per year, within one day; in MDL at 20-24% up to 3 years;
- Risk coverage: CASCO, financial risk insurance, buy-back contract with the equipment vendors;

4. **03.00 a.m.** – **<u>Victoria Asigurari</u>** (former "Orateh" Insurance company), Lungu Octavian, General Director, str. Romana 8, tel: 22-83-53, mob: 069126390

- "Victoria Bank" – is the main shareholder
- Portfolio – real estate/property insurance, equipment insurance, travel insurance, medical insurance, motor insurance, CASCO insurance, etc.
- Starting from 2007 they will increase their equity up to 15 mln. MDL;
- They just intend to start collaboration with several leasing companies;

6-th of December 2006, Wednesday

5. **10.00 a.m. - <u>Electro-System Leasing,</u>** Semionova Elena V., Vice-Director, str. V. Alexandri 78, tel: 54-87-74; tel: 22-38-22

- Portfolio – about 20 mln. lei, the ratio is 95% legal entities/5% physical entities; 40% of their sales are in MDL and other 60% in currency ($&Euro);
- Conditions: 30% down payment, 16% interest rate in currency for up to 7 years, 19% interest rate in MDL for up to 2 years;
- Risk covering – 3-rd part guarantee, warranty from the equipment vendors, additional collateral, CASCO for vehicles, a few buy-back agreements with the suppliers;
- Clients – most of them come from 29 branches of Energbank (from all over the country), others are repeated clients who recommend new clients (snow ball effect);
- Strategy – they want to make their portfolio like 50% equipment and 50% other assets;

6. **12.00 a.m. – <u>USAID Program</u>**, Corneliu Rusnac, Project manager,_57/1 Banulescu-Bodoni Street, ASITO Building, 5th Floor, tel: 20-18-00; fax: 23-72-77

- It was a short introduction about ATCI Project in Ukraine and a review of the meetings we had with local leasing companies

7. ***03.00 p.m. - East-Auto-Lada & Iveco Leasing,*** *Mararita Mihail, Dealer-President, str. 43 Cucorilor, tel: 46-38-42; mob: 069102288 –* ***CANCELED !!!***

8. **04.00-05.00** p.m. - **IMC Leasing,** Sahanovski Sergiu-General Director, mob: 079401075, Zbanca Serghei – Finance Director str. 20 Moscova tel: 498-444,

- Portfolio – about 14 mln. Euro, the ratio: is 60% legal entities/ 40% physical entities;
- Diversification: about 84% car-vehicles, 8% trucks and 8% capital equipment and agricultural equipment;
- The new strategy is - to have 60% vehicles and 40% other equipment (including agricultural) in about 2-3 years;
- Their needs: they need advising in elaborating long-term strategy, in interest rates protection, in products standardization, in long-term financing, in accounting standards;
- They have shown high interest in Corporate Bonds issuance; they would like us to give them advise in these regards, and to provide technical assistance step by step;
- Also, they promised to send us a list with concrete problems they face up till now;
- Bob promised to send them a curriculum about the CLP training program; they are quite interested to have such trainings courses as soon as possible, but to the course to be tailored to the local needs, regulations and laws;

7-th of December 2006, Thursday

9. **10.00 a.m. – Status Leasing,** General Director, Dorian Harghel, str. Bucuresti 83, tel: 23-26-22; mob: 069110692
    - They registered their company in April 2006 and started their activity in June 2006
    - Portfolio – about $ 200 000;
    - Diversification: they are focused on the roads construction equipment, water purification equipment, streets lightening equipment, and expensive cars; they intend to increase the equipment financing because of the European trend;
    - Conditions: for the cars – 15% interest rate in currency, up to 3 years, 20% down payment; CASCO insurance up to 4.5%;
    - Conditions: for the equipment – 17% interest rate in currency, up to 3 years, 30% down payment, insurance up to 1.5%;
    - They charge an interest rate on VAT too (which is not fair in respect to the lessees);
    - They believe the Moldovan State would be a potential customer/client in terms of leasing in the near future;
    - Number of employees – 5 in total;
    - They would like to take that CLP course, just if it is adapted to the local laws and regulations;

10. **11.30 a.m. – "Dina Cociuc",** food & beverage equipment vendors, Mihail Cociuc-General Director & Popova Liudmila-Finance Director, str. Dacia 38/7, tel: 56 88 30; mob: 079110706
    - They sell 15% of their equipment mostly through MAIB Leasing, sometimes through Euro-Leasing and another 15% they sell through retail credits offered by the local banks – especially, through Agroindbank and Mobiasbank;
    - Most of the clients who buy the equipment in leasing are legal entities;
    - They have buy-back agreements with the leasing agencies, so they are who bear all the risks not the leasing company;

- They believe that the market is ready to swallow more leasing transaction, because about 70% of the total population understand the importance of leasing and of retail loans;
- They hold – 1-st place in the refrigerators & freezers equipment selling, in the heating segment they are the 4-th in the market; they outsource the engineering;
- Profit –increased by 25% compared with the last year;
- They are looking for opportunities to sign new contract with equipment vendors; food and beverage, bakery, display cases;
- They have their own food production and a warehouse of 54 ha, plus a department which repairs and fixes the broken equipment;
- Number of employees – 220 in total;

11. **02.30 p.m. – CEED Project** (Competitiveness Enhancement and Enterprise Development), Eugenia Stancu-Financial Services Advisor & Doina Nistor-Deputy Chief of Party, str. Tighina 49/4, 3-rd floor, tel: 50 52 30; fax: 50 52 49
    - We talked about the objectives, problems and opportunities of CEED project and about our ATCI project too;
    - CEED is seeking an international IT professional (or software developer) in order to assist them to implement the assignment they have – "to elaborate, implement and develop the Management Information System (MIS) of IMC Leasing (up to 10 days)";
    - Their fields of activity: competitiveness enhancement of

    1) Wine makers (organic wine); 2) cloth manufacturers (textile industry); 3) MIS elaboration and implementation for the Leasing companies;

ATTACHMENT 5

NCFM Technical Assistance Projects
To be Discussed with the USAID Representatives

This document includes 11 technical assistance Projects of the NCFM (National Commission for Financial Markets) for some of which there is a preliminary commitment of the USAID (or its partners) to offer technical assistance, as well as other projects for which potential donors have not yet been identified.

1. Project name: **Elaborating the Electronic System for Supervision of Exchange Transactions**

   Potential donor: **USAID**

   Project initiation: **during 2007**

This Project provides for the creation of an electronic system of exchange transaction supervision performed at the Stock Exchange of Moldova. The electronic supervision system shall provide:

- online visualizing of operations taking place at the stock exchange, including transaction orders, summoning orders, clearing operations, etc.
- automated discovery of manipulation situations and other violations while performing stock exchange transactions and application of necessary measures in such situations (automated blockage of accounts, clearing suspension, etc.);
- automated discovery of exchange transactions' prices fluctuation over the established limits and operative application of necessary measures (suspension of transactions with such securities, etc);
- generating reports regarding exchange transactions;
- storing the information in a data bank within the NCFM, providing storage of such information for at least 15 years;
- interaction with the automated interactive transactions system of the Stock Exchange and National Depositary for Securities.

Similar systems applied by supervisory bodies in other countries (CONSOB Italy, CNVM Romania, AFM Netherlands, etc.) can be considered as models for the mentioned information system.

It is necessary to mention that this Project might constitute a continuation of Projects and assistance offered to the State Commission for Securities during 1995-1997 (setting up of Securities Stock Exchange and National Depositary for Securities).

2. Project name: **Implementation of Public Information Systems**

   Potential donor: **USAID**

   Project initiation: **beginning of 2007**

This Project provides for the creation and operation of a data base regarding public interest subjects acting on the market. The data bases suppose cumulating of data and free offer of public interest information, such as for example: public companies reports. This information system will interact with the internal data base of the NCFM and form, based on it, the information stock available to the public.

The public interest information systems will include (but not limited to) the following categories of information:

- data regarding issues of securities performed by companies;
- specialized corporate and statistic reports;
- information regarding main shareholders;
- information regarding transactions with company's securities;
- information regarding the events and actions affecting the financial situation of the company.

3. Project name: **Financing the Membership of the NCFM in IOSCO**

   Potential donor: **USAID**

   Project initiation: **beginning of 2007**

Financing the membership of NCFM in IOSCO presumes payment of annual fee and cost for participating in different meetings of IOSCO members. The NCFM joining IOSCO is supported by the IMF, World Bank, USAID and other authorities supervising the financial market (CONSOB Italy, AFM Netherlands, CNVM Romania). At present the NCFM is performing an auto-evaluation of its correspondence to the criteria applied to the members of this organization.

4. Project name: **Creating the Capital Markets Normative Framework**

   Potential donor: **not identified**

   Project initiation: **during 2007**

Drafting, and later approval, of some new laws regarding the capital market inevitably supposes the creation of normative framework subordinated to these laws. It is worthy to mention that there are over 50 regulatory acts (regulations and instructions) in this area. As a consequence, together with the approval of the new legislative framework it will be necessary to substitute all these regulations and instructions with new normative acts pursuant to the provisions of new legislation.

Ideally, drafting new regulations and instructions (or at least the most important acts) should be done together with drafting these new laws. This means that together with new laws, new regulations subordinated to laws will be adopted. Thus, the regulatory vacuum that might appear in the period from entering into force of laws till the approval of normative acts subordinated to laws will be avoided.

5. Project name: **Drafting a New Law in the Area of Micro-Financing Organizations**

Potential donor: **not identified**

Project initiation: **during 2007**

The Law on micro-financing organizations was approved in the middle of 2004. It is clear that the criteria provided by this Law don't correspond to present requirements. It will be necessary to draft a new law regarding micro-financing organizations or to prepare some amendments to the existing law. This issue equally involves drafting the normative framework subordinated to the law in regarding micro-financing organizations.

6. Project name: **Drafting the Methodological Framework of Supervision and Control**

Potential donor: **not identified**

Project initiation: **during 2007**

One of the main components of the new authority (NCFM) activity will be the control of the non banking financial market. In conformity with the international practice in this area, the control of non banking financial market shall be divided in two categories: prudential control and market behavior control. In conformity with the valid legislation the actual supervisors also perform the control of the supervised market participants. At the same time, at present there is no clear distinction and limit between the prudential control and the market behavior control, there are no rules and procedures for their performing. Moreover, very often these two types of control are confused. These considerations persist due to the fact that both components of the market control (prudential and market behavior control) represent new elements for the market regulation and supervision system and for existing controllers, including the employees directly participating in such controls.

As a consequence, it is necessary that the new regulatory **authority drafts some methodological norms regarding prudential and market behavior control**s for each segment of supervision.

These methodological norms will not be public acts but internal instructions (rules and criteria of activity) for the new authority employees. The new methodologies will provide how the employees, who directly participate in controls, will implement the correct measures for revealing the law violations by market participants.

7. Project name: **Drafting the Legislative Framework Regarding Penalties and Sanctions on the Non Banking Market.**

Potential donor: **not identified**

Project initiation: **during 2007-2008**

Together with the appearance of a new framework for regulating the non banking financial market, it will be necessary to draft amendments to the Penal Code and the Code on administrative contraventions aimed to adjust these laws' provisions to the new legislation provisions.

8. Project name: **Implementation of an Internal Data Base Regarding the Financial non Banking Market and Its Participants**.

Potential donor: **not identified**

Project initiation: **during 2007**

The quality of non banking financial market and its participants supervision will, to a great extent, depend on the implementation of some information systems adapted to modern requirements of the market. These systems will offer the possibility to rapidly obtain information regarding the real situation on the market, generate reports regarding operations on the market, be able to reveal the risk areas and participants.

Within this context, after the creation of a single authority for regulation and supervision, it will become necessary to implement three distinct (but complementary) information systems referring to non banking financial market.

This Project provides for drafting and implementing the following information systems:

- internal data base (within NCFM) for storage and processing of information regarding all segments of the non banking financial market and its participants;
- specialized ledgers in electronic form on the non banking financial market and its participants (ledger of the non banking financial market participants, ledger of issued licenses, state ledger of securities, specialized insurance ledgers, etc.);
- electronic systems of receipt, processing and storage of non banking financial market participants' reports (professional participants of the securities market, issuers, insurers, credit and savings associations, micro-financing organizations, etc.).

9. Project name: **Hiring a foreign expert by the NCFM**

Potential donor: **not identified**

Project initiation: **April, 2007**

The assistance offered within this Project presumes recruiting one (or several) foreign experts and their hiring by the NCFM for setting up the base for organizing the activity of the NCFM and establishing the strategic guidelines of NCFM activity, as well as to benefit from some operative consultancy in various domains of NCFM activity.

10. Project name: **Assistance in NCFM Employees' Training.**

Potential donor: **not identified**

Project initiation: **April, 2007**

This project will include three major components:

- training of employees depending on the non banking financial market segments taking into consideration the area of activity of every employee and distinguishing among the three main sectors (capital market, insurance market, savings and credit associations and micro-financing organizations market);

- training of employees directly involved in the process of control regarding the control techniques and tactics, conditions of on-site and off-site inspections;
- training the NCFM responsible officers (upon case, organizing study tours to other countries' unique regulating authorities).

11. Project name: **Strengthening and Maintaining the Operation Capacities**.

Potential donor: **not identified**

Project initiation: **during 2007-2008**

In conformity with the principles of creation and operation of the unique regulating authority, the NCFM will be a body financed by the market, on the account of funds paid by non banking market participants. During the process of drafting the amendments to the legislation, their adoption will enable the constituting of the NCFM, various involved parties insisted that the existing system of fees collection shouldn't be extended and present fees shouldn't be increased.

Due to the fact that the new regulating body will cumulate all present supervisors, including their staff, there is a danger that during the first years of activity the fees collected by the NCFM will not be sufficient to ensure the operation and functional capacity of the NCFM. In such conditions, any form of granted assistance will help to overcome these problems. In particular, the granted assistance might be associated with provision of technical equipment and furniture, as well as with the involvement of NCFM employees in different programs providing payment for the respective participation fees.

It is worthy to mention that during some meetings with foreign experts (the team headed by Pierre Olivier) the latter mentioned their availability for offering assistance to NCFM subdivisions responsible for supervision of savings and credit associations. A similar approach will be appreciated in relation with other areas of NCFM activity (capital market and insurance market).

ATTACHMENT 6

List of Corporate Bonds Issues (Information provided by the CNVM)

1. **19.09.2002 –** J.S.C. "Elat" (#177025565 from 10.18.2001; mun. #99, Decebal Ave, Chisinau);

   a. 100 000 nominative bonds are registered in the state ledger of securities for placement, 1 class, dematerialized, with the nominal value of 100 lei, with the interest rate of 19% annual, with payment of income by 4 (four) coupons – (1 coupon -10.30.2002), (2 coupon -01.30.2003), (3 coupon -04.30.2003), (4 coupon -01.10.2003), period of circulation 1 (one) year, with the right to redeem them before maturity only once (01.30.2003), with the bonds redemption date on the date of circulation term expiration (10.01.2003), with the state registration number MD31ATLE1004;

   b. To register the reports regarding the results of J.S.C. „Elat" bonds, closed issue, total number - 78 840 nominative bonds, 1 class, in the amount of 7 884 000 lei.

2. **10.17.2002** – S.C. "Pielart-Resurse" (#105076840 from 09.05.2001; #10, Calea Ieşilor Street, Chisinau mun.);

   a. Securities of S.C. "Pielart-Resurse" authorized for placement, total number of 15 502 nominative bonds, dematerialized, 1 class, convertible, with the nominal value of 100 lei, with fixed interest, cumulative from the nominal value in the amount of 12% annual, with the circulation term of 2 years (11.01.2002 – 11.01.2004), with payment at the end of the circulation period, with state registration number MD32ARTP1004 and insured by pledging issuer's own funds.

   b. The report regarding the results of S.C. "Pielart-Resurse" bonds, closed issue, total number – 15 502 nominative bonds, 1 class, in the sum of 1 550 200 lei.

3. **11.14.2002** – S.C. "Cereale" Cahul (#136022470 from 01.17.1996; Industrial zone, Cahul);

   a. Securities of S.C. „Cereale" Cahul authorized for placement, total number 10 458 nominative bonds, dematerialized, 1 class, convertible, with the nominal value 100 lei, with fixed income, cumulative from the nominal value in the amount of 15% annual, with the circulation term of 3 years (12.01.2002 – 12.01.2005), with payment at the end of the circulation period, with the state registration number MD32CECA1003 and insured by pledging issuer's own funds.

   b. The report regarding the results of S.C. „Cereale" Cahul closed bonds issue, total number – 10 458 nominative bonds, 1 class, in the sum of 1 045 800 lei.

4. **12.26.2002 –** S.C. "Pielart" (#10503760 from 12.27.1994; #10, Calea Ieşilor Street, Chisinau, mun);

a. Securities of S.C. „Pielart" authorized for placement, total number 80 000 nominative bonds, dematerialized, 1 class, convertible, with the nominal value 100 lei, with fixed income, cumulative from the nominal value in the amount of 13% annual, with the circulation term of 3 years (01.01.2003 – 01.01.2006), with payment at the end of the circulation period, with the state registration number MD32PIEL1009 and insured by pledging issuer's own funds.

b. The report regarding the results of S.C. „Pielart" closed bonds issue, total number – 20 000 nominative bonds, 1 class, in the sum of 2 000 000 lei.

5. **12.26.2002** – S.C."ATC-Agrotehcomerț" (#15800096-3 from 07.19.1993; #33, M. Spataru Street, Hînceşti);

a. Securities of S.C. "ATC-Agrotehcomerț" authorized for placement, total number 10 000 nominative bonds, dematerialized, 1 class, convertible, with the nominal value 100 lei, with fixed income, cumulative from the nominal value in the amount of 14% annual, with the circulation term of 3 years (01.01.2003 – 01.01.2006), with payment at the end of the circulation period, with the state registration number MD32ATEH1009 and insured by pledging issuer's own funds.

b. The report regarding the results of S.C. "ATC-Agrotehcomerț" closed bonds issue, total number – 10 000 nominative bonds, 1 class, in the sum of 1 000 000 lei.

6. **MAIB-Leasing** – nominative, non convertible, 560 bonds, nominal value – 10.000 lei, fixed income – 10% annually, circulation period 540 days. Payment periodicity – 4 times per year. Insurance by the guarantee issued by the insurance company „AFES-M" Ltd;

7. **J.C. Elat** - nominative, non convertible, 240 bonds, nominal value – 50.000 lei, variable income within the limits of 10-20% related with average weighted interest on 364 days Government Securities. Payment periodicity – twice per year. Insurance by „Moldinconbank" S.C. bank guarantee.

8. **Hidroinpex – 22 bonds:**

Bonds class – 1;
Bonds type – nominative, convertible;
Nominal value – 50 000 lei;
Provided income – fixed, 12% annual of the bond nominal value;
Beginning of placement – following 15 days after the publication in the press of the announcement informing the potential investors regarding bonds public placement;
Closing of placement – one month after the beginning of bonds placement or on the predecessor day (upon issuer decision) if the total volume of bonds announced for placement is fully covered;

Beginning of circulation – date of entry of bond buyers in the Ledger of bonds;

End of circulation – three years after the entry of bonds buyers in the Ledger of bonds;

Date of bonds redemption beginning – from the day following after the end of circulation;

Date of bonds redemption closing – two months following after the beginning of bonds redemption;

Income calculation – begins on the day of bonds placement in circulation, income is paid in the form of coupon, which amount is determined by the formulae:

$$C = N \times \frac{R_c \times (Tc)}{100\% \times 365}$$

where:

C – amount of coupon;

N – nominal value of one bond (50 000 lei);

R_c – fixed interest rate rata used for determining the amount of the coupon (R_c = 12%);

Tc – number of expired days from the beginning of bonds circulation till the end of circulation;

Periodicity of income payment - cumulative, sole payment at the end of circulation period, by transfer;

Form of issue – dematerialized;

Issue procedure – open;

Placement price – on nominal value on the first day of placement, beginning on the second day of placement, the underwriter will pay off the nominal value plus the amount of the accumulated coupon;

Insurance – by pledging own property.

9. **Nufarul – 60 bonds:**

Bonds class – I class;

Bonds type - nominative, convertible;

Nominal value– 50 000 lei;

Provided income – fixed, 12% annual of the bond nominal value;

Beginning of placement – two weeks following the publication in press of the announcement to inform the potential investors regarding the beginning of bonds public placement;

Placement closing – two months after the date of the beginning of bonds placement;

Circulation beginning – the date of entry in the Ledger of bonds buyers;

Circulation end – three years after the registration of buyers in the Ledger of bonds;

Date of bonds redemption beginning – the day following the end of circulation;

Date of bonds redemption closing – two months following the beginning of bonds redemption.

Interest calculation – begins on the date of bonds circulation beginning, income is paid in the form of coupon, which amount is determined under the formulae:

$$C = N \times \frac{R_c \times (Tc)}{100\% \times 365}$$

where:

C – coupon amount;

N – nominal value of one bond (50 000 lei);

R_c – fixed interest rate used for determining the amount of the coupon (R_c = 12%);

Tc – number of expired days from the date of bonds circulation beginning till the end of circulation;

Interest payment periodicity – cumulative, sole payment at the end of circulation period, by transfer;

Issue form – dematerialized;

Issue procedure – open;

Placement price – on nominal value on the first day of placement, the underwriter will pay off the nominal value plus the amount of one coupon beginning on the second day of placement.

10. **Angrocomerț-Vest-Est – 80 Bonds:**

Bonds class – I class;

Bonds type - nominative, convertible;

Nominal value– 10 000 lei;

Provided income – fixed, 12% annual of the bond nominal value;

Beginning of placement – two weeks following the publication in press of the announcement to inform the potential investors regarding the beginning of public placement;

Closing of placement – one month after the date of the beginning of bonds placement;

Circulation beginning – the date of entry in the Ledger of bonds of bond buyers;

Circulation end – three years after the registration of bond buyers in the Ledger of bonds;

Date of bonds redemption beginning – the day following the end of circulation;

Date of bonds redemption closing – two months following the beginning of bonds redemption.

Interest calculation – begins on the date of bonds circulation beginning, income is paid in the form of coupon, which amount is determined under the formulae:

$$C = N \times \frac{R_c \times (Tc)}{100\% \times 365}$$

where:

C – coupon amount;

N – nominal value of one bond (10 000 lei);

R_c – fixed interest rate used for determining the amount of the coupon (R_c = 12%);

Tc – number of expired days from the date of bonds circulation beginning till the end of circulation;

Interest payment periodicity – cumulative, sole payment at the end of circulation period, by transfer;

Issue form – dematerialized;

Issue procedure – open;

Placement price – on nominal value on the first day of placement, beginning on the second day of placement, the underwriter will pay off the nominal value plus the amount of accumulated coupon;

11. **DAAC-Ciocana – 66 Bonds**

Bonds class – I class;
Bonds type - nominative, convertible;
Nominal value– 10000 lei;
Provided income – fixed, 12% annual of the bond nominal value;

Beginning of placement – 15 days following the publication in press of the announcement to inform the potential investors regarding the beginning of public placement;

Closing of placement – one month after the date of the beginning of bonds placement or on a preceding day (upon issuer decision) if the total volume of bonds announced for placement is covered;

Circulation beginning – the date of entry of bond buyers in the Ledger of bonds;

Circulation end – three years after the registration of bond buyers in the Ledger of bonds;

Bonds redemption period – from the second day following the end of circulation – two months following the beginning of bonds redemption;

Interest calculation – from the date of bonds circulation beginning, which is determined under the formulae:

$$C = N \times \frac{R_c \times (Tc)}{100\% \times 365}$$

Where:

C – coupon amount;
N – nominal value of one bond (10 000 lei);
R_c – fixed interest rate used for determining the amount of coupon (R_c = 12%);

Tc – number of expired days from the date of bonds circulation beginning till the end of circulation period;

Income payment periodicity – cumulative, sole payment at the end of circulation period, by transfer;

Issue form – dematerialized;
Issue procedure – public offer;

Placement price – on the nominal value on the first day of placement, the underwriter will pay the nominal value plus the accumulated coupon beginning on the second day of placement.

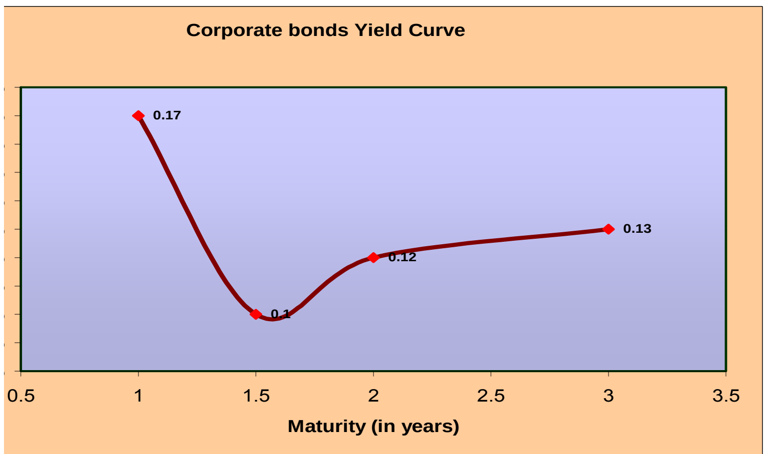
Redemption (extinguishing) of bonds before the term can take place upon the decision of the general meeting of shareholders, on their nominal value plus the coupon value for the period of its holding.

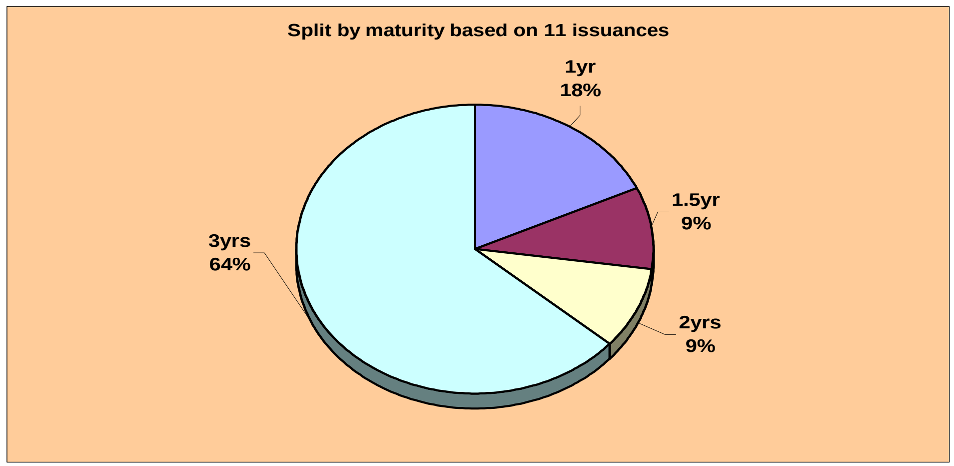
Placement process organization – by the underwriter C.B.”Victoriabank”.

The bonds will be insured by a contract of guarantee, signed with S.C. „Nufarul” as a guarantor.

ATTACHMENT 7: Summary of corporate bond issuances in Moldova

Company Name	Coupon	Date of issue	Call date	Denomination M	Quantity	Size MDL	Maturity r	Type of bond	Coupon
Joint Company "ELAT" S.A	19%	30/09/2002	30/01/2003	100.00	78,840.00	7,884,000.00	12.00	Callable	
SA “Pielart-Resurse” JSC	12%	37,267.00	-	100.00	15,520.00	1,552,000.00	24.00	Convertible	cumula
SA “Cereale” Cahul JSC	15%	37,268.00	-	100.00	10,458.00	1,045,800.00	36.00	Convertible	cumula
SA “Pielart” JSC	13%	26/12/2002	-	100.00	20,000.00	2,000,000.00	36.00	Convertible	cumula
SA“ATC-Agrotehcomerț” JSC	14%	37,622.00	-	100.00	10,000.00	1,000,000.00	36.00	Convertible	cumula
S.A."MAIB-Leasing" JSC	10%	14/07/2005	-	10,000.00	560.00	5,600,000.00	18.00	bullet	
Joint Company "ELAT" S.A	Floating	N/A	-	50,000.00	240.00	12,000,000.00	12.00	bullet	
S.A."Hidroinpex" JSC	12%	N/A	-	50,000.00	22.00	1,100,000.00	36.00	Convertible	cumula
S.A."Nufărul" JSC	12%	N/A	-	50,000.00	60.00	3,000,000.00	36.00	Convertible	cumula
S.A."Angrocomerț-Vest-Est" JSC	12%	N/A	-	10,000.00	80.00	800,000.00	36.00	Convertible	cumula
S.A."Daac-Ciocana" JSC	12%	N/A	-	10,000.00	66.00	660,000.00	36.00	Convertible	cumula
TOTAL						**36,641,800**			





Maturity yrs	nr. Issues	Average coupon by maturity
1	2	17%
1.5	1	10%
2	1	12%
3	7	13%
ALL	**11**	