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Programmatic Technical Assistance Partnership
For Capital Market Development and Pension Reform
in Ukraine

Challenges and Opportunities of EU-Ukraine Free Trade Agreement for the Development of Securities Markets and Non-Bank Financial Sector in Ukraine

Kyiv, September 2008

Acronyms and Abbreviations

AA	Agreement of Association between Ukraine and the European Union
AFSP	World Bank Access to Financial Services Project
AMA	Advanced Measurement Approach
ATCI	USAID Access To Credit Initiative
AUSD	All-Ukrainian Share Depository
BIA	Basic Indicator Approach
CCP	Clearing and Central Counterparty
CEBS	Committee of European Banking Supervisors
CEIOPS	Committee of European Insurance and Occupational Pension Supervisors
CESR	Committee of European Securities Supervisors
CIT	Corporate Income Tax
CLC	Commercial Law Center
CMP	USAID Capital Markets Project
CRD	Capital Requirement Directive
CSD	Central Security Depository
CSE	Communal Services Enterprise
DG	General Directorate
DVP	Delivery *vs.* Payment
EACH	European Association of Central Counterparty Clearing Houses
ECSDA	European Central Securities Depositories Association
EEA	European Economic Area
EC	European Commission
ECB	European Central Bank
ENP	Europe Neighborhood Policy
EU	European Union
FESE	Federation of European Securities Exchanges
FIRST	World Bank Financial Sector Reform and Strengthening Program
FOP	Free of Payment
FOR	Fixed Overhead Requirement
FSAP	Financial Services Action Plan
FTA	Free Trade Agreement
FX	Foreign Exchange
G-30	The Group of Thirty
GDP	Gross Domestic Product
IATF/SEC/NBFI	Inter-Agency Task Force for the Reform of the Legal and Regulatory Framework for Securities Markets and NBFIs
ICAAP	Individual Capital Adequacy Assessment Process
IAIS	International Association of Insurance Supervisors
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards

IMS	Interim Management Statement
IORP	Institution of Occupational Retirement Provision
IOSCO	International Organization of Securities Commissions
ISD	Investment Services Directive
JII	Joint Investment Institutions
JSC	Joint Stock Company
LTV	Loan-to-Value
MCR	Minimum Capital Requirement
MiFID	Market in Financial Instruments Directive
MFS	Interregional Depository and Clearing/Settlement Organization (Mizhregionalny Fondovy Sojuz)
MOF	Ministry of Finance
MOU	Memorandum of Understanding
MTF	Multilateral Trading Facility
NAV	Net Asset Value
NBFI	Non-Bank Financial Institution
NBU	National Bank of Ukraine
NDU	National Depository of Ukraine
NSPF	Non-State Pension Fund
OTC	Over-the-Counter
PCA	Partnership and Cooperation Agreement
PD	Primary Dealer
PFTS	First Securities Trading System (Persha Fondova Torgova Systema)
PPP	Public-Private Partnership
PTAP	USAID/World Bank Programmatic Technical Assistance Partnership
Repo	Repurchase Agreement
ROSC	Report on the Observance of Standards and Codes
SCR	Solvency Capital Requirement
SCRFSM	State Commission for Regulation of Financial Services Markets
SCSSM	State Commission for Securities and Stock Market
SDMD	The Financial Policy and Debt Management Department of the Ministry of Finance
SMI	State Mortgage Institution
SNG	Sub-National Government
SPV	Special Purpose Vehicle
SRO	Self-Regulated Organization
TD	Transparency Directive
TSA	The Standardized Approach
UAH	Ukrainian Currency – Hryvnia
UC	Ultimate Controller
UCIT	Undertaking of Collective Investment in Transferable Securities
UICE	Ukrainian Inter-Currency Exchange
UIT	Unit Investment Trusts
USAID	United States Agency for International Development
WTO	World Trade Organization

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Executive Summary

1. This Report examines the challenges and opportunities presented by the future integration of the Ukrainian securities market and NBFIs in the EU single market in financial services, in the framework of the Free Trade Agreement (FTA) currently being negotiated between the Ukrainian Government and the European Commission. The FTA is part of the proposed Agreement of Association that is set to replace the existing Partnership and Cooperation Agreement between Ukraine and the European Union.

2. Ukraine faces three key challenges in integrating its securities market and NBFIs in the EU single market in financial services:

(i) Approximation of Ukrainian legislation with EU securities market and NBFI Directives (Level 1) and implementing measures (Level 2);

(ii) Mutual recognition between Ukrainian securities market and NBFI regulatory agencies and their counterparts in EU Member States; and

(iii) Adaptation of Ukrainian securities market professional participants, NBFIs, and securities issuers to the EU single market in financial services.

Approximation of Ukrainian legislation with EU securities market and NBFI Directives and implementing measures

3. The EU Directives concerning securities markets and NBFIs and their implementing measures constitute a deeply integrated and far-reaching body of financial legislation and regulation. This body of legislation is built upon a set of fundamental, cross-cutting principles:

(i) ***Level playing field among market participants***. The Directives establish a comprehensive set of rules concerning internal governance, conduct of business, risk management, and compliance management that ensure a level playing field among market participants; 1/

1/ Private equity investment funds and non-occupational private pension funds are not covered by the EU Directives as of to date, with the exception of the Directives on supplementary supervision of financial conglomerates, acquisition and increase of

holdings in the financial sector, and money laundering that apply, directly or indirectly, to all financial services firms.

(ii) ***Freedom of services.*** The Directives establish a passport for market participants, allowing a regulated entity licensed by the regulatory authority in its home state to provide services in other EU Member States upon simple notification by the regulated entity to the host state regulator. This applies to investment firms, undertakings of collective investment in transferable securities (UCITSs), institutions of occupational retirement provision (IORPs), and insurance and re-insurance companies. Regulated markets (exchanges) licensed in one Member State are allowed to provide arrangements to facilitate access to, and trading by remote members or participants established in other EU Member States, through simple notification by the regulated market through its home state regulator to the host state regulator;

(iii) ***Reputation of ultimate controllers.*** The Directives require market participants to disclose their ultimate controllers to the regulator, ie any natural or legal person that exercises a significant influence, directly or indirectly, over the regulated entity, irrespective of ownership, and require the regulator to assess the reputation of these ultimate controllers;

(iv) ***Reputation and experience of persons who direct the business.*** The Directives require market participants to disclose all persons who direct the business to the regulator, and require the regulator to assess the reputation and experience (propriety and fitness) of these persons;

(v) ***Disclosure and Transparency.*** The Directives require a high degree of transparency for both issuers and investors. Extensive reporting requirements apply to publicly traded issuers and their controlled undertakings, including interim management statements and reports that cover risk management policies for all risks. Extensive notification requirements apply to investors for the acquisition and disposal of major shareholdings of issuers;

(vi) ***Risk-based supervision of regulated entities.*** The Directives apply the Basel II international guidelines for capital measurement and capital standards to investment firms, and a Directive Proposal for the application of the Basel II guidelines to the insurance sector is currently under discussion at the Council and the Parliament. The Directives apply the Basel II three-pillar supervision framework, ie risk-based capital adequacy requirements (Pillar 1), risk-based supervision requirements (pillar 2), and disclosure to market participants (Pillar 3);

(vii) ***Supplementary supervision of financial conglomerates***. The Directives establish common rules for the supplementary supervision of groups that

straddle more than one sector of the industry, provided that they fit the definition of a financial conglomerate. Supplementary supervision is carried out by a coordinator designated among regulatory agencies and covers capital adequacy, intra-group transactions, risk concentration, and management qualification; and

(viii) ***Prevention of money laundering and terrorism financing***. The Directives establish common rules for the prevention of money laundering and terrorism financing, The rules extend to the ultimate controllers of clients, and require all market participants to establish adequate policies and procedures of customer due diligence, reporting, record keeping, internal control, risk assessment, risk management, compliance management and communication in order to forestall and prevent operations related to money laundering and terrorism financing.

4. The deeply integrated nature of this body of financial legislation argues for developing a simultaneous, well-coordinated and internally consistent approach to approximating Ukrainian legislation with EU securities markets and NBFI Directives. At the same time, the actual implementation of the Directives will require both a quantum leap in the supervisory powers and practices of financial sector regulators, as well as in governance, business practices, risk management, compliance and disclosure by market participants. This in turn argues for building in reasonable transition periods in the regulations implementing the new body of legislation, in particular with respect to the transition to risk-based supervision of investment funds and insurance companies.

5. In light of the above, the authorities could consider a three-phased approach to the approximation process: (i) legal gap analysis (Phase 1); (ii) approximation of Ukrainian legislation with Level 1 Directives (Phase 2); and (iii) approximation of Ukrainian regulations with Level 2 implementing measures (Commission Implementing Directives and Regulations), including built-in transition periods (Phase 3).

Mutual recognition between Ukrainian securities market and NBFI regulatory agencies and their counterparts in EU Member States

6. In order to enforce the EU Directives, the State Commission for Securities and Stock Market (SCSSM) and the State Commission for the Regulation of Financial Services Markets (SCRFSM) will need to achieve compliance with international standards of regulation and supervision as defined under the IOSCO, IAIS and IOPS Principles. In turn, compliance with IOSCO, IAIS and IOPS Principles will be a *sine qua non* to achieve mutual recognition with counterpart regulatory agencies in EU Member States that is required to implement the passport provisions of the Directives. Operational independence of regulators, including financial sector regulators, would also be a requirement under the Agreement of Association between Ukraine and the European Union.

7. To achieve this objective, the Ukrainian authorities need to focus on four fundamental priorities:

(i) to prepare and adopt ***Amendments to the Financial Services Law*** (i) to empower the financial sector regulatory agencies to trace the ultimate controllers of regulated entities and to carry out criminal, fiscal, and economic background checks of ultimate controllers, both in Ukraine and abroad and (ii) to establish the principles of supplementary supervision of financial conglomerates by financial sector regulatory agencies and to empower them as coordinators to carry out the supplementary supervision of financial conglomerates;

(ii) to prepare and adopt ***SCSSM and SCRFSM Framework Laws*** to establish the operational independence and financial autonomy of the two Commissions;

(iii) to design and implement ***twinning programs*** between SCSSM and SCRFSM and EU counterpart regulatory agencies with the objective to strengthen the capacity of the two Commissions to exercise effective supervision of securities markets and NBFIs up to international and EU standards of regulation and supervision. Twinning programs for the two Commissions are currently being prepared with the support of the joint USAID/World Bank Programmatic Technical Assistance Partnership (PTAP) and are being funded in the framework of the IBRD Access to Financial Services Project. (AFSP); and

(iv) to carry out regular ***third-party assessments*** of compliance with IOSCO, IAIS and IOPS Principles by SCSSM and SCRFSM to monitor their progress towards achieving international standards of regulation and supervision, and to communicate the results of these assessments to the EU Commission, the Committee of European Securities Regulators (CESR) and the Committee of European Insurance and Occupational Pension Supervisors (CEIOPS).

Adaptation of Ukrainian professional securities market participants, NBFIs and securities issuers to the EU single market in financial services

8. Integration in the EU single market in financial services will have major implications for Ukrainian professional securities market participants, NBFIs and securities issuers.

9. Professional securities market participants and NBFIs will be required to disclose their ultimate controllers, both Ukrainian residents and foreigners, to the regulatory authorities. In turn, the regulatory authorities will be required to assess the reputation of these ultimate controllers. At the same time, the regulatory authorities will be required to

assess the reputation and experience of all persons who direct the business of securities market professional participants and NBFI; and professional securities market participants and NBFIs belonging to a financial conglomerate will be subject to supplementary supervision;

10. There will be a major consolidation of exchanges, resulting from increased competition from other channels of trade information, the impact of EU and ECB initiatives in the area of securities settlement, the development of multilateral trading facilities (MTFs), and increased competition among regulated markets. The abolition of the trade concentration rule and the implementation of the best execution rule means that only exchanges that offer cutting-edge trading technology and that are closely interconnected and/or integrated with major Euro-Atlantic exchanges are likely to survive.

11. In addition to raising their disclosure, conduct of business, governance and reporting standards to the best in the market, insurance companies will need to meet the capital adequacy and risk management standards required by Solvency II as the latter are phased-in by the regulatory authorities. Smaller insurance companies could face major difficulties in meeting these requirements, resulting in a sweeping consolidation of the industry.

12. Securities issuers will on the one hand gain access to the vast pool of liquidity of the single market. On the other hand, they will compete head-on for the attention of investors with other issuers in similar asset classes across the single market. Government, sub-national government and corporate securities issuers will therefore need to raise the quality of their issuances in order to reap the benefits of financial market integration.

13. To support the adaptation of market participants to integration in the EU single market, the authorities should focus on the following priorities:

(i) ***Re-validate the licenses of all professional securities market participants and NBFIs***, specifically enforcing the reputation test for the ultimate controllers of regulated entities and the reputation and professional experience tests for persons who direct the business of regulated entities, in accordance with the relevant EU Directives;

(ii) ***Implement supplementary supervision of financial conglomerates,*** specifically enforcing the capital adequacy, intra-group transaction, and risk concentration requirements for entities in financial conglomerates, and the management qualification requirements at the level of financial conglomerates, in accordance with the relevant EU Directive;

(iii) ***Enforce enhanced anti-money laundering measures,*** including due diligence of ultimate controllers of customers, and enhanced customer due diligence in cases of cross-border banking relationships and in cases of

politically exposed persons in third countries in accordance with the relevant EU Directive;

(iv) ***Implement the switch to risk-based supervision over the medium-term,*** progressively enforcing the prudential requirements of the capital requirement Directive and of the Solvency II Directive Proposal in line with the Basel II three-pillar supervisory structure;

(v) ***Implement a Trade Reporting System (TRS) and enforce enhanced regulations against market abuse*** in accordance with the relevant EU Directive;

(vi) ***Establish a Central Securities Depository (CSD)***, specifically adopting the new Depository Law, establishing the All-Ukrainian Securities Depository (AUSD) as CSD, carrying out the merger between AUSD and MFS, adopting a state-of-the-art post-trading platform at MFS; and ensuring that AUSD meets the Principles established under the European Code of Conduct for Clearing and Settlement;

(vii) ***Develop a long-term government bond yield curve with liquid benchmarks*** to compete with other sovereign issuers on the single market in order to provide a long-term source of financing for public investments in domestic currency and a risk-free reference for the pricing of non-government debt securities;

(viii) ***Reform the legal and regulatory framework for sub-national government (SNG) borrowing*** to improve the stability and transparency of SNG finances, thereby enabling them to compete with other sub-national issuers on the single market in order to finance local infrastructure investments;

(ix) ***Adopt the joint stock company law and enforce disclosure of the identity of significant shareholders and/or persons or entities entitled to exercise voting rights on behalf of shareholders*** to protect minority investors and enable corporate issuers to compete with other issuers on the single market to finance their investments; and

(x) ***Enhance and enforce business and financial reporting requirements*** for all publicly traded issuers and their controlled undertakings, including undertakings over which a natural person or legal entity has the power to exercise, or actually exercises, dominant influence or control, in accordance with the relevant EU Directives ; and adopt legislation requiring widely-traded public joint stock companies, and public interest institutions (i.e. banks, insurance companies) to prepare financial reports in compliance with International Financial Reporting Standards (IFRS).

I: Background

1. Ukraine was invited to join WTO on February 5, 2008 and ratified its accession protocol on April 16, 2008. With these steps, Ukraine fulfilled the criteria set by the EU fir the start of negotiations on a Free Trade Agreement (FTA). The negotiations were officially launched in Kyiv in mid-February 2008 and three rounds of negotiations have taken place by July 2008.

2. The FTA is part of the proposed Agreement of Association (AA) to replace the existing Partnership and Cooperation Agreement (PCA) between Ukraine and the European Union. For Ukraine, the AA is one step on the way toward realizing its EU membership aspirations. For the EU, the AA is aimed at achieving a new type of deep integration under the Europe Neighborhood Policy (ENP), which could serve as a model for other ENP countries in the future. The FTA is at the core of the economic and financial integration efforts pursued under the AA.

3. The Ukrainian authorities have indicated that they seek a broad and deep FTA spanning the four freedoms in the markets for goods, services, capital and labor. In the capital market, the Ukrainian authorities have indicated that their objective is full integration of the Ukrainian capital market in the EU single market.

4. The objective of this Report is to examine the challenges and opportunities presented by the future integration of the Ukrainian securities market and NBFIs in the EU single market in financial services in the framework of the FTA. Part II reviews the development of the EU single market in financial services and introduces the key challenges presented by the integration of the Ukrainian securities market and NBFIs in the EU single market. Part III reviews the EU legislation in force in securities markets and NBFIs and formulates a strategy for approximating Ukrainian legislation and regulations with EU securities market and NBFI Directives and Implementing Measures. Part IV formulates a strategy to strengthen the capacity of Ukrainian securities market and NBFI regulatory agencies to enforce EU-compliant legislation and to achieve mutual recognition with their counterparts in EU Member States. Part V examines the challenges and opportunities presented by the adaptation of Ukrainian professional capital market participants, NBFIs and securities issuers to the EU single market in financial services. Part VI formulates a summary multi-year action plan to achieve the integration of the Ukrainian capital market in the EU single market in financial services in the framework of the FTA.

II: Joining the EU Single Market in Financial Services: Key Challenges for Ukrainian Securities Markets and NBFIs

5. This Part reviews the development of the EU single market in financial services and identifies the key challenges facing Ukraine in integrating the EU single market in financial services.

II.1 Development of the EU single market in financial services

6. The integration of the European financial market has been driven forward by the Financial Services Action Plan 1999-2005 (FSAP) that was approved by the Commission in May 1999. The FSAP had three strategic objectives: (i) establishing a single EU market for wholesale financial services (Objective I); (ii) developing open and secure markets for retail financial services (Objective II); and (iii) establishing state-of-the-art prudential rules and supervision (Objective III). The FSAP contained 42 measures aimed at achieving these objectives. Under Objective I, program measures covered raising capital on an EU-wide basis, establishing a common legal framework for integrated securities and derivatives markets, harmonizing financial statements for listed companies, containing systemic risk in securities settlement, establishing a secure and transparent environment for cross-border company restructuring, and establishing a single market for investment funds. The development of European legislation under the FSAP followed the four-level "Lamfalussy process" (See Box 1).

Box 1: The Lamfalussy Process

1. The Lamfalussy process is based on the four-level regulatory approach recommended by the Committee of Wise Men on the Regulation of European Securities Markets, established by decision of the Stockholm European Council Resolution of March 23, 2001. The mandate of the Committee was subsequently extended to cover not only securities legislation but also the banking, insurance, occupational pensions and UCITS sectors. The Committee is chaired by Baron Alexandre Lamfalussy (See EC, 2004b, pp. 3-16).

2. At *Level 1*, the European Commission adopts formal proposals for a Directive/Regulation after a full consultation process and sends them for discussion and approval to the Council and European Parliament. Legislation is based on framework principles, and defines implementing powers for the Commission.

3. At *Level 2,* the Commission seeks advice from the Committee of European Securities Regulators (CESR), the Committee of European Banking Supervisors (CEBS), and the Committee of European Insurance and Occupational Pensions Supervision (CEIOPS) on technical implementing measures on the basis of a provisional mandate established once final agreement has been reached on the Level 1 measure. CESR, CEBS and/or CEIOPS prepare advice in consultation with market participants, end-users and consumers, and submit it to the Commission. The Commission examines the advice and, following publication of a working document containing initial view on the content of the draft implementing measure, makes a proposal to CESR, CEBS or CEIOPS, which vote on the proposal within 3 months. The Commission subsequently adopts the implementing measure.

4. At *Level 3,* CESR, CEBS and CEIOPS work on joint interpretation recommendations, consistent with guidelines and common standards (in areas not covered by European legislation), peer review and

compares regulatory practice to ensure consistent implementation and application.

5. At *Level 4,* the Commission checks Member State compliance with EU legislation. The Commission may take legal action against Member State suspected of breach of Community Law.

7. By June 2004, 93% of FSAP measures had been implemented at the European level. FSAP program implementation at the European level was completed by end-2005. As of June 20, 2008, the transposition of FSAP Directives by Member States was mostly completed, with the exception of (i) the Directive on the taking up and pursuit of the business of credit institutions by Spain; (ii) the Directive on the capital adequacy of investment firms and credit institutions by Spain and Hungary; (iii) the transparency Directive by the Czech Republic, Hungary, Netherlands and Poland; and (iv) the Directive on markets in financial instruments (MiFID) by the Czech Republic and Poland. No Member State had completed the transposition of the Third Directive on money laundering as of that date (See Technical Annex II).

8. Under the impetus of the FSAP, Europe has made considerable progress in creating a single market for wholesale financial services. Markets for inter-bank lending, government bonds, investment banking and derivatives are almost completely integrated. Equity market returns are increasingly correlated showing rising cross-border portfolio diversification, However, securities market infrastructure remains fragmented, and high costs for cross-border transactions hamper further integration, especially for equity markets (See EC, 2004b, pp 8-10).

9. The integration of equity markets is progressing at a good pace. The cross-country dispersion of equity returns in the Euro area has dropped significantly since 200, with the average difference between index returns narrowing from around 3% to 1.5 % over the 2004-2006 period. Integration has been even stronger in the government bonds market. Until 2006, yields on government bonds in the EU15-Member States have converged to a common level, while yields in the whole EU-25 area are still more diversified. However, in the wake of the international credit crisis in 2007, government bond yields started to diverge again among EU-15 Member States as a result of a flight to liquidity. The corporate bond market shows sign of increasing integration as the variance of total yield spread explained by country effects is close to zero. The money market in the Euro area has reached full integration since the introduction of the Euro. (See EC, 2007, p.9).

10. EU investors still demonstrate a home bias concerning equities, although the value of the bias has substantially declined over the years. At the same time, the share of total foreign equity investments done in another EU country has increased slightly from 52% in 2001 to 55% in 2005, suggesting that the declining home bias has been accompanied by an increasing regional bias in the EU (See EC, 2007, p.9).

11. In the insurance sector, cross-border integration has mainly happened through cross-border merger and acquisitions and the creation of Pan-European groups. The 20 largest European insurance groups collected Euro 523 billion in Europe in 2005, representing more than 50% of total premium income in Europe. These groups operate

mainly in Europe, where 72% of their premium income was collected in 2005 (See EC, 2007, p.12).

12. While securities markets are becoming increasingly European, the post-trading infrastructure remains largely fragmented along national lines. Barriers to the integration of post-trading structures and the complexity of market structures that have evolved to overcome these barriers translate into higher cost and potentially higher risks for cross-border investors. A synthesis of studies examining European post-trading costs indicted that investors pay, on average, 2.5 to 4 times more for a cross-border equity transaction than for a domestic transaction (See EC, 2006, pp 21-22).

13. Beyond the FSAP, the European Commission produced a White Paper that articulated its financial services policy for the 2005-2010 period around four major objectives: (i) to consolidate towards an integrated, open, competitive, and economically efficient EU financial market; (ii) to remove the remaining economically significant barriers so financial services can be provided and capital can circulate freely throughout the EU at the lowest possible cost; (iii) to implement, enforce and continuously evaluate existing legislation and to implement rigorously the better regulation agenda to future initiatives; and (iv) to enhance supervisory cooperation and convergence in the EU and deepen relations with other global financial market places. The White Paper reaffirmed the four-level Lamfalussy process for the development and implementation of EU financial services regulation (See EC, 2005, pp 9-10).

14. As part of the legislative reform agenda, key reform priorities contained in the White Paper include (i) legislation to support the integration of the retail banking market, (ii) legislation to overhaul the regulation and supervision of the insurance sector (Solvency II), (iii) legislation to strengthen the prudential assessment of acquisitions and increase in holding in the financial sector, and (iv) framework legislation to regulate the cross-border clearing and settlement industry. In addition, reflections are under way to eliminate unjustified barriers to cross-border consolidation, to strengthen the legal certainty of e-money, and to support insurance guarantee schemes. Future initiatives include measures to ensure consistent implementation of UCITS law across Member States and measures to open up the fragmented retail financial services market.

15. As part of the strengthening of the supervisory framework, key reform priorities contained in the White Paper include (i) clarifying and optimizing home-host responsibilities; (ii) exploring the delegation of tasks and responsibilities between supervisors; (iii) avoiding duplicative reporting and information requirements between supervisors; and (iv) strengthening cooperation among supervisors (See EC, 2005, pp. 10-15).

II.2 Key challenges for integration of Ukrainian securities markets and NBFIs in the EU single market in financial services

16. In light of the above, Ukraine faces three key challenges in integrating its securities market and NBFIs in the EU single market for financial services:

(i) Approximation of Ukrainian legislation with EU securities market and NBFI Directives (Level 1) and implementing measures (Level 2);

(ii) Mutual recognition between Ukrainian securities market and NBFI regulatory agencies and their counterparts in EU Member States; and

(iii) Adaptation of Ukrainian securities market professional participants, NBFIs, and securities issuers to the EU single market in financial services.

17. The following Parts examine these three challenges in detail.

III: Approximation of Ukrainian Legislation with EU Securities Market and NBFI Directives and Implementing Measures

18. This Part (i) reviews the EU legislation in force or currently under consideration by the European Commission, the European Parliament and/or the Council in the area of securities markets and NBFIs; and (ii) proposes a strategy for approximating Ukrainian legislation with EU securities market and NBFI Directives and implementing measures.

III.1 EU securities market and NBFI Directives and implementing measures

19. EU legislation in force pertaining to securities markets and NBFIs covers seven areas:

(i) Securities markets
(ii) Undertakings of Collective Investment in Transferable Securities (UCITS)
(iii) Insurance
(iv) Institutions for Occupational Retirement Provision (IORP)
(v) Acquisition and increase of holdings in the financial sector
(vi) Supplementary supervision of financial conglomerates
(vii) Money laundering

20. EU legislation in force includes three sets of European Commission Directives and implementing measures (Commission Implementing Directives and Regulations): (i) those adopted prior to the FSAP; (ii) those adopted as part of the FSAP during the period 2000-2005; and (iii) those adopted post-FSAP from 2006 to the present.

21. In addition, there are a number of key legislations and implementing measures pertaining to securities markets and NBFIs currently under discussion, in particular (i) the

amended Solvency II Directive Proposal adopted by the European Commission on 2/26/2008 and currently under discussion in the European Parliament and the Council (Level 1); and (ii) the implementing measures pertaining to Directive 2007/44/EC of 9/5/2007 on procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase in holdings in the financial sector, that are currently under discussion between CESR, CEBS, CEIOPS and the European Commission (Level 2).

III.1.1 Securities markets

22. The EU legislation in force pertaining to securities markets consists of eight Directives and their implementing measures (See Table 1).

Table 1: Securities Market Directives

Directive 98/26/EC on settlement finality (***Settlement Finality Directive***)
Directive 2002/47/EC on financial collateral (***Financial Collateral Directive***)
Directive 2003/6/EC on insider dealing and market manipulation (***Market Abuse Directive***)
Directive 2003/71/EC on prospectuses (***Prospectus Directive - PD***)
Directive 2004/25/EC on takeover bids (***Takeover Bid Directive***)
Directive 2004/39/EC on markets in financial instruments (***Markets in Financial Instruments Directive - MiFID***)
Directive 2004/109/EC on harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (***Transparency Directive - TD***)
Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions (***Capital Requirement Directive - CRD***)

Source: EU Commission, DG Internal Market and Services

23. In addition, the Federation of European Securities Exchanges (FESE), the European Association of Central Counterparty Clearing Houses (EACH), and the European Central Securities Depositories Association (ECSDA) adopted a European Code of Conduct for Clearing and Settlement on November 7, 2006.

24. The review does not cover the Settlement Finality Directive and the Financial Collateral Directive. The assessment of the legal and regulatory framework for securities settlement is covered separately as part of the Report on the Observance of Standards and Codes (ROSC) – Payment Systems (See IMF (2003)).

III.1.1.1 The Market Abuse Directive

25. The Market Abuse Directive (Directive 2003/6/EC) and its implementing measures was the first piece of EU legislation prepared following the Lamfalussy process. The Directive was approved by the European Parliament and the Council on January 23, 2003 and came into effect in July 2004.

III.1.1.1.1 Scope of the Directive

26. The objective of the Market Abuse Directive is to promote the integrity of Europe's financial markets through introducing a common framework for preventing and detecting market abuse and for ensuring a proper flow of information to the market.

27. The Directive applies to any financial instrument admitted to trading (or where a request for admission has been made) on a regulated market in at least one Member State (See Table 2). The Directive applies to all transactions concerning these instruments, whether these transactions occur on a regulated market or elsewhere. The insider dealing provisions also apply to financial instruments not admitted on a regulated market, but whose value depends on such financial instruments (derivatives) (See FSA (2004), p 12).

Table 2: Market Abuse Directive:
Financial Instruments Coverage

Shares in companies and securities equivalent to shares in companies
Bonds and other forms of securitized debt
Any other securities giving the right to acquire shares or bonds
Derivatives on commodities
Units in collective investment undertakings
Money market instruments
Financial futures contracts
Forward interest rate agreements
Options
Interest rate, currency and equity swaps

Source: FSA (2004)

28. Each Member State is required to apply the provisions of the Directive to actions carried out on its territory concerning financial instruments admitted to trading on any

regulated market in the EEA (or for which request for admission to trading on such market has been made). Member States are also required to apply the provisions of the Directive to actions carried out overseas concerning financial instruments that are admitted to trading (or for which a request for admission to trading has been made) on a market situated on their territory.

III.1.1.1.2 Market Abuse

29. The Market Abuse Directive prohibits two broad types of market abuse, ie ***insider trading*** and ***market manipulation.***

III.1.1.1.2.1 Insider Trading

30. The Directive prohibits anyone in possession of inside information from dealing (or attempting to deal) in relevant securities, encouraging others to deal and disclosing the information. The Directive establishes ***three categories of inside information*** (See FSA (2004) p. 9):

(i) For all financial instruments except commodity derivatives, inside information is defined as information in relation to financial instruments that is precise, not in the public domain and, if it were made public, would be likely to have a significant effect on the prices of those instruments or on the price of related derivative instruments. This is information that a reasonable investor would be likely to use as part of his investment decision;

(ii) For commodity derivatives, inside information is defined as information of a precise nature which has not been made public and which users of markets on which such derivatives are traded would expect to receive in accordance with accepted market practice on those markets; and

(iii) For intermediaries executing client orders, inside information is defined as precise information about pending orders which, if made public, would have a significant effect on prices of financial instruments or related derivative financial instruments.

III.1.1.1.2.2 Market Manipulation

31. The Directive defines three types of market manipulation (See FSA (2004), pp 9-10):

(i) Where transactions or orders to trade could give false or misleading signals as to the demand and supply of a price or where the price was deliberately fixed at an abnormal or artificial level, unless the originator of the transaction can demonstrate to the regulatory authorities that their

behavior was for legitimate reasons and conformed to accepted market practice;

(ii) Transactions or orders to trade where some form of deception is used; and

(iii) Dissemination of information via the media or any other means that gives misleading signals, news or rumors about financial instruments by persons who know or ought to know that the information is false or misleading.

32. The Directive provides for two sets of circumstances where a ***safe harbor*** exist, ie., trading in own shares in buy-back programmes and stabilization of a financial instrument. To qualify for safe harbor status, buyback programmes and stabilization activities must conform to the requirements established under implementing measures.

III.1.1.1.3 Disclosure of Information

33. The Directive provides measures to improve the quality of information disclosed to the market. (See FSA (2004), pp 10-11):

(i) requiring issuers to inform the public of inside information as soon as possible;

(ii) requiring members of the management of issuers of shares, ***and persons closely associated with them***, to disclose their dealings in the shares (or other instruments linked to the shares) of the issuer;

(iii) requiring those producing or disseminating research or other information recommending or suggesting investment strategy to present the information fairly and to disclose any interests or conflicts of interest; and

(iv) requiring those arranging transactions to notify the competent authorities of any suspicious transaction.

34. In disclosing inside information, issuers must ensure that the disclosure is made promptly to all investors in a synchronized manner, so as to prevent some investors gaining an advantage over others through earlier access to information. Any significant change to publicly disclosed information must also be promptly disclosed. However, disclosure of inside information can be delayed by issuers to protect their legitimate interests, for example during the course of negotiations, provided that the confidentiality of the information can be ensured during the delay and provided that such delay would not be likely to mislead the public.

35. In respect to investment recommendations, Member States can choose the most appropriate form of regulation to ensure compliance, including self-regulatory mechanisms.

III.1.1.2 The Prospectus Directive (PD)

36. The Prospectus Directive (Directive 2003/71/EC) (PD) was adopted by the European Parliament and the Council on April 29, 2004. The objective of the Directive is to create common disclosure standards for public issues of securities throughout the EU and to facilitate mutual recognition of prospectuses and listing particulars.

37. The PD regulates (i) the form and content of prospectuses; (ii) the responsibility for prospectuses; (iii) the choice of home state; (iv) approval of prospectuses and passport rights; and (v) exemptions from the prospectus requirement (See KattenMuchinRosenmanCornish (2005) pp. 2-3).

III.1.1.2.1 Form and Content of Prospectuses

38. The PD establishes general format principles for the prospectus. Specifically, the prospectus must provide all information necessary to enable investors to make an informed assessment of the assets and liabilities, profits and losses and prospects of the issuer and of the rights attached to the securities.

39. For certain non-equity securities issued by credit institutions under an offering programme, the PD allows the use of a ***base prospectus*** and of a ***term sheet supplement*** containing the final terms of the offer. The base prospectus must contain all required material on the issuer and the security, and the final terms of each particular issue can be filed without any further approval by the competent authority. However, any supplementary information relating to changes in the base prospectus requires approval by the competent authority.

40. For all equity securities and for non-equity securities other than those described above, the PD allows the use of a ***single prospectus*** or of a ***three-part prospectus***. A three-part prospectus comprises (i) a Summary which can be used independently of the other parts; (ii) a Registration document containing information about the issuer and (iii) a Security Note setting out details of the securities.

III.1.1.2.2 Responsibility for Prospectuses

41. The civil liability laws of individual Member States apply to those responsible for the information contained in a prospectus. However, the PD requires that national laws be amended to ensure that no civil liability attached to any person solely on the basis of the Summary, unless the latter is misleading or inaccurate.

III.1.1.2.3 Choice of Home State

42. For EU issuers of equity securities and low-denomination debt (*ie*. non-equity securities with a denomination of less than Euro 1,000), the PD establishes their home state as the EU Member State in which they have their registered office. For non-EU issuers of equity securities and low-denomination debt, the PD establishes their home

state as the EU Member State in which they make their first offer of securities to the public or their first application for listing on an EU regulated market. Issuers of wholesale debt and high denomination retail debt can select their home state on an issue by issue basis.

III.1.1.2.4 Approval of Prospectuses and Passport Rights

43. The PD requires that the competent authority in the issuer's home state approve the prospectus within 10 working days after the issuer has filed a complete prospectus (20 days on the first occasion an issuer seeks prospectus approval). Upon approval by the competent authority, each prospectus must be published by one of the permitted methods which include insertion in a newspaper and publication by various electronic means including the issuer's web site.

44. The approval of the prospectus by the competent authority in the home state provides mutual recognition rights to the issuer ***(passport right***). Under passport rights, (i) issuers are only required to notify host state regulators in relation to public offer or listing request in their jurisdiction and (ii) host state national regulators cannot require issuers to comply with additional requirements.

III.1.1.2.5 Exemptions from the Prospectus Requirement

45. Exemptions from the prospectus requirement include offers (i) directed at fewer than 100 offerees per Member State; (ii) of securities with a minimum denomination or minimum subscription of Euro 50,000; (iii) made solely to Qualified Investors (based on size, net worth, investment experience and/or regulatory status criteria).

46. If an issuer issues its securities within one or more of the exemptions, no PD compliant prospectus will be required unless the securities are listed on a EU regulated market. Any secondary resale of securities originally offered within a prospectus exemption (including placement of securities through intermediaries) requires a PD compliant prospectus unless the secondary market resale is also within PD exemption.

III.1.1.3 The Takeover Bid Directive

47. The Takeover Bid Directive (Directive 2004/25.EC) was approved by the European Parliament and the Council on April 21, 2004. The objective of the Directive is to establish minimum guidelines for the conduct of takeover bids involving the securities of companies governed by the laws of Member States, where all or some of the securities are admitted to trading on a regulated market in one or more Member States. The Directive also seeks to provide an adequate level of protection for holders of securities throughout the EU, by establishing a framework of common principles and general requirements which Member States must implement through more detailed rules under their national systems.

48. The Directive contains a number of mandatory and optional rules. Mandatory rules include (i) the mandatory bid rule (Article 5); (ii) the right of squeeze-out (Article 15); and (iii) the right of sell-out (Article 16). Optional rules include (i) the restriction on frustrating action (Article 9) and (ii) the breakthrough principle (Article 11).

III.1.1.3.1 Mandatory Bid Rule

49. The Directive establishes that, where a natural or legal person acquires securities in a company, either on his/her own or in concert with other persons, either directly or indirectly, giving him/her a specific percentage of voting rights that confer control of that company, such person is required to make a bid as a means of protecting the minority shareholders of that company. Such a bid must be addressed at the earliest opportunity to all the holders of those securities for all their holdings at an equitable price (Article 5(1)).

50. The percentage of voting rights which confers control of the company and the method of its calculation is defined by the Member State in which the company has its registered office (Article 5(3)).

51. The equitable price is defined as the highest price paid for the same securities by the offeror, or by persons acting in concert with him/her over a period to be determined by Member States, of not less than 6 months and not more than 12 months prior to the bid. If, after the bid has been made public and before the offer closes for acceptance, the offeror or any person acting in concert with him/her purchases securities at a price higher than the offer price, the offeror must increase his/her offer so that it is no less than the highest price paid for these securities (Article 5(4)).

52. The regulatory authorities of Member States may adjust the price defined above in accordance with clearly determined criteria, for example where the highest price was set by agreement between a purchaser and a seller, where the market price of the securities in question has been manipulated, or where market prices in general or certain market prices have been affected by exceptional circumstances. The regulatory authorities may also determine the criteria to be applied in such cases, such as the average market value over a particular period, the break-up value of the company or other objective valuation criteria (Article 5(4)).

53. Offerers must offer a cash consideration at least as a alternative where they have purchased for cash securities carrying at least 5% of the voting rights in the offeree company from the beginning of the period of calculation of the equitable price until the offer closes for acceptance.

54. The Directive also establishes the information to be contained in the offer document.

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III.1.1.3.2 Right of Squeeze-out

55. The Directive establishes a right of squeeze-out. Specifically, the Directive requires that an offeror is able to require all the holders of the remaining securities to sell him/her those securities at a fair price (i) where the offeror holds securities prepresenting not less than 90% of the capital carrying voting rights and 90% of the voting rights in the offeree company or (ii) where, following acceptance of the bid, the offeror has acquired or has firmly contracted to acquire securities representing not less than90% of the offeree company's capital carrying voting rights and 90% of the voting rights comprised in the bid (Article 15).

56. If an offeror wishes to exercise the right of squeeze-out, he/she must do so within three months of the end of the time allowed for acceptance of the bid.

III.1.1.3.3 Right of Sell-out

57. The Directive establishes a right of sell-out. Specifically, the Directive requires that a holder of remaining securities is able to require the offeror to buy his/her securities from him/her at a fair price under the same circumstances as mentioned in para 61 above.

III.1.1.3.4 Restriction on Frustrating Action

58. The Directive establishes restrictions on frustrating action by the board of the offeree company (Article 9).

59. Specifically, Article 9 provides that, during a defined period, the board of the offeree company must obtain the prior authorization of the general meeting of shareholders before taking any action, other than seeking alternative bids, which may result in the frustration of the bid, and in particular before issuing any shares which may result in a lasting impediment to the offeror's acquiring control of the offeree company. Such authorization is mandatory at least from the time the board of the offeree company receives the information concerning the result of the bid is made public or the bid lapses.

60. Member States may reserve the right ***not to require companies registered in their territories to apply the provisions of Article 9*** (Article 12)**.**

III.1.1.3.5 Breakthrough Principle

61. The Directive establishes a breakthrough principle (Article 11).

62. Any restrictions on the transfer of securities provided for in the articles of association of the offeree company, or in contractual agreements between the offeree company and the holders of its securities, or in contractual agreements between the holders of the offeree company's securities, shall not apply *vs* the offeror during the time allowed for acceptance of the bid.

63. Restrictions on voting rights provided for in the articles of association of the offeree company shall not have effect at the general meeting of shareholders which decides on defensive measures in accordance with Article 9 above.

64. Following a bid, where the offeror holds 75% or more of the capital carrying voting rights, no restrictions on the transfer of securities or on voting rights as defined above, nor any extraordinary rights of shareholders concerning the appointment or removal of board members provided in the articles of association of the offeree company shall apply; multiple-vote securities shall carry only one vote each at the first general meeting of shareholders following closure of the bid, called by the offeror in order to amend the articles of association or toe remove or appoint board members.

65. Member States may reserve the right ***not to require companies registered in their territories to apply the provisions of Article 11*** (Article 12).

III.1.1.4 The Markets in Financial Instruments Directive (MiFID)

66. The Markets in Financial Instruments Directive (2004/39/EC) (MiFID) was adopted by the European Parliament and the Council on April 21, 2004 and came into effect on November 1, 2007. MiFID heralds a profound transformation in the competitive landscape of securities markets in the EU. It opens the door for banks to operate as exchanges for some activities, for alternative exchanges to offer alternative execution services that more closely resemble the structure of OTC markets than traditional organizes markets, and the decentralization of order execution among a panoply of venues previously governed by concentration rules. It has major implications for the organization, operations and business strategies of investment firms, exchanges, asset managers and other financial market intermediaries.

III.1.1.4.1 Scope of MiFID

67. MiFID is based on two fundamental pillars:

(i) ***Pillar 1*** consists of a ***strengthened single passport for investment firms*** allowing them to provide investment services in the 27 EU Member States and the 3 European Economic Area (EEA) States on the basis of a single authorization and high level of home state control. As a quid pro quo, MiFID imposes high standards of investor protection rules valid across the EU. Specifically, MiFID introduces rules on the internal governance of investment firms and harmonizes conduct of business rules for securities trading, including client categorization, best execution of trades, and transaction reporting.

(ii) ***Pillar 2*** consists of the ***abolition of the trade concentration rule*** of the Investment Services Directive (ISD), by which Member States could require

trades to be executed on the domestic main exchange or the regulated market. The abolition of the concentration rule provides for free competition between exchanges, multilateral trading facilities (MTFs) and systematic internalizers for the trading of financial instruments, including transferable securities, money market instruments, units in collective investments (non-UCITS), options, futures, swaps and other derivatives, financial contracts for difference, and derivative instruments for the transfer of credit risk. As a quid pro quo, MiFID imposes increased pre- and post-trade transparency for regulated markets, MTFs and systematic internalizers. However, the pre- and post-trade transparency requirements of MiFID do not apply to the bond market.

III.1.1.4.2 MiFID Requirements for Investment Firms

68. MiFID imposes new requirements for ***investment firms*** with respect to internal governance, conduct of business, and transaction reporting.

69. ***Internal governance requirements*** pertain to risk management, internal audit and compliance functions, limitations on personal dealing by employees, managers and directors, limits to outsourcing to third countries, and comprehensive policy for identifying, managing and disclosing conflicts of interest.

70. ***Conduct of business requirements*** pertain to the *suitability* of investment advice and portfolio management to the investor's level of experience, risk appetite and investment objectives, and to the *appropriateness* of other services, i.e. the investor must be able to understand risk, except for a limited class of non-complex products. These are known as "*know your client rules"*. Investment firms are also required to deliver *best execution* when executing orders on behalf of clients. Specifically, they must take all reasonable steps to obtain, when executing client orders, the best possible result for clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature and any other relevant consideration. MiFID also requires investment firms to establish an *order execution policy* and to obtain the prior consent of clients to this policy, with prior consent required if the policy permits orders to be executed outside regulated markets or MTFs. Firms must monitor the effectiveness of their policy to correct deficiencies and demonstrate, at the client's request, that the firm has been following the policy. Payments to and from firms in relation to investment services must be justified and fully disclosed to the client, and must enhance quality of service to the client. Finally, MiFID requires a mandatory written client agreement for retail clients.

71. ***Transaction reporting requirements*** pertain to reporting to regulatory authorities of buy and sell transactions in all financial instruments admitted to trading on a regulated market, and sharing of data among competent authorities to ensure adequate supervision. There are carve-outs from obligation for primary market transactions, securities financing, and option exercises. In the case of interest-rate, FX and commodity derivatives, the exchange reports transactions to the local regulators since there is no OTC trading of exchange-admitted instruments. Some regulators apply rules to a broader

range of instruments, for example to OTC-only instruments that are not admitted to trading on a regulated market.

III.1.1.4.3 MiFID Requirements for Exchanges

72. MiFID imposes detailed requirements on ***exchanges.***

73. MiFID imposes detailed ***requirements for the organization and*** conduct ***of regulated markets and MTFs***, and detailed ***transparency provisions*** apply to financial instruments admitted to trading on regulated markets, MTFs and systematic internalizers. However, the transparency requirements of MiFID do not apply to bond markets.

74. MiFID imposes detailed ***pre-trade transparency requirements*** for liquid shares (ie approximately 500 shares or 90% of market capitalization in the EU single market). These pertain to publication of bid/offer prices by systematic internalizers, client limit orders, and sequential order handling. MiFID also imposes ***post-trade transparency requirements*** on all listed shares and their derivatives. These pertain to reporting of trades in real time or within 3 minutes, agreements between parties on responsibility for publication of data, deferred publication possibilities for large trades, and publication of OTC and off-hours trading.

III.1.1.5. The Transparency Directive (TD)

75. The Transparency Directive (TD) (2004/106/EC) establishes (i) the minimum content of annual, half-yearly and interim management statements; (ii) the notification requirements of both issuers and investors in relation to the acquisition and disposal of major shareholding in companies; and (iii) the method of disseminating and storing the information contained in the above disclosures on a pan-European basis. Member States are allowed to impose additional requirements above the minimum levels established in the TD, although these additional requirements may apply only to issuers incorporated in their own country. Exchanges are allowed to impose additional requirements on issuers traded on their markets.

III.1.1.5.1 Periodic Reporting Requirements

76. The TD establishes three types of periodic reporting requirements for issuers: (i) interim management statements; (ii) half-yearly financial reports and (iii) annual reports (See PriceWaterhouseCoopers (2007a), pp. 4-12).

77. The reporting requirements apply to issuers and to their controlled undertakings. The Directive defines a ***controlled undertaking*** as any undertaking (i) in which a natural person or legal entity has a majority of the voting rights; (ii) of which a natural person or a legal entity has the right to appoint or remove a majority of the members of the administrative, management or supervisory body and is at the same time a shareholder in,

or member of, the undertaking in question; (iii) of which a natural person or legal entity is a shareholder or member and alone controls a majority of the shareholders' or members' voting rights, respectively, pursuant to an agreement entered into with other shareholders or members of the undertaking in question and (iv) ***over which a natural person or legal entity has the power to exercise, or actually exercises, dominant influence or control (ultimate controller principle)*** (TD Article 2 (f)).

78 The publication of an ***interim management statement (IMS)*** is required from issuers whose shares (excluding preference shares) are admitted to trading on a regulated market and whose home state is a EU Member State. An IMS shall be issued during the first six-month period of the financial year, and another one during the second six-month period of the financial year (specifically ten weeks after the beginning and six weeks before the end of the relevant six-month period). The IMS shall provide information that covers the period between the beginning of the relevant six-month period and the date of publication of the statement. The IMS shall provide an explanation of material events and transactions that have taken place during the relevant period and their impact on the financial position of the issuer and its controlled undertakings, and a general description of the financial position and performance of the issuer and its controlled undertakings during the relevant period. Issuers that choose to publish quarterly financial reports in accordance with national legislation or the rules of the regulated market are not required to produce an IMS.

79. The publication of a ***half-yearly financial report*** is required from issuers of shares or debt securities whose home state is an EU Member state. The half-yearly financial report is due at the latest two months after the end of the relevant period. The half-yearly report shall comprise a condensed set of financial statements, and interim management report, and statements made by persons responsible within the issuer. Where the issuer is required to prepare consolidated accounts, the condensed set of financial statements is prepared in accordance with EU-adopted IAS 34. Where the issuer is not required to prepare consolidated accounts, the condensed set of financial statements shall at least contain (i) a condensed balance sheet; (ii) a condensed profit and loss statement and (iii) explanatory notes on these accounts. The ***interim management report*** included in the half-yearly report shall include (i) an indication of important events that have occurred during the first six months of the financial year and their impact on the condensed set of financial statements; (ii) a description of the principal risks and uncertainties for the remaining months of the financial year; and (iii) related party transactions for issuers of shares.

80. The publication of an ***annual financial statement*** is required from issuers whose transferable securities (including any class of shares and debt) are admitted to trading on a regulated market and whose home state is a EU Member State. The annual financial statement shall be made public at most four months after the end of the financial year. The annual financial statement shall comprise (i) the audited financial statements, (ii) the management report and (iii) the responsibility statements. Consolidated accounts are required to be prepared in accordance with IFRS, and single entity accounts must be prepared in accordance with the national law of the EEA in which the issuer is

incorporated. The ***management report*** shall include (i) a fair review of the issuer's main business and a description of the principal risks and uncertainties facing the issuer; (ii) a balanced and comprehensive analysis of the development and performance of the business and the position of the issuer's business at the end of the year; (iii) to the extent necessary, an analysis including key financial and other performance indicators, as well as information relating to environmental and employee matters; and (iv) references to and additional explanations of amounts included in the issuer's annual financial statements. The management statement shall also include an indication of important events that have occurred since the end of the previous financial year; (ii) the issuer's likely future development (iii) information concerning the acquisition of own shares; (iv) the existence of branches; (v) where material, financial risk management objectives and hedging policies; and (vi) issuer's exposure to price risk, credit risk, liquidity and cash flow risk.

III.1.1.5.2 Notification of Acquisition and Disposal of Major Shareholdings

81. The TD provides detailed regulations for the notification of acquisition and disposal of major shareholdings of issuers. These pertain to (i) notification procedures; (ii) responsibility for notification; and (iii) information accompanying notification.

III.1.1.5.2.1 Notification Procedures

82. The TD requires that a shareholder that acquires or disposes of shares of an issuer whose shares are admitted on a regulated market and to which voting rights are attached, shall notify the issuer of the proportion of voting rights of the issuer held by the shareholder ***where that proportion reaches, exceeds or falls below the thresholds of 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75%*** (See TD Article 9(1)).

83. This notification does not apply to shares acquired for the sole purpose of clearing and settling within the usual short settlement cycle, or to custodians holding shares in their custodian capacity provided such custodians can only exercise the voting rights attached to such shares under instructions given in writing or in electronic form.

III.1.1.5.2.2 Responsibility for Notification

84. The TD establishes broad responsibility for the notification of major shareholding. Specifically, the notification requirement extends to a natural person or a legal entity that is entitled to acquire, dispose of, or exercise voting rights in any of the following cases of combination thereof (See TD Article 10):

(i) voting rights held by a third party with whom that person or entity has concluded an agreement which oblige them to adopt, by concerted exercise of the voting rights they hold, a lasting common policy towards the management of the issuer;

(ii) voting rights held by a third party under an agreement concluded with that person or entity providing for the temporary transfer for consideration of the voting rights in question;

(iii) voting rights attaching to shares which are lodged as collateral with that person or entity, provided the person or entity controls the voting rights and declares its intention to use them;

(iv) voting rights attaching to shares in which that person or entity has the life interest;

(v) voting rights which are held, or may be exercised within the meaning of points (i) to (iv), ***by an undertaking controlled by that person or entity;***

(vi) voting rights attaching to ***shares deposited with that person*** or entity which the person or entity can exercise at its discretion in the absence of specific instructions from the shareholders;

(vii) voting rights held by a third party in its own name ***on behalf of that person or entity***; and

(viii) voting rights which that person or entity may exercise ***as a proxy*** where the person or entity can exercise the voting rights at its discretion in the absence of specific instructions from the shareholders.

III.1.1.5.2.3 Information Accompanying Notification

85. The TD establishes detailed information requirements to accompany the notification. Specifically, the TD requires that notification be accompanies byt he following information: (See TD Article 12(1)):

(i) the resulting situation in terms of voting rights;

(ii) the chain ***of controlled undertakings through which voting rights are effectively held,*** if applicable;

(iii) the date at which the threshold was reached or crossed; and

(iv) the ***identity of the shareholder, even if that shareholder is not entitled to exercise voting rights under the conditions laid down in Article 10*** (See above)***, and of the natural person or legal entity entitled to exercise voting rights on behalf of that shareholder.***

86. The notification requirements also apply to a natural person or legal entity who holds, directly or indirectly, financial instruments that result in an entitlement to acquire,

on such holder's own initiative alone, under a formal agreement, shares to which voting rights are attached, already issued, of an issuer whose shares are admitted to trading on a regulated market (See TD Article 13).

III.1.1.6 The Capital Requirement Directive (CRD)

87. The Capital Requirement Directive (CRD) (2006/49/EC) applies the international guidelines for capital requirement adopted in June 2004 by the Basel Committee on Banking Supervision (Basel II) to banks and investment firms registered in Member States. The CRD came into force on January 1, 2007, with some elements subject to transitional arrangements until January 1, 2008.

88. The CRD implements under EU Law the three pillar supervisory structure of Basel II: (i) Pillar 1 covers minimum, risk-based capital requirements; (ii) Pillar 2 covers risk-based supervision by the regulatory authority; and (iii) Pillar 3 addresses market disclosure requirements by regulated entities.

89. Under ***Pillar 1***, the CRD requires firms to calculate their minimum capital requirement based on credit, market and operational risk. In the case of investment firms, the calculation of minimum capital requirement under the CRD differs in function of the range of activities that the firm is allowed to undertake. Specifically, the CRD allows Member States to distinguish investment firms into three types: "full investment firm", "limited license" firm and "limited activity" firm:

(i) A ***full investment firm*** is an investment firm with no restrictions or limitations on its license or activity. It can deal as principal without any conditions or restrictions and can also underwrite financial instruments;

(ii) A ***limited license firm*** is an investment firm whose authorization does not allow it to deal on its own account or underwrite and/or place financial instruments on a firm commitment basis; and

(iii) A ***limited activity firm*** is an investment firm that deals on its own account only for the purpose of filling or executing client orders, or for the purpose of gaining entrance to a clearing and settlement system when acting as agent or executing a client order.

90. The following describes the regulations in force for the calculation of minimum capital requirements for each of the three types of investment firms as established by the UK FSA under the CRD ("the CRD regulations").

91. In the case of ***full investment firms***, the CRD regulations provide for a two-stage approach for the calculation of the minimum capital requirement:

(i) ***Stage one*** consists of assessing the ***base capital resource requirement*** of the firm depending on the firm's categorization. The CRD regulations distinguish four types of firms for the purpose of base capital resource requirement (i) own account broker; (ii) matched principal broker; (iii) broker/manager and (iv) advisor/arranger. The CRD regulations define a minimum capital requirement in nominal terms for each category of firm. As of end-2005, the minimum capital requirement varied from Euro 730K for own account dealers to Euro 125K for matched principal brokers, to between Euro 50K and 125K for broker managers and advisors/arrangers .

(ii) ***Stage two*** consists of assessing the method of calculation of minimum capital requirement that a firm must use. The default methodology applying to full license firms is ***the higher of the base capital requirement or the sum of credit risk, market risk and operational risk.***

92. In the case of ***limited license firms***, the minimum capital requirement is calculated as the higher of (i) the base capital requirement; (ii) the sum of credit and market risk requirements; or (iii) the fixed overhead requirement (FOR). Broker/managers and advisor/arranger automatically fall under the limited license category.

93. In the case of ***limited activity firms***, the minimum capital requirement is calculated as the higher of (i) the base capital requirement or (ii) the sum of credit risk, market risk and FOR.

94. For full license firms, there are three possible approaches to the calculation of the capital charge required to cover operational risk. Under the Basic Indicator Approach (BIA), the capital charge is defined as 15% of the average gross income for the whole business over 3 years. Under the Standardized Approach (TSA), the gross income of eight business lines is considered separately and the capital charge ranges from 12% to 18% depending on the business line. The TSA also requires qualitative entry criteria including policies for managing operational risk, a framework for managing operational risk, processes and systems for monitoring operational risk/losses, and internal and external reporting. Under the Advanced Measurement Approach (AMA), the firm may recognize diversification benefits, in particular through the free transfer of capital between branches and subsidiaries to support risk. AMA requires firms must have an independent operational risk management function, three years of historical internal loss data, extensive risk modeling, apply qualitative criteria building on TSA, and provide for external verification. In practice, most investment firms opt for the BIA or TSA approaches.

95. Under ***Pillar 2,*** the CRD requires all firms to document their risk management processes under an Individual Capital Adequacy Assessment Process (ICAAP). The ICAAP is a firm's own assessment of its risk management processes and covers (i) identification and assessment of material risks; (ii) identification of mitigating controls; (iii) identification of amount of capital in relation to business plan, strategies and profile

and (iv) production of capital number and assessment. The ICAAP must (i) be an integral part of the management process, (ii) reviewed regularly, (iii) risk-based, (iv) comprehensive, (v) forward looking, and (vi) based on capable of allocating the group adequate measurement and assessment process. The ICAAP must be carried out at the level of the consolidation group, and allocate the group capital numbers to the individual firms**.** The CRD requires that the regulatory authority reviews and evaluate the firms' risks and control factors; reviews and assesses the firm's own risk assessment and produces a supervisory conclusion.

96. Under ***Pillar 3***, the CRD requires that the firm provides regular information to the market about its risk profile and level of capitalization in order to enable market participants to make informed decisions based on key information. Specifically, firms need to disclose to the market on an annual basis detailed qualitative and quantitative information ***on risk management objectives and policies, scope of application, capital resources, credit and dilution risk and credit risk mitigation, market risk, operational risk, and securitization.***

III.1.1.7 The European Code of Conduct for Clearing and Settlement

97. The European Code of Conduct for Clearing and Settlement ("The Code") was adopted as a voluntary code of conduct by the Federation of European Securities Exchanges (FESE), the European Association of Central Counterparty Clearing Houses (EACH), and the European Central Securities Depositories Association (ECSDA) on November 7, 2006. The Code was endorsed by the European Commissioner for Internal Market and Services on the same date (See McCreevy (2006)).

98. The objective of the Code is to offer market participants the freedom to choose their preferred provider of services separately at each layer of the transaction chain (trading, clearing and settlement), and to make the concept of "cross-border" redundant for transactions between EU Member States. The Code constitutes a voluntary self-commitment by the signatory organizations ("The signatories") to adhere to a number of principles on the provision of post-trading services for cash equities. These principles pertain to (i) price transparency, (ii) access and interoperability; and (iii) service unbundling and accounting separation (See FESE (2006), pp. 4-9).

III.1.1.7.1 Price Transparency

99. The first objective of the Code is to increase price transparency, specifically (i) to enable customers to understand the services they will be provided with, and to understand the prices they will have to pay for these services, including discount schemes, and (ii) to facilitate the comparison of prices and services, and to enable customers to reconcile ex-post billing of their business flow against published prices and the services provided.

100. To achieve this objective, the Code establishes a first set of Principles, specifically:

(i) The signatories should publish all offered services and their respective prices including applicable terms and conditions;

(ii) The signatories should publish all discounts and rebate schemes and applicable eligibility criteria;

(iii) The signatories should publish examples that explain prices, as well as discount and rebate schemes for different types of customers or customer groups; and

(iv) The signatories should publish all information regarding services and prices on a prominent place on the signatories websites.

101. These Principles apply to all prices charged by the signatories, including one-time and periodic fees (membership, connectivity and set-up), prices of transactions-related services (trading, clearing and settlement), prices of custody services, and prices of additional services to customers.

III.1.1.7.2 Access and Interoperability

102. MiFID provides some access rights in the post-trade area to regulated markets and investment firms, specifically: (i) the right of market participants to access remotely a foreign CCP and/or CSD; (ii) the right of market participants to choose the settlement location of their trades (but not the location of the Central Counterparty Clearing) provided links are in place between the regulated market and the entity in question; and (iii) the right of regulated markets to choose a particular CCP and/or CSD to clear and settle their trades. The second objective of the Code is to extend the rights provided by MiFID to additional relations in the clearing and settlement sector, mainly addressing relationships between infrastructures.

103. To achieve this objective, the Code establishes a second set of Principles, specifically:

(i) CCPs should be able to access other CCPs;

(ii) CCPS should be able to access CSDs;

(iii) CSDs should be able to access other CSDs;

(iv) CCPs and CSDs should be able to access transaction feeds from trading venues;

(v) CSDs should be able to access transaction feeds from CCPs; and

(vi) A trading venue should be able to access a CSD and/or CCP for its post-trading activities.

III.1.1.7.3 Service Unbundling and Accounting Separation

104. The third objective of the Code is to provide service unbundling and accounting separation for customers in order to provide them flexibility in the choice of services and relevant information on the service provided. Specifically, service unbundling and account separation are designed (i) to make transparent the relation between revenue and cost of different services to facilitate competition; (ii) to make transparent potential cross-subsidies between the different services; and (iii) to provide users with choice regarding the services available for purchase.

105. To achieve this objective, the Code establishes a third set of Principles, specifically:

(i) The services of trading venues, CCPs and CSDs will be unbundled from each other; and

(ii) Each CSD will un-bundle the following services from each other:

. Account provision, establishing securities in book entry form, and asset servicing
. Clearing and settlement (including verification)
. Credit provision
. Securities lending and borrowing and
. Collateral management.

III.1.2 Investment Funds (Undertakings of Collective Investments in Transferable Securities - UCITS)

106. EU legislation in force pertaining to investment funds consists of four Directives and their implementing measures (***UCITS III***):

(i) Directive 2001/107/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (***Management Directive***);

(ii) Directive 2001/108/EC amending Council Directive 85/611/EEC, extending the range of assets eligible for investment by UCITS (***Product Directive***);

(iii) Directive 2004/39/EC (MiFID Directive) re. provisions that are applicable to management companies (see above); and

(iv) Directive 2005/1/EC replacing the UCITS Contact Committee by the European Securities Committee.

III.1.2.1 Management Directive

107. The ***Management Directive*** has three fundamental objectives: (i) to widen the scope of activities that may be undertaken by management companies; (ii) to strengthen the availability of a EU passport for such companies to operate throughout the EU; and (iii) to introduce a requirement for a simplified prospectus intended to provide more accessible, comprehensive information to investors (See Ernst & Young (2003), pp 10-12). In addition, the Management Directive provides for detailed authorization conditions for management companies by the regulatory authorities of Member States.

108. The Management Directive extends the ***permitted activities*** of management companies to make it consistent with the Investment Services Directive (ISD), to include the management of UCITS, investment funds other than UCITS and managed accounts (including private pension funds) and non-core activities such as custody, administration, investment advice and transfer agency services.

109. The Management Directive establishes a ***passport*** under which a management company authorized by the regulatory authority in one Member State is allowed to operate in all Member States subject to compliance with host state notifications. Although a management company may delegate some of its functions, they must not do so to the extent that they become a "letterbox" entity. Management companies are required to put in place measures to monitor the activities of any entity to which functions have been delegated and ensure that such entities are qualified and capable of performing their duties so as to demonstrate the level of supervision and control required from management companies.

110. The Management Directive introduces the concept of ***simplified prospectus*** which must be both investor friendly and contain all relevant information to enable investors to make an informed judgment. In particular, the prospectus must contain the following information: (i) country of registration of the UCITS and identity of the management company, service providers, auditors and fund promoter, investment objective and policy, risk warnings and investor profile; (iii) tax regime, commissions and fees and expenses; (iv) subscription/redemption/conversion details, distribution policy and availability of Net Asset Value (NAV) per share detail; and (v) name of regulator where the prospectus and fund reports may be obtained.

111. The Management Directive provides that regulatory authorities of Member States shall not to grant authorization to a management company unless the persons who effectively conduct the business of the management company are of sufficiently good repute and are sufficiently experienced in relation to the type of UCITS managed by the

management company (***fitness and propriety***). The conduct of a management company's business must be decided by at least two persons meeting such conditions (***four eyes principle***). In addition, if ***close links*** exist between the management company and other natural or legal persons, the competent authorities shall grant authorization only if those do not prevent the effective exercise of their supervisory functions.

112. The Management Directive further requires that regulatory authorities of Member States shall not grant authorization to a management company until they have been informed of the identities of the shareholders or members, whether direct or indirect, natural or legal persons, that have qualifying holdings and of the amount of these holdings. The regulatory authorities shall refuse authorization if they are not satisfied as to the ***suitability of the shareholders or members*** of the management company, taking into account the need to ensure the sound and prudent management of the management company.

III.1.2.2 Product Directive

113. .The ***Product Directive*** expands the range and type of financial instruments to include the following: 9i) transferable securities and money market instruments; (ii) bank deposits; (iii) units of other investment funds; (iv) financial derivative instruments and (v) index tracking funds. Transferable securities are defined as (i) shares in companies and other securities equivalent to shares in companies; (ii) bonds and other forms of securitized debt; and (iii) any other negotiable securities which carry the right to acquire any such transferable securities by subscription or exchange (See Ernst & Young (2003) pp. 4-9).

114. The Product Directive applies aggregate limits on investments in instruments issued by or made with the same body, and individual limits on specific instruments.

III.1.2.2.1 Aggregate Limits

115. The Product Directive applies ***aggregate limits*** on investments in instruments issued by or made with the same body. Specifically, a UCITS fund is permitted to invest an overall combined limit of 35% of its assets in (i) transferable securities and money market instruments; (ii) deposits and/or (iii) derivative instruments issued by or made with the same body. A maximum limit of 20% of the NAV of a UCITS fund applies to (i) transferable securities and money market instruments; (ii) deposits and/or (iii) exposures arising from OTC derivative transactions issued by or made by the same body. Therefore the 20% limit applies to combined investments including OTC derivatives while the 35% limit applies to combined investments including derivatives traded on a regulated market as well as OTC derivatives. Group companies are considered as a single issuer for the purpose of calculating restriction limits.

III.1.2.2.2 Limits on Transferable Securities and Money Market Instruments

116. A UCITS may invest a maximum of 5% of its assets in transferable securities and money market instruments issued by a single issuer. Member States may increase this limit to 10% but the total value of positions in excess of 5% must not exceed 40% of NAV. Member States may permit a UCITS to invest a maximum of 35% of its assets in transferable securities and money market instruments issued or guaranteed by a EU Member State or its local authorities, by a non-Member state or by public international bodies to which one or more Member states belong. This limit may be raised to 100% under certain conditions. In case of money market instruments that are not traded on a regulated market, investment is only permitted if the issuer is regulated and if the money market instruments are subject to specific conditions.

III.1.2.2.3 Limits on Bank Deposits

117. A UCITS may invest in deposits of credit institutions if the credit institution has its registered office in a EU Member state or, if located in a non-Member State, is subject to equivalent prudential rules of a EU Member State. A UCITS may invest a maximum of 20% of its assets in deposits of the same credit institution (including the UCITS custodian).

III.1.2.2.4 Limits on Financial Derivative Instruments

118. The Product Directive allows a UCITS to invest in derivatives for efficient portfolio management, and extends the nature of investments to include financial derivative instruments including equivalent cash settled instruments dealt on a regulated market and/or OTC market ("OTC derivatives). The investment limits set by the Directive for derivatives apply even when derivatives are used for efficient portfolio management or are embedded in transferable securities or money market instruments.

119. Specifically, the Directive requires that (i) the global exposure relating to derivative instruments must not exceed the NAV if the UCITS fund; (ii) the exposure must be calculated taking into account the current value of the underlying assets, the counterparty risk, future market movements and the time available to liquidate the positions; and (iii) in the case of OTC derivatives, the exposure to a single counterparty must not exceed 10% of NAV if the counterparty is a EU credit institution or equivalent, of 5% of NAV in other cases. For OTC derivative transactions, the counterparties must be subject to prudential supervision, the OTC derivatives must be subject to reliable and verifiable valuation on a daily basis and must be capable of being closed at any time.

120. The Directive requires that UCITS demonstrate that they have appropriate risk management controls and valuation procedures in place in relation to investments in derivatives, and report these risk controls and procedures to the regulatory authorities. The definition of these risk controls and procedures is the responsibility of regulatory authorities in Member States.

III.1.2.2.5 Funds of Funds

121. The Product Directive allows funds of funds to qualify as UCITS subject to the following conditions: (i) it invests up to 10% of its NAV in a single UCITS or equivalent, provided the equivalent structure is subject to risk diversification, leverage and regulatory controls similar to that of a UCITS. Members States are allowed to increase this limit to 20%; (ii) total investments in funds other than UCITS must not exceed 30% of the NAV of the fund; (iii) a UCITS may not acquire more than 25% of the units of any single UCITS; and (iv) a UCITS fund of funds may not invest in an underlying fund if that underlying fund is permitted to invest more than 10% of its NAV in other funds of funds.

III.1.2.2.6 Index Tracking Funds

122. In the case of index tracking funds, the directive imposes a limit of 20% of the NAV in the shares and/or debt securities issued by the same body. This limit may be increased by Member States to 35% where it is justified by exceptional market conditions. The index must be sufficiently diversified, represent an adequate benchmark, and be published in an appropriate manner.

III.1.3 Insurance

III.1.3.1 The Solvency I Directives

123. The EU legislation in force pertaining to insurance consists of a set of Directives and implementing measures pertaining to life insurance, non-life insurance, motor insurance, reinsurance, solvency, accounting, e-commerce, insurance groups, insurance mediation, and winding-up, respectively (***Solvency I Directives***) (See Table 3 below).

Table 3: Solvency I Directives

Sector	**Directive**
Life	Directive 2002/83/EC on life insurance (***Life Insurance Directive***) Directive 2000/64/EC amending 92/49/EEC and 92/96/EEC on exchange of information with third countries
Non-Life	Directive 73/239/EEC on taking up and pursuit of the business of non-life insurance (***First Non-life Insurance Directive***) Directive 73/240/EEC on abolition of restrictions on freedom of establishment Directive 78/473/EEC on community co-insurance Directive 84/641/EEC amending 73/239/EEC on

	tourist assistance Directive 87/343/EEC amending 73/239/EEC on credit insurance and suretyship insurance Directive 87/344/EEC on legal expenses insurance Directive 88/357/EEC amending 73/239/EEC on provisions to facilitate effective exercise of freedom to provide services (***Second Non-life Insurance Directive***) Directive 90/618/EEC amending 73/239/EEC abd 88/357/EEC on motor vehicle liability insurance Directive 92/49/EEC amending 73/239/EEC and 88/357/EEC (***Third Non-life Insurance Directive)*** Directive 95/26/EC amending 73/239/EEC, 92/49/EEC, 79/267/EEC and 92/96/EEC post-BCCI Directive 2000/64/EC amending 92/49/EEC and 92/96/EEC on exchange of information with third countries Directive 2002/13/EC amending 73/239/EEC on solvency margin for non-life insurance undertakings ***Fourth Non-Life Insurance Directive)***
Motor insurance	Directive 72/166/EC on insurance against liability in respect of the use of motor vehicles (***First Motor Insurance Directive***) Directive 72/430/EEC amending 72/166/EEC Directive 84/5/EEC (***Second Motor Insurance Directive***) Directive 90/232/EEC (***Third Motor Insurance Directive***) Directive 2000/26/EC amending 72/239/EEC and 88/357/EEC (***Fourth Motor Insurance Directive***) Directive 2005/14/EC amending 72/166/EEC, 84/5/EEC, 88/357/EEC, 90/232/EEC and 2000/26/EC (***Fifth Motor Insurance Directive***)
Reinsurance	Directive 2005/68/EC on reinsurance Directive 64/225/EEC on abolition of restrictions on freedom of establishment and freedom to provide services
Solvency	Directive 2002/13/EC on solvency

Accounting	Directive 91/674/EEC on annual and consolidated accounts for insurance undertakings Directive 78/660/EEC on annual accounts of certain types of companies Directive 83/349/eec on consolidated accounts
E-commerce	Directive 2000/31/EC on electronic commerce
Insurance groups	Directive 98/78/EC on supplementary supervision of insurance undertakings in an insurance group
Insurance mediation	Directive 2002/92/EC on insurance mediation
Winding-up	Directive 2001/17/EC on reorganization and winding-up of insurance undertakings

Source: EU Commission, DG Internal Market and Services

124. Solvency I establishes a ***passport*** for insurance undertakings**.** Insurers with a head office within a Member State must notify their home State supervisory authority if they propose to establish a branch within the territory of another Member State, or if they intend to provide insurance services into the territory of another Member State under the freedom to provide services. If the home State supervisory authority approves the proposal, it communicates the information provided by the insurer to the supervisory authority in the Member State in which the branch is to be established or in which insurance services are to be provided (the "host State").

125. Under the passport provisions, the financial supervision of the insurer, including that of the business it carries on either through branches or under the freedom to provide services, is the sole responsibility of the supervisory authority in the home Member State. Detailed provisions for the operation of the passport provisions in the insurance sector are contained in the General Protocol relating to the collaboration of the insurance supervisory authorities of the Member States of the European Union ("The Protocol")(See CEIOPS (2008)). The Protocol incorporate clauses to extend their provisions to the supervisory authorities on non-European Union States that are parties to the EEA Agreement.

126. The first EU solvency rules were established in 1973 for non-life insurance and in 1979 for life insurance, and were last updated in 2002. Although there have been relatively few failures of insurance companies under the Solvency I Directives, a study conducted by CEIOPS (2005) showed that in most cases of actual failure, the current solvency margins did not provide early warning that intervention was required.

127. The Solvency I Directives suffer from several weaknesses. The system is retrospective and not prospective. It does not require management of insurance companies and insurance supervisors to examine the individual risk position of each insurer. It does not take into account a number of important risks, such as asset/liability management risk, credit risk or market risk. The system fails to harmonize the most important element of a insurer's balance sheet, ie technical provisions, and therefore does not allow comparability between the financial position of insurance companies from different Member States (See van Hulle (2007a) p.92).

III.1.3.2 The Solvency II Directive Proposal

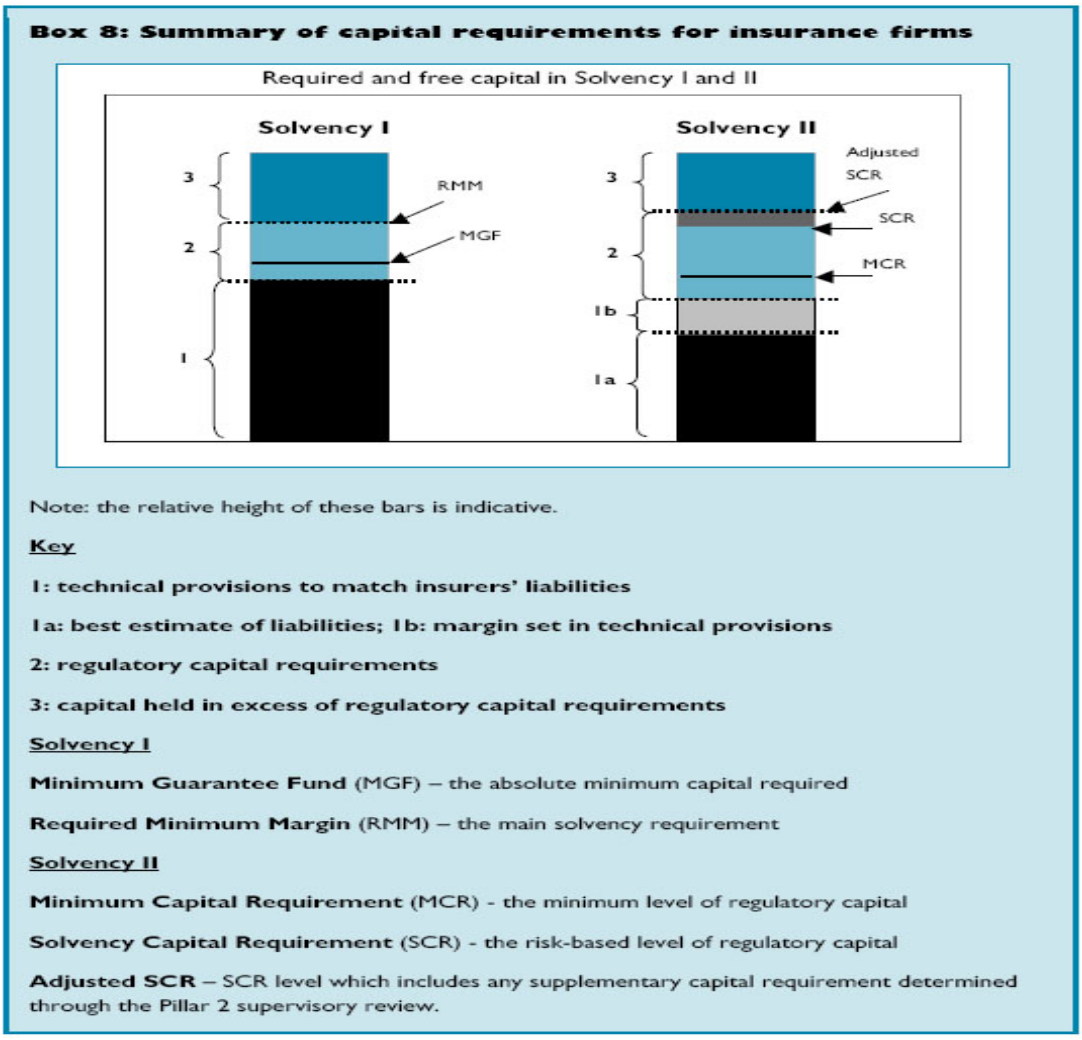
128. To address these weaknesses, the European Commission developed a new framework for insurance supervision since 2005. A Proposal for a new Directive on the taking-up and pursuit of the business of Insurance and Re-insurance was adopted by the Commission in July 2007. An Amended Proposal for a Directive on the taking-up and pursuit of the business of insurance and re-insurance (2007/0143) (COD) (***The Solvency II Directive Proposal***) was submitted by the Commission to the European Parliament and the Council in February 2008. The Solvency II Directive Proposal is based on a three-pillar structure inspired by Basel II: risk-based capital adequacy requirements (Pillar 1); risk-based supervision requirements (Pillar 2); and disclosure to market participants (Pillar 3). The Solvency II Directive Proposal maintains the passport provisions of Solvency I.

III.1.3.2.1 Pillar 1

129. ***Pillar 1*** establishes two specific capital requirements: the ***Solvency Capital Requirement (SCR)*** and the ***Minimum Capital Requirement (MCR***) (See Figure 1 below). The SCR is the level of capital that enables an institution to absorb significant unforeseen losses. It will be set at a level that leaves less than 1 in 200 chance that capital will prove inadequate over 1 year. The SCR is the risk-based capital requirement and the key solvency control level and will be calculated either using a Standard Approach or internal models. Subject to "use test" and regulatory approval. The calculation of the SCR will include an evaluation of operational risk, along with insurance, investment and other financial risks The SCR may not fall below the MCR, which reflects the level of capital below which ultimate supervisory action will be triggered. An insurance undertaking that breaches the MCR and cannot restore its capital position quickly will have to be close to new business (See van Hulle (2007a), p 93).

130. Pillar 1 also harmonizes the calculation of technical provisions. Technical provisions must be established by insurance undertakings to fulfill their obligations towards policyholders and beneficiaries, taking account expenses. The measurement of technical provisions will be based on information provided by financial markets and generally available data on insurance technical risks. Technical provisions will be calculated as best estimate plus a risk margin (See van Hulle (2007a), p.93).

Figure 1: Solvency I and II Regulatory Requirements



Source: FSA (2006)

III.1.3.2.2 Pillar 2

131. ***Pillar 2*** requires that insurance undertakings have sound and effective strategies and processes to assess the risks to which they are exposed and to assess and maintain their capital needs against these risks. Firms will be required to undertake an ***annual self-assessment of governance systems and their ongoing capital needs***. These self-assessments will be subject to review by the regulatory authorities. If the authorities conclude that the insurance undertaking should hold more or higher quality capital, and capital add-on can be imposed to the SCR to reach an Adjusted SCR. (See figure 1 above). If the problem identified is more related to inadequate risk management, the

undertaking may be required to improve its management rather than to increase its capital (See van Hulle (2007a), p 93).

III.1.3.2.3 Pillar 3

132. ***Pillar 3*** requires disclosures about the capital adequacy of insurance undertakings to market participants such as equity holders, debt holders, re-insurers and large commercial buyers of insurance. The required disclosures can be divided into three classes. ***Class 1*** pertains to measures of financial condition and performance, including firm's income statements, balance sheet and cash-flows. ***Class 2*** pertains to measures of risk profiles, including measures of the risk level and diversification of portfolios, such as value-at-risk and portfolio stress tests. ***Class 3*** pertains to measures of the uncertainty of Class 1 and Class 2 information, including sensitivity analysis to parameter value and comparison of outcomes with previous estimates (See FSA (2006), p. 44).

III.1.3.2.4 Solvency II Implementation

133. The Solvency II Directive is expected to be adopted by the European Parliament and the Council in 2009. Adoption of the implementing measures is planned for 2010 and the transposition of the Directive by Member States is planned for 2012.

134. The implementation of Solvency II will have fundamental implications for the governance insurance companies. Solvency II will require the establishment and/or strengthening of key functions by insurance companies, including risk management, actuarial, internal audit, and internal control and compliance. Solvency II will also have major implications for the development of data systems to support risk-based capital modeling under Pillar 1, the measurement and management of market, credit, life, health and non-life risks under Pillar 2, and reporting requirements under Pillar 3. Finally, Solvency II will require the development of actuarial modeling (See PriceWaterHouseCoopers, 2007b, pp2-3).

III.1.4 Occupational Pension Funds

135. Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision (***IORP Directive***) provides the foundation for a Pan-European market for occupational pension funds. Specifically, it allows pension funds to manage occupational pension schemes for companies established in another Member State and allows a pan-European company to have only one occupational pension fund for all its subsidiaries across Europe.

III.1.4.1 Scope of IORP Directive

136. The IORP Directive applies to institutions, operating on a funded basis, established separately from any sponsoring undertaking or trade for the purpose of providing retirement benefits in the context of an occupational activity, on the basis of an

agreement or a contract agreed individually or collectively between the employers and the employees or their representatives, or with self-employed persons in compliance with the legislation in the home and host Member States. Member States may also choose to apply the Directive to the occupational pension business of life insurance undertakings. However, in this case, the pension assets and liabilities must be ring-fenced, managed and organized separately from the insurance undertaking. The Directive does not apply to state social security schemes cover by EEC Regulation 1408/71 or pay-as-you-go schemes (See Birmingham (2003), p. 108).

137. For the purposes of the IORP Directive, retirement benefits include not only benefits paid upon reaching retirement, but also benefits payable on death, disability, or cessation of employment, and payments of services in case of sickness, indigence or death. The Directive requires the legal separation between the sponsoring employer(s) and the pensions institution to safeguard the pension scheme assets in the event of insolvency of the sponsoring employer(s).

III.1.4.2 Regulation of IORPs Investment Policy

138. Under the IORP Directive, Member States are required to regulate the investment policy of IORPs under the ***prudent person principle***, ie requiring that pension fund assets are invested in the members' and beneficiaries' best interests. Specifically, this means that assets must be predominantly invested on regulated markets and, to the extent that they are not invested in such markets, investments must be restricted to a prudent level. Investments in derivatives are permitted to reduce investment risk and facilitate efficient portfolio management, but excessive risk exposure to a single counterparty and other derivative operations must be avoided. Assets must be properly diversified to avoid excessive reliance on any particular asset, issuer or group. However, Member States may decide not to impose this obligation with respect to investments in government bonds.

139. Member States may not require IORPs established on their territory to invest in particular asset categories, nor may they impose any requirements for prior approval for, or systematic notification of investment decisions. However, Member States may impose more detailed rules, including quantitative rules, where they are prudentially justified. In this case, IORPs retain the right to invest: (i) up to 70% of the assets needed to meet the actuarial obligations under defined benefit schemes, or of the whole portfolio of defined contribution schemes, in shares, negotiable securities treated as shares and corporate bonds traded on regulated markets. However, where the institution provides a long-term interest guarantee and bears the investment risk, Member States may impose a lower limit; (ii) up to 30% of the assets needed to meet actuarial obligations in securities denominated in non-matching securities; (iii) in risk capital markets. Member States may also impose more stringent investment rules on individual pension institutions if they are prudentially justified.

III.1.4.3 Regulation of Cross-border Activities of IORPs and of Sponsoring Undertakings

140. The IORP Directive regulates the cross-border activities of IORPs and of sponsoring undertakings (See IOPS Directive, Article 20). Specifically:

(i) Member States should allow undertakings located within their territories to sponsor IORPs authorized in other Member States, and should allow IORPs authorized in their territories to accept sponsorship by undertakings located within the territories of other Member States;

(ii) An IORP wishing to accept sponsorship from a sponsoring undertaking located within the territory of another Member state is subject to prior authorization by the competent authorities in its home Member State. Specifically, the IORP must notify the competent authorities in its home Member State of its intention to accept sponsorship from a sponsoring undertaking in another Member State. As part of this notification, the IORP submits information regarding (i) the host Member State; (ii) the name of the sponsoring undertaking and (iii) the main characteristics of the pension scheme to be operated for the sponsoring undertaking;

(iii) Unless they have reason to doubt that the administrative structure or th financial situation of the institution or the good repute and professional qualification or experience of the persons running the institution are compatible with the operations proposed in the host Member State, the authorities in the home Member State shall, within three months, communicate the information submitted by the IORP to the competent authorities in the host Member State;

(iv) Within two months of receiving this information, the competent authorities in the host Member State informs the competent authorities in the home Member State, if appropriate, of the requirements of social and labor law relevant to the field of occupational pensions, and the competent authorities in the home Member State communicate this information to the IORP; and

(v) Upon receiving the above communication, or if no communication is received at the end of the two month period, the IORP may start to operate the pension scheme in accordance with the host Member State's requirements of social and labor law relevant to the field of occupational pensions.

III.1.5 Acquisition and Increase of Holdings in the Financial Sector

141. Directive 2007/44/EC establishes prudential rules and evaluation criteria for the prudential assessment of acquisition and increase of holdings in the financial sector. The Directive amends the European prudential Directives applicable to credit institutions, investment firms, and insurance and re-insurance undertakings by introducing identical procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase of holdings across all financial institutions. The Directive does not alter or reduce the competence of the supervisor to supervise the fitness and propriety of existing shareholders of supervised financial institutions on an ongoing basis.

142. The Directive has four main objectives (see CESR *et. al*. (2008) p. 4):

(i) to harmonize the conditions under which the proposed acquirer of a holding in a financial institution is required to provide notification of intent to the competent authority responsible for the prudential supervision of the target financial institution;

(ii) to define a clear and transparent procedure for the prudential assessment of the proposed acquisition by the competent authorities;

(iii) to specify clear prudential criteria to be applied by the competent authorities in the assessment process; and

(iv) to ensure that the proposed acquirer knows what information he is required to provide to the competent authorities in order to allow them to assess the proposed acquisition in a complete and timely manner.

143. The Directive establishes ***five assessment criteria***: (i) reputation of the proposed acquirer; (ii) reputation and experience of those who will direct the business; (iii) financial soundness of the proposed acquirer; (iv) compliance with prudential requirements; and (v) suspicion of money laundering or terrorism financing (See CESR *et.al.* (2008) pp 8-21).

144. If significant shareholdings are held indirectly through one or more third parties, the Directive requires that ***all persons in the chain of holdings who may gain significant influence, hold capital in, or have voting rights (directly or indirectly) in the target financial institution be assessed against the five assessment criteria*** (***ultimate controller principle).***

145. The ***responsibility for disclosure rests fully with the proposed acquirer***. Specifically, the proposed acquirer should attest to the target supervisor that all the information communicated by him is accurate, and is not false, misleading or deceptive. In the event that some pieces of information provided by the proposed acquirer are false or forged, rendering the conclusions of the competent supervisor erroneous, the competent supervisor must refuse to approve the acquisition.

146. The Level 2 regulatory process for Directive 2007/44/EC is currently under way. As part of this process, CESR, CEBS and CEIOPS have prepared a consultation paper presenting detailed guidelines for the prudential assessment of acquisitions and increase of holdings in the financial sector required by Directive 2007/44/EC ("The Guidelines").

147. The requirements of the Directive under each assessment criteria are discussed in more detail below (See CESR *et al.* (2008), pp 9-21).

III.1.5.1 First Assessment Criterion: Reputation of the Proposed Acquirer

148. The Directive requires that the target supervisor assess the reputation of the proposed acquirer. The integrity requirements of the Directive are very stringent and cover a broad range of situations which may cast doubt on the integrity and trustworthiness of the acquirer, specifically:

(i) conviction of a relevant criminal offence;

(ii) any criminal offences currently being tried or having been tried in the past;

(iii) current or past investigations and/or enforcement actions related to the acquirer, or the imposition of administrative sanctions for non-compliance with provisions governing financial markets;

(iv) current or past investigations and/or enforcement actions by any other regulatory or professional bodies for non-compliance with any relevant provisions; and

(v) correctness of past business dealings, including any evidence that the acquirer has not been transparent, open, and cooperative in its dealings with supervisory or regulatory authorities, refusal or revocation of registration, authorization, membership or license to carry out a trade, business or profession, dismissal from employment or a position of trust, fiduciary relationship, or having been asked to resign from such a position, disqualification from acting as a director.

149. The Directive provides a very broad definition of the persons subject to the integrity requirements. In case the shareholder is a company or an institution, the integrity requirements must be satisfied by the legal person as well as by all the persons who effectively direct the business, subject to national legislation. When assessing the integrity of the acquirer, the supervisory authority may take into consideration ***any person linked to the acquirer, ie any person who has, or appears to have, a family or a business relationship with the acquirer.***

III.1.5.2 Second Assessment Criterion: Reputation and Experience of Those Who Will Direct the Business

150. The Directive requires that the target supervisor assess the reputation and experience of any person who will direct the business of the financial institution as a result of the proposed acquisition. This criterion is applied when the proposed acquirer is in a position to appoint new directors or managers of the financial institution and has already identified the new directors or managers that he intends to appoint. In this case, all the integrity criteria described above apply.

III.1.5.3 Third Assessment Criterion: Financial Soundness of the Proposed Acquirer

151. The Directive requires that the target supervisor assess the financial soundness of the proposed acquirer, in particular in relation to the type of business pursued and envisaged in the financial institution in which the acquisition is proposed. The financial soundness of the proposed acquirer is defined as the capacity of the acquirer to finance the proposed acquisition and to maintain a sound financial structure for the foreseeable future. This should be reflected in the strategy of the acquirer but also, in case of change of control, in the forecast financial objectives, consistent with the strategy identified in the business plan.

152. The target supervisor should oppose the acquisition if it concludes that the acquirer is likely to face financial difficulties during the acquisition process or in the foreseeable future. The target supervisor should also analyze whether the financial mechanisms put in place by the proposed acquirer to finance the acquisition, or existing financial relationships between the acquirer and the target financial institution, could give rise to conflicts of interests that could destabilize the financial structure of the target financial institution.

III.1.5.4 Fourth Assessment Criterion: Compliance with Prudential Requirements

153. The Directive requires that the target supervisor assess the compliance of the target financial institution with the prudential requirements of the Directives.

154. Specifically, the target supervisor should take into account the ability of the target institution to comply at the time of the acquisition and to continue to comply thereafter with all prudential requirements including capital requirements, liquidity requirements, large exposure limits, requirements related to governance arrangements, internal control, risk management and compliance.

155. If the target institution will be part of a group, the structure of the group should make it possible to exercise effective supervision, effectively exchange information with the competent authorities, and determine the allocation of responsibilities among the competent authorities. Group structure covers the members of the group, including parent

entities and subsidiaries, and intra-group corporate governance rules (decision-making, level of independence, capital management). Both the target financial institution and the group should have clear and transparent governance arrangements and adequate organization, including an effective internal control system and independent control functions (risk management, compliance and internal audit). The group of which the target institution will become part should be adequately capitalized, and its own funds should be distributed appropriately within the group according to the level of risk of each part.

III.1.5.5 Fifth Assessment Criterion: Suspicion of Money Laundering or Terrorist Financing

156. The Directive requires that the target supervisor assess whether there are reasonable grounds to suspect that money laundering or terrorism financing within the meaning of Article 1 of Directive 2005/60/EC (see below) is being or has been committed or attempted in connection with the proposed acquisition, or that the proposed acquisition could increase the risk thereof.

157. If the proposed acquirer is suspected or known to be involved in money laundering operations or attempts, or is listed as being a terrorist or if he is suspected or known to finance terrorism, the integrity criterion is sufficient for the target supervisor to oppose the proposed acquisition. The target supervisor can also oppose the acquisition even in the absence of criminal conviction if the circumstances surrounding the acquisition would lead a reasonable person to suspect that the transaction involves the proceeds of criminal activity.

III.1.6 Supplementary Supervision of Financial Conglomerates

158. Directive 2002/87/EC (***Supplementary Supervision Directive***) establishes the principles for supplementary supervision of financial conglomerates. The Supplementary Supervision Directive does not replace the existing consolidated or supplementary supervision of groups that operate in one sector of the financial industry, but introduces a supplementary supervision of the regulated entities in groups that straddle more than one sector in the financial industry.

159. In order to determine whether a regulated entity is subject to supplementary supervision, three tests must be made: (i) is the entity part of a ***group;*** (ii) is this group a ***financial conglomerate;*** and (iii) is the regulated entity one that is the ***addressee*** of supplementary supervision.

III.1.6.1 Definition of Group

160. A ***group*** is determined by a (i) parent-subsidiary relationship; (ii) a relationship based on participation; or (iii) a horizontal structure. A subsidiary is defined as an undertaking in which a shareholder (the parent) has a majority of the voting rights or the

right to exercise a controlling influence. A participation is defined as an equity investment of 20 percent or more. A horizontal structure exists without an equity relationship if undertakings are managed on a unified basis pursuant to a contract or charter provision or if the administration management or supervisory bodies of both undertakings consist for the major part of the same persons. ***A horizontal structure means control without equity investment***. (See Gruson (2004), pp. 8- 10).

III.1.6.2 Definition of Financial Conglomerate

161. A group is a ***financial conglomerate*** if it meets certain conditions (See description of financial conglomerates subject to supplementary supervision in Technical Annex III):

(i) A group that is headed by a EU regulated entity, or by a non-EU entity, or by a non-regulated entity, qualifies as a financial conglomerate if the activities of the entities in the insurance sector and the activities of the entities in the banking and investment services sector taken together must be *significant* (each financial sector must represent at least 10% of the group or the balance sheet of the smallest sector in the group must exceed Euro 6 billion);

(ii) A group that is not headed by an EU-regulated entity qualifies as a financial conglomerate if the group's activity *mainly* occur in the financial sector (ie. financial sector entities must represent at least 40% of the group); and

(iii) A group that is headed by an EU-regulated entity qualifies as a financial conglomerate even though its activities do not mainly occur in the financial sector.

162. The Directive defines a ***mixed financial holding company*** as a financial conglomerate headed by a non-regulated entity holding company. A mixed financial holding company could be a non-regulated financial sector entity, or a commercial or industrial company.

163. In cases of a financial conglomerate headed by a non-EU regulated entity and of a financial conglomerate headed by a mixed financial holding company having its head office outside the EU, the regulated entities in those financial conglomerates are not subject to supplementary supervision. However, they may be subject to ***equivalent supplementary supervision*** by the home country of the non-EU regulated entity or the mixed financial holding company, or to ***analogous or appropriate supplementary supervision*** by a Member State under the Directive (See below).

164. The Directive gives the regulatory authorities of Member States discretion to ***extend the application of supplementary supervision to groups that do not meet the definition of financial conglomerate or group and to carry out supplementary***

supervision as if they were a financial conglomerate. The regulatory authorities may exercise supplementary supervision over regulated entities that are controlled by another entity or in which another entity has a capital investment even though the relationship does not qualify as a group or as a financial conglomerate. Regulated entities in such quasi-financial groups are subject to supplementary supervision at the discretion of the regulatory authorities of Member States if (i) at least one of the regulated entities is a EU-regulated entity; (ii) at least one of the entities of within the insurance sector and at least one is within the banking or investment services sector; and (iii) the consolidated and/or aggregated activities of the entities within the insurance sector and the consolidated and/or aggregated activities of the entities within the banking and investment services sector are each significant (See Gruson (2004), pp 13-14).

III.1.6.3 Definition of Addressee

165. The Directive distinguishes between entities that are the ***addressees*** of supplementary supervision, entities that are subject to certain obligations under the Directive and entities that are indirectly affected by the Directive (See Gruson (2004 pp 14-17):

(i) Entities subject to supplementary supervision include every EU-regulated entity that is at the head of a financial conglomerate, or whose parent undertaking is a mixed financial holding company having its head office in the EU, or belongs to a horizontal financial conglomerate.

(ii) The Directive imposes certain obligations on all regulated entities in a financial conglomerate in order to make supplementary supervision at the level of the financial conglomerate possible.

(iii) Supplementary supervision of financial conglomerates indirectly affect all entities in a financial conglomerate, including non-EU regulated entities, non-regulated entities and mixed-financial holding companies in a financial conglomerate. In particular, intra-group transactions and risk concentration are defined to include relations between regulated entities (EU regulated or non-EU regulated) in a financial conglomerate and other entities or undertakings in the financial conglomerate

III.1.6.4 Rules of Supplementary Supervision

166. The supplementary supervision follows a “solo plus” approach to supervision. The solo supervision of individual entities is complemented by a general quantitative assessment of the group as a whole and by a quantitative group-wide assessment of the adequacy of capital. The Directive does not require additional consolidation of the accounts of the financial conglomerate beyond that imposed by existing Directives.

III.1.6.4.1 Capital adequacy

167. The Directive requires regulatory authorities to exercise supplementary supervision of the capital adequacy of the regulated entities in a financial conglomerate. The key objective of this assessment is to ***eliminate any inappropriate intra-group creation of own funds,*** such as double or multiple gearing, or excessive leveraging, in which the same own funds are used simultaneously as a buffer more than once to cover he capital requirement of the parent company as well as those of a subsidiary. The Directive provides different methodologies for the calculation of the solvency position on the level of the financial conglomerate.

168. Under the Directive, Member States must require that regulated entities have adequate capital adequacy policies at the level of the financial conglomerate and that these policies be subject to supervision by the supervisory authority designated as coordinator for the purpose of the supplementary supervision of financial conglomerates (See Gruson (2004) pp 21-22).

III.1.6.4.2 Intra-group transactions and risk concentration

169. The Directive requires supplementary supervision of intra-group transactions and risk concentration of regulated entities in a financial conglomerate.

170. The Directive defines ***intra-group transactions*** as transactions by a regulated entity in a financial conglomerate with any other undertaking in the financial conglomerate. Intra-group transactions also include ***transactions with natural or legal persons linked to the undertakings within the group by close links***, even though such persons are not members of the group and therefore not members of the financial conglomerate. Intra-group transactions cause supervisory concerns when they (i) result in capital or income being inappropriately transferred from the regulatory entity; (ii) are on terms or under circumstances which parties operating at arms length would not allow and may be disadvantageous to a regulated entity; (iii) can adversely affect the solvency, liquidity and profitability of individual entities within the group and (iv) are used as a means of supervisory arbitrage, thereby evading capital and other regulatory requirements. The introduction of specific limits and requirements on intra-group transactions is the responsibility of Member States.

171. The Directive defines ***risk concentration*** as all exposures with a loss potential borne by entities within a financial conglomerate that are a large enough to threaten the solvency or the financial position of the regulated entities in the financial conglomerate. The introduction of specific limits and requirements on risk concentration is the responsibility of Member States (See Gruson (2004) p 22).

III.1.6.4.3 Management Qualification

172. The Directive requires Member States to provide that persons who effectively direct the business of a mixed financial holding company, an insurance holding company or a financial holding are of sufficient repute and have sufficient experience to perform their duties.

III.1.6.4.4 Implementation of Supplementary Supervision

173. The Directive establishes rules for the implementation of supplementary supervision by Member States. Specifically, the regulatory authorities should appoint from among them a ***coordinator*** responsible for the coordination and exercise of the supplementary supervision of the regulated entities in a financial conglomerate. The Directive provides specific rules for the automatic designation of the coordinator, but the regulatory authorities of Member States may wave these rules by agreement and appoint a different regulatory authority as coordinator (See Gruson (2004) p. 23).

174. If the parent of a financial conglomerate is a regulated entity or a mixed financial holding company with head office outside the EU, the EU-regulated entities belonging to such a non-EU group are not directly subject to the rule of supplementary supervision.

175. As a first step, the Directive requires that the regulatory authority in the Member state verifies whether the EU-regulated entity, whose the parent has its head office outside the EU, is subject to supervision by the home country of the parent that is ***equivalent*** to the supplementary supervision of regulated entities in a financial conglomerate as provided for in the Directive. In the affirmative, the Directive yields to foreign supervision. In the absence of equivalent supervision, the Directive requires the Member States by analogy to apply the supplementary supervision provisions of the Directive to EU regulated entities. In particular, the regulatory authorities may ***require the creation of a sub-holding company with head office in the EU*** and apply supplementary supervision under the Directive to the European sub-holding company.

III.1.7 Money Laundering

176. Directive 2005/60/EC establishes the regulations for the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (***Third Directive on money laundering***).

177. The Directive establishes detailed rules for ***customer due diligence***, including enhanced customer due diligence for high-risk customers or business relationships, including appropriate procedures to determine whether a person is a politically exposed person, and detailed requirements such as the existence of compliance procedures and policies.

178. The scope of the Directive is very broad and encompasses credit and financial institutions, as well legal and natural persons acting in the exercise of professional activities including: (i) auditors, accountants and tax advisors; (ii) notaries and other independent professionals acing on behalf of their clients in real estate, securities, opening of accounts, organization of contributions for the creation, operation or management of companies, and creation of trusts, (iii) trusts or other company services providers; (iv) real estate agents, (v) other natural or legal persons trading in goods where the payment is in cash above EUR 15K; and (vi) casinos. The Directive defines criminal activity as any kind of criminal involvement in the commission of a serious crime, and the definition of serious crime includes corruption.

179. The Directive extends customer due diligence to the ***beneficial owners of customers***. In the case of corporate entities, a beneficial owner is defined as natural persons who ultimately own or control a legal entity through direct or indirect ownership or control over a sufficient percentage of the share or owning rights in that legal entity (25% plus one share) or the natural person who otherwise exercises control over the management of the legal entity (***ultimate controller principle*).** In the case of legal entities such as foundations and legal arrangements such as trusts, which administer and distribute funds, beneficial owner means: (i) the natural person who is the beneficiary of 25% or more of the property of a legal arrangement or entity (where beneficiaries have already been identified); or (ii) the class of persons in whose main interest the legal arrangement or entity is set-up or operates (where individual beneficiaries have yet to be determined); and (iii) the natural person who exercise control over 25% or more of the property of the legal arrangement or entity.

180. The Directive provides for ***enhanced customer due diligence*** in cases the customer has not been physically present for identification purposes, in case of cross-frontier correspondent banking relationships with respondent institutions from third countries, and in case of transactions or business relationships with politically exposed persons residing in another Member state or in third countries. In particular, in the latter case, The Directive require Member States to ensure that institutions and persons that are under the scope of the Directive (i) have appropriate risk-based procedures in place to determine whether a customer is a politically exposed person; (ii) require senior management approval for establishing business relationships with such customers; (iii) take adequate measures to establish the source of wealth and source of funds that re involved in the business relationship or transaction; (iv) and conduct enhanced ongoing monitoring of the business relationship.

181. The Directive also provides for ***detailed enforcement procedures and enforcement powers*** for competent authorities in Member States. In particular, the Directive establishes that Member States should require all institutions and persons that are under the scope of the Directive to establish adequate policies and procedures of customer due diligence, reporting, record keeping, internal control, risk assessment, risk management, compliance management and communication in order to forestall and prevent operations related to money laundering or terrorist financing. The Directive requires Member States to ensure that competent authorities have adequate powers,

including the power to compel the production of any information that is relevant to monitoring compliance and perform checks, and have adequate resources to perform these functions.

III.2 Approximation Strategy

182. The EU Directives concerning securities markets and NBFIs and their implementing measures constitute a deeply integrated and far-reaching body of financial legislation and regulation. This body of legislation is built upon a set of fundamental, cross-cutting principles:

(ix) ***Level playing field among market participants***. The Directives establish a comprehensive set of rules concerning internal governance, conduct of business, risk management, and compliance management that ensure a level playing field among market participants; 1/

(x) ***Freedom of services.*** The Directives establish a ***passport*** for market participants, allowing a regulated entity licensed by the regulatory authority in its home Member State to provide services in other Member States upon simple notification by the regulated entity to the regulatory authorities in the host Member States. This applies to investment firms, UCITSs, IORPs and insurance and re-insurance companies. Regulated markets licensed in one Member State are allowed to provide arrangements to facilitate access to and trading by remote members or participants established in other Member States through simple notification by the regulated market made through the home Member State regulatory authority to the host Member State regulatory authority;

(xi) ***Reputation of ultimate controllers.*** The Directives require market participants to disclose their ultimate controllers to the regulator, ie any natural or legal person that exercises significant influence, directly or indirectly, over the regulated entity ***irrespective of ownership***, and require the regulator to assess the reputation of these ultimate controllers;

(xii) ***Reputation and experience of persons who direct the business.*** The Directives require market participants to disclose all persons who direct the business, and require the regulator to assess the reputation and experience (***propriety and fitness***) of these persons;

1/ Non-UCITs funds and non-occupational private pension funds are not covered by the EU Directives as of to date, with the exception of the Directives on supplementary supervision of financial conglomerates, acquisition and increase of holdings in the financial sector, and money laundering that apply, directly or indirectly, to all financial services firms.

(xiii) ***Transparency.*** The Directives require a high degree of transparency for both issuers and investors. Extensive reporting requirements apply to issuers and their controlled undertakings, including interim management statements and reports that cover risk management policies for all risks. Extensive notification requirements apply to investors for the acquisition and disposal of major shareholdings of issuers;

(xiv) ***Risk-based supervision of regulated entities.*** The Directives apply the Basel II international guidelines for capital measurement and capital standards to investment firms, and a Directive Proposal for the application of the Basel II guidelines to the insurance sector is currently under discussion at the Council and the Parliament. The Directives apply the Basel II three-pillar supervision framework, ie risk-based capital adequacy requirements (Pillar 1), risk-based supervision requirements (pillar 2), and disclosure to market participants (Pillar 3);

(xv) ***Supplementary supervision of financial conglomerates***. The Directives establish common rules for the supplementary supervision of groups that straddle more than one sector of the industry, provided that they fit the definition of a financial conglomerate. Supplementary supervision is carried out by a ***coordinator*** designated among regulatory agencies and covers capital adequacy, intra-group transactions, risk concentration, and management qualification; and

(xvi) ***Prevention of money laundering and terrorism financing***. The Directives establish common rules for the prevention of money laundering and terrorism financing, The rules extend to the ultimate controllers of clients, and require all market participants to establish adequate policies and procedures of customer due diligence, reporting, record keeping, internal control, risk assessment, risk management, compliance management and communication in order to forestall and prevent operations related to money laundering and terrorism financing.

183. The deeply integrated nature of this body of financial legislation argues for developing a simultaneous, well-coordinated and internally consistent approach to approximating Ukrainian legislation with EU securities markets and NBFI Directives. At the same time, the actual implementation of the Directives will require both a quantum leap in the supervisory powers and practices of financial sector regulators, as well as in governance, business practices, risk management, compliance and disclosure by market participants. This in turn argues for building in reasonable transition periods in the regulations implementing the new body of legislation, in particular with respect to the transition to risk-based supervision of investment funds and insurance companies.

184. In light of the above, the authorities could consider a three-phased approach to the approximation process: (i) legal gap analysis (Phase 1); (ii) approximation of Ukrainian legislation with Level 1 Directives (Phase 2); and (iii) approximation of Ukrainian

regulations with Level 2 implementing measures (Commission Implementing Directives and Regulations) (Phase 3).

III.2.1 Phase 1 - Legal Gap Analysis

185. The legal gap analysis consists of reviewing existing laws and regulations of Ukraine and identifying the provisions that must be amended in order to conform with EU Level 1 Directives and Level 2 implementing measures, as well as areas not covered under the laws and regulations of Ukraine and where new laws and regulations must be prepared. The list of existing laws and regulations of Ukraine subject to approximation is presented in Technical Annex. The list is illustrative and is not all-inclusive.

186. The legal gap analysis is planned to be completed in three segments. The first two segments are being undertaken with the support of a TA grant from the EU (EUROPEAID/119860/C/SV/multi). The first segment covers securities market Directives (except MiFID) and the UCITS Directives. It is currently being launched and is scheduled to be completed by December 2008. The second segment covers MiFID and is scheduled to be carried out between January and June 2009. The third segment would cover the insurance, IORPs, acquisition and increase of holdings in the financial sector, supplementary supervision of financial conglomerates, and money laundering. In the insurance sector, the gap analysis would be carried out with respect to the Solvency II Directive Proposal, or with respect to the Directive itself following its planned adoption by the Council and the European Parliament. The funding for the third segment has not been identified as of to date and needs to be mobilized urgently. The third segment would need to be undertaken and completed between January and June 2009.

III.2.2 Phase 2 – Approximation with Level 1 Directives

187. The second Phase would consist of approximating Ukrainian legislation with Level 1 Directives in the securities market and NBFI Sector.

188. This second Phase would be undertaken by the existing Inter-Agency Task Force for the Reform of the Legal and Regulatory Framework for Securities Markets and NBFIs (IATF/SEC/NBFI) that brings together NBU, SCSSM and SCRFSM under the chairmanship of SCRFSM. The legal approximation process would be supported in the framework of multi-year twinning programs between SCRFSM and SCSSM and counterpart regulatory agencies in EU Member States. These twinning programs are being developed and followed-up by the two Commissions with the support of the USAID/World Bank Technical Assistance Partnership (PTAP), and are being funded under the IBRD Access to Financial Services Project (AFSP) (See Part IV below).

189. This Phase would proceed in two parallel segments. The first segment would cover approximation with the securities market Directives and the two UCITS Directives. The second segment would cover approximation with the Directives in the areas of insurance, IORPs, acquisition and increase in holdings in the financial sector,

supplementary supervision of financial conglomerates, and money laundering. These two segments would be carried out between July 2009 and June 2010.

III.2.3. Phase 3 – Approximation with Level 2 Implementing Measures

190. The third Phase would consist of approximating Ukrainian regulations with Level 2 Implementing Measures (EU Commission Implementing Directives and Regulations). This Phase would be undertaken by the IATF/SEC/NBFI and would be supported through the twinning programs with EU counterpart regulatory agencies as in Phase 2.

191. The third Phase would proceed in two parallel segments. The first segment would cover the securities market Directives and the two UCITS Directives. The second segment would cover insurance, IORPS, acquisition and increase in holdings in the financial sector, supplementary supervision of financial conglomerates, and money laundering. These two segments would be carried out between July 2010 and June 2011.

192. Each set of Implementing Measure would need to include ***built-in transition periods*** that provide enough time for both the regulatory agencies and market participants to meet the requirements of the regulation. Because they are on the critical path to the implementation of all Directives, the Implementing Measures providing for the assessment of the reputation of ultimate controllers of regulated entities, and of the reputation and experience of persons who direct businesses, would be implemented with immediate effect. The Implementing Measures providing for the regulation of securities markets, UCITSs, IORPs, acquisitions and increase in holdings in the financial sector, for the supplementary supervision of financial conglomerates, and for combating money laundering, would be adopted with a transition period of 6 months. The Implementing Measures providing for the implementation of risk-based supervision of investment firms and insurance companies would be adopted with varying transition periods, depending on the difficulty of the transformation in supervisory practices required from the two Commissions and on the degree of adaptation required from market participants, and could extend up to five years. The Implementing Measures for MiFID would also be adopted with a five year transition period.

IV: Mutual Recognition of Ukrainian Securities Market and NBFI Regulatory Agencies with their Counterparts in EU Member States

193. In order to enforce the EU Directives, SCSSM and SCRFSM will need to achieve compliance with international standards of regulation and supervision as defined under the IOSCO, IAIS and IOPS Principles. Compliance with IOSCO, IAIS and IOPS Principles will be a *sine qua non* to achieve mutual recognition with counterpart regulatory agencies in EU Member States that is required to implement the passport provisions of the Directives. Operational independence of regulators, including financial sector regulators, would also be a requirement under the Agreement of Association (AA) between Ukraine and the European Union.

194. To achieve this objective, the Ukrainian authorities need to focus on four fundamental priorities:

(i) to prepare and adopt Amendments to the Financial Services Law (i) to empower the financial sector regulatory agencies to trace the ultimate controllers (UCs) of regulated entities and to carry out criminal, fiscal, and economic background checks of UCs, both in Ukraine and abroad and (ii) to establish the principles of supplementary supervision of financial conglomerates by financial sector regulatory agencies and to empower them as coordinators to carry out the supplementary supervision of financial conglomerates;

(ii) to prepare and adopt SCSSM and SCRFSM Framework Laws to establish the operational independence and financial autonomy of the two Commissions;

(iii) to design and implement twinning programs between SCSSM and SCRFSM and EU counterpart regulatory agencies with the objective to strengthen the capacity of the two Commissions to exercise effective supervision of securities markets and NBFIs up to international and EU standards of regulation and supervision; and

(iv) to carry out regular third-party assessments of compliance with IOSCO, IAIS and IOPS Principles by SCSSM and SCRFSM to monitor their progress towards achieving international standards of regulation and supervision, and to communicate the results of these assessments to the EU Commission, CESR and CEIOPS.

IV.1 Amendments to the Law on Financial Services

195. As a first priority, the authorities need to prepare and adopt Amendments to the Law on Financial Services to provide the financial sector regulatory authorities with clear responsibilities and enforcement powers in two critical areas: (i) disclosure of ultimate controllers of regulated entities; and (ii) supplementary supervision for financial conglomerates.

IV.1.1 Disclosure of Ultimate Controllers of Regulated Entities

196. The Amendments to the Law on Financial Services ("The Amendments") should provide NBU, SCSSM and SCRFSM with clear enforcement powers regarding the disclosure of ultimate controllers of regulated entities (IOSCO Principle 15 and 24, IAIS Principle 7, IOPS Principle 4).

IV.1.1.1 Definition of Concept of Ultimate Controller

197. The Amendments should clearly define the concept of ultimate controller (UC). A UC is any natural person who exercises a ***significant influence*** on a regulated entity, either directly or indirectly through a related party or through a legal entity that is connected with the regulated entity. This includes:

(i) any shareholder of the regulated entity or of any company or trust that is connected with the regulated entity, and their related parties, both Ukrainian nationals and foreign nationals, above a defined threshold holding ("qualified holding");

(ii) any member of the Board of Directors of the regulated entity or of any company or trust that is connected with the regulated entity, and their related parties, both Ukrainian nationals and foreign nationals;

(iii) any manager (chief executive officer, chief financial officer, or any other manager), legal counsel, risk management officer, chief accountant, internal auditor, external auditor, credit rating agency of the regulated entity or of any company or trust that is connected with the regulated entity, and their related parties, both Ukrainian nationals and foreign nationals; and

(iv) any other natural person who is in any position to exercise significant influence over the conduct of the business of the regulated entity or of any company or trust connected with the regulated entity, either directly or indirectly through any third party company, trust or other legal entity, and their related parties, both Ukrainian nationals and foreign nationals.

198. A related party of the UC is any natural person over which the UC may exercise significant influence, through family, social, or business relationship of any type, including as nominee designator, both Ukrainian nationals and foreign nationals.

199. A connected company or trust is any company or trust which exercises significant influence over the conduct of business of the regulated entity, either directly or indirectly through a third party connected company, either registered in Ukraine or in any other country or territory. Connection includes share ownership, convertible debenture ownership or trust interest, joint share ownership, convertible debenture ownership or trust interest in third party companies or trusts, voting right, participation in the board of directors, participation in management, or any form of business partnership or agreement.

200. The best international practice for the definition of the minimum threshold for disclosure of qualified holding is 5%.

IV.1.1.2 Responsibility for Disclosure of Ultimate Controllers

201. The Board of Directors of the regulated entity or of the entity applying for a license to NBU, SCSSM and/or SCRFSM is legally responsible for knowing at any moment all UCs of the regulated entity or of the entity applying for license to the regulators.

202. The Board of Directors of the regulated entity or of the entity applying for a license to NBU, SCSSM and/or SCRFSM is legally responsible for disclosing to the regulatory authorities any and all UCs of the regulated entity or of the entity applying for a license to the regulators, and of any change in the status of any and all UCs at any time from the time of application for a license and throughout the operational life of the entity, including throughout any bankruptcy or liquidation procedure and throughout any procedure of acquisition by a third party entity.

203. The Board of Directors of any entity acquiring a regulated entity is responsible for disclosing to the regulatory authorities any and all of their ultimate controllers at all times starting from the time of expression of interest to acquire a regulated entity and throughout the acquisition process and operational life of the entity (See EU Directive 2007/44/EC above).

204. The by-laws of any entity applying for a license to NBU, SCSSM, and/or SCRFSM, of any regulated entity, or of any company or trust connected with a regulated entity will be required to contain detailed clauses that are fully aligned with the above Amendments.

205. Any UC is legally responsible for disclosing its status as ultimate controller to the Board of Directors of the regulated entity or of any company or trust that is connected, directly or indirectly, with the regulated entity.

IV.1.1.3. Enforcement of Disclosure of Ultimate Controllers

206. The Amendments should provide NBU, SCSSM, SCRFSM) with legal power to trace the ultimate controllers (UCs) of regulated entities, both Ukrainian nationals and foreigners and to carry out economic, fiscal and criminal background checks of UCs, either directly and/or in collaboration with other domestic or foreign institutions. The regulatory authorities should also have legal power to conclude Memorandums of Understandings (MOUs) to formalize their collaboration with any other domestic or foreign institution in the area of tracing of UCs of regulated entities and carrying out economic, fiscal and criminal background checks of UCs of regulated entities.

207. Failure by an entity applying for a license or for renewal of an existing license to NBU, SCSSM, and/or SCRFSM to disclose all it UCs to the regulatory authorities, or

failure of any UC to clear the economic, fiscal and criminal background check carried out by the regulators should result in automatic denial of license or renewal of license**.**

208. Failure by a licensed entity to disclose to NBU, SCSSM, and/or SCRFSM any existing UC, any change in UC, or any legal violation by any UC (with the exception of minor traffic offenses) should trigger an ***automatic regulatory capital sanction***, ie deduction of the capital of the connected entity in which the failure to disclose has occurred from the regulatory capital of the regulated entity. In case the regulated entity takes no action, the financial sector regulators should have the power to seize the shares of the connected entity in the regulated entity. In case the regulated entity takes no action, the financial sector regulators should have the power to revoke the license of the regulated entity.

209. In case the failure to disclose pertains to a direct UC of the regulated entity itself, the financial sector regulatory authorities should have the power to either suspend or revoke the license of the offending regulated entity.

IV.1.2 Supplementary Supervision of Financial Conglomerates

210. The Amendments should empower NBU, SCSSM and SCRFSM to carry out supplementary supervision of financial conglomerates, and establish the framework for the supervision of financial conglomerates in accordance with the corresponding EU Directive.

211. Specifically, the Amendments should provide for the definition of group, financial conglomerate, and the entities that are the addressees of supplementary supervision. The Amendments should define the procedures for supplementary supervision of financial conglomerates, including the assessment of capital adequacy, intra-group transactions, risk concentration, and management qualification. Finally, the Amendments should establish the regulations governing the appointment of the regulatory agency that will act as coordinator for the supervision of the regulated entities in a financial conglomerate.

IV.2 SCSSM and SCRFSM Framework Laws

212. As a second priority, the authorities need to prepare and adopt SCSSM and SCRFSM Framework Laws that are fully in compliance with IOSCO, IAIS and IOPS Principles, in particular:

(i) ***Clear and objective responsibilities.*** (IOSCO Principle 1; IAIS Principle 2; IOPS Principle 1).The Framework Laws should establish clear and objective responsibilities for SCSSM and SCRFSM, ensuring that (i) there is a clear division of responsibilities between them in order to avoids gaps or inequities; (ii) the same type of conduct is not subject to inconsistent regulatory requirements between them; and (iii) there is effective cooperation between them and the NBU through appropriate channels;

(ii) ***Operational independence and accountability in the exercise of powers and functions.*** (IOSCO Principle 2; IAIS Principle 3; IOPS Principle 2).The Framework Laws should ensure that SCSSM and SCRFSM (i) are ***operationally independent from external political interference and from commercial or other sectoral interests*** in the exercise of their functions and powers; (ii) have clear procedures for the periodic reporting of their activities; and (ii) have adequate legal protection for them and for their staff acting in *bona fide* discharge of their functions and powers; and

(iii) ***Adequate powers, proper resources and the capacity to perform functions and exercise powers.*** (IOSCO Principle 3; IAIS Principle 3; IOPS Principles 3 and 4). The Framework Laws should ensure that SCSSM and SCRFSM (i) have adequate powers of licensing, supervision, inspection, investigation and enforcement; (ii) have adequate funding to exercise their powers and responsibilities; (iii) have resources that recognize the difficulty of attracting and retaining experienced staff and (iv) ensure that their staff receive adequate, ongoing training.

213. To implement these Principles, SCSSM and SCRFSM Framework Laws should follow best international practice following which regulatory agencies are established as independent agencies outside the executive branch of government, providing staff of the regulatory agencies with special status outside the civil service, allowing the regulatory agencies to pay salaries at levels required to attract and retain staff with the adequate academic background and securities market experience, and allowing regulatory agencies to fund themselves through fees applied on market participants, progressively reducing reliance on budget transfers. The Framework Laws should also follow best international practice following which the heads of the regulatory agencies are nominated by the Head of State and confirmed by Parliament, are appointed for a pre-defined term, and can be removed only for cause by Parliament, following a judgment by a civil or criminal Court.

214. In addition, SCSSM and SCRFSM Framework Laws should be in full compliance with the following IOSCO, IAIS and IOPS Principles:

(i) ***Clear and consistent regulatory process*** (IOSCO Principle 4, IAIS Principle 4; IOPS Principle 5). The Framework Laws should require that SCSSM and SCRFSM adopt regulatory processes that are (i) consistently applied; (ii) comprehensible; (iii) transparent to the public; and (iv) fair and equitable;

(ii) ***Consultation with regulated entities and right of appeal of decisions*** (IOSCO Principle 2; IAIS Principle 3). The Framework Laws should establish the procedures to be followed by SCSSM and SCRFSM when making a decision that affects a natural or legal person, in particular (i) public hearing of suggested regulatory changes; and (ii) right of natural

and legal persons to appeal adverse decisions by the Commissions in court;

(iii) ***Highest professional standards for staff*** (IOSCO Principle 5; IAIS Principle 3; IOPS Principles 8 and 10). The Framework Laws should require that SCSSM and SCRFSM staff observe the highest professional standards and be given clear guidance on conduct matters including (i) the avoidance of conflicts of interest; (ii) the appropriate use of information obtained in the course of the exercise of powers and the discharge of duty; (iii) the proper observance of confidentiality and secrecy provisions and the protection of personal data; and (iv) the observance of procedural fairness; and

(iv) ***Powers to collaborate with domestic and foreign supervisors*** (IOSCO Principles 11, 12 and 13, IAIS Principle 5; IOPS Principle 7). The Framework Laws should empower SCSSM and SCRFSM (i) to share both public and non-public information with domestic and foreign counterparts; (ii) to establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts; and (iii) to provide assistance to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.

IV.3 Twinning Programs Between SCSSM and SCRFSM and EU Regulatory Agency(ies)

215. As a third priority, the authorities need to design and implement multi-year twinning programs between SCSSM and SCRFSM and EU counterpart regulatory agencies with the objective to strengthen the capacity of the two Commissions to exercise effective supervision of securities markets and NBFIs in accordance with international and EU standards of regulation and supervision. The twinning programs are being prepared and followed-up with the support of the joint USAID/World Bank Programmatic Technical Assistance Partnership (PTAP) and are being funded in the framework of the IBRD Access to Financial Services Project (AFSP).

216. While each twinning program has been carefully tailored to fit the particular mission and specific developmental needs of each Commission, the programs have been structured to cover the following priority areas:

(i) To elaborate strategic development plans for the Commissions

To prepare prospective analyses of the development of securities markets and NBFIs in the perspective of the integration of the Ukrainian financial sector within the EU single market for financial services in the framework of the EU-Ukraine FTA.

To prepare prospective analyses of the development of the two Commissions over the medium-term, in particular in the perspective of achieving mutual recognition between the two Commissions and EU counterpart regulatory agencies.

(ii) To strengthen the political independence, financial autonomy and powers of the Commissions

To prepare and support the adoption of Amendments to the Law on Financial Services empowering the financial sector regulatory agencies to trace the ultimate controllers and to carry out economic, fiscal and criminal background checks of ultimate controllers of regulated entities, and empowering the financial sector regulators to carry out supplementary supervision of financial conglomerates in accordance with relevant EU Directives (see above).

To prepare and support the adoption of SCSSM and SCRFSM Framework Laws that are in full compliance with IOSCO, IAIS and IOPS Principles, in particular (i) providing the Commissions with clear and objective responsibilities, operational independence and accountability in the exercise of powers, adequate powers, proper resources and the capacity to perform their functions and exercise powers,.(ii) ensuring that the two Commissions follow clear and consistent regulatory processes, (iii) providing natural or legal persons affected by Commissions' decisions with the right to seek review in court, (iv) requiring the staff of the Commissions to observe the highest professional standards, and (vi) providing the Commissions with powers to cooperate with and assist domestic and foreign supervisory agencies (see above).

(iii) To strengthen the Commissions' capacity to perform their enhanced responsibilities and powers

To develop and implement reforms of the Commissions' internal organizational structure and processes consistent with their enhanced responsibilities and powers.

To develop and implement reforms of management direction and control.

To develop and implement staff development plans consistent with changes in personnel status and funding under the SCSSM and SCRFSM Framework Laws.

(iv) To support the approximation Ukrainian legislation EU securities market and NBFI Directives (Level 1) and implementing measures (Level 2) by the Commissions

To support the drafting of new legislation and amendments to existing legislation with the objective to approximate EU securities markets and NBFI Directives (Level 1) and implementing measures (Level 2) in accordance with the three-stage approximation strategy presented above.

To support the adoption of the new/amended legislation and regulations.

To support a broad information campaign to sensitize securities market participants, NBFIs and the public to the new legal and regulatory framework for securities markets and NBFIs.

(v) To implement new licensing procedures for regulated entities in accordance with the Amendments to the Law on Financial Services and the SCSSM and SCRFSM Framework Laws

To verify the licenses of all regulated entities (including SROs) on the market in accordance with the requirements of the Amendments to the Law on Financial Services and of the SCSSM and SCRFSM Framework Laws for tracing of ultimate controllers and for carrying out economic, fiscal, and criminal background checks of ultimate controllers of regulated entities and/or

To carry out the comprehensive re-licensing of regulated entities in specific sub-sectors as needed.

To apply the new licensing procedures to all new applicants.

(vi) To develop and implement plan of action to improve off-site surveillance of regulated entities

To analyze required improvements in financial reporting and disclosure by securities market participants and NBFIs.

To analyze requirement improvements in systems to analyze reports submitted by securities market participants and NBFIs.

To develop early warning systems.

To develop improved processes for exchange of information concerning securities market participants and NBFIs.

To develop a plan of action to improve off-site surveillance of securities market participants and NBFIs and to provide hands-on support to the implementation of the action plan.

(vii) To strengthen market surveillance and IT systems

To carry out an assessment of SCSSM IT systems and development needs taking into account the IT development programs currently being implemented by PFTS, UICE and AUSD/MFS with the support of NASDAQ/OMX.

To prepare specifications for a Trade Reporting System (TRS) compatible with the TRS systems in operation in EU Member States.

To support the implementation of the Electronic Disclosure system (EDS) developed by the USAID CMP, in particular through the drafting of operational manuals for SCSSM and issuers, the provision of training for the staff of central and regional SCSSM offices in the operation of EDS, and the development of training programs for issuers on the copletion and filing of electronic disclosure forms, the use of electronic signatures and the operation of EDS.

To carry out a thorough evaluation of the CRFSM IT system.

To develop a practical plan for bringing the SCRFSM IT system in line with current IT best practices in the field of NBFI supervision.

(viii) To develop and implement a plan of action to improve on-site inspection of regulated entities

To develop a training program to evaluate the risks of regulated entities while on site and to develop appropriate actions when potential risks are identified, such as issue warnings and revealing risks to the public. Risk analysis should cover general compliance, evaluation of management and administrative systems, identification and evaluation of intended or potential fraud (including money laundering), development of on-site risk-based measures to supplement indicators of management risk, financial stability, reliability and solvency derived from reporting forms.

To implement the training program to improve on-site inspection of regulated entities.

(ix) To establish the criteria for the financial stability and reliability of regulated entities

To analyze the Commissions' regulatory documentation establishing the criteria of financial stability and reliability of regulated entities.

To present specific recommendations on improvement of regulatory and legal framework establishing the criteria of financial stability and reliability of regulated entities in accordance with relevant EU Directives.

(x) To develop a framework for analysis and disclosure of the information about operations of regulated entities

To analyze the legal and regulatory documents regulating information disclosure requirements and procedures and the submission of reports by regulated entities.

To prepare a framework for analysis and disclosure of the information about operations of regulated entities.

(xi) To develop and implement a plan of action to improve investigation and enforcement

To develop laws and regulations to impose discipline from within the regulated entities, such as internal audits, internal risk management programs, and other internal control systems of securities market participants and NBFIs.

To identify measures to strengthen the capacity of the Commissions to identify non-compliance and apply sanctions that will change behavior rather than become a cost of doing business.

To evaluate and make recommendations for strengthening investigation and enforcement authority of the Commissions by (i) exercising stronger control over regulated entities founders, boards and administrators; (ii) having appropriate sanctions available to meet all legal and regulatory breaches; and (iii) imposing discipline from peers through SROs and other means, including criteria for selection of SROs, as well as implementation of IOSCO, IAIS and IOPS Principles in the supervision of SROs.

To develop an action plan to strengthen investigation and enforcement by the Commissions, focusing on consistent application of enforcement tools, more effective use of existing tools and development and application of new enforcement tools.

To provide hands-on support and advice to the two Commissions for the implementation of the investigation and enforcement strengthening action plan.

(xii) To prepare and implement a medium-term plan to switch to risk-based supervision

To implement the eight-point Action Plan established by SCSSM with the support of USAID CMP for switching to risk-based supervision, specifically:

(i) to incorporate the capital requirements of the CRD, MiFID into Ukrainian legislation (see point iv above);

(ii) to incorporate best execution into both legislation and practice of market intermediaries in accordance with MiFID (see point iv above);

(iii) to implement the new licensing requirements established in accordance with IOSCO, IAIS, IOPS and the relevant EU Directives (see point v above);

(iv) to conform to the Prospectus and Transparency Directives, in particular with respect to publicly traded issuers and stock exchange listing requirements (see point iv above);

(v) to establish a prudential department within SCSSM;

(vi) to develop and implement a training program for SCSSM staff in the execution of prudential supervision in accordance with the requirements of the relevant EU Directives;

(vii) to develop and implement a training program in risk management for securities market participants in accordance with the requirements of the relevant EU Directives; and

(viii). to assess the level of risk of each securities market participant.

To analyze the legal and regulatory documents elaborated by SCRFSM for the introduction of internal control and risk management systems of NBFIs, and make recommendation for inclusion of revision of certain provisions in light of relevant EU Directives.

To analyze the existing legal and regulatory framework related to the system of supervision of NBFIs and prepare detailed proposals to implement a switch to tisk-based supervision of NBFIs.

To develop and implement a training program for SCRFSM staff in the execution of risk-based supervision of NBFIs in accordance with the relevant EU Directives.

To develop and implement a training program in risk management for NBFIs in accordance with the requirements of relevant EU Directives.

To support the assessment of the level of risk of each NBFI .

IV.4 Third-Party Assessment of Compliance with International Standards of Regulation and Supervision

217. As a fourth priority, the authorities need to organize periodic third-party assessments of compliance of SCSSM and SCRFSM with international standards of regulation and supervision. The objective of these assessments would be (i) to establish the baseline assessment of compliance of the two Commissions with IOSCO, IAIS and IOPS Principles; (ii) to periodically assess the progress of the two Commissions in achieving compliance with IOSCO, IAIS and IOPS Principles and (iii) in the medium term, to verify that the two Commissions achieve broad compliance with IOSCO, IAIS and IOPS Principles in order to qualify for recognition by counterpart regulatory agencies in EU Member States.

218. A baseline IOSCO assessment was carried out by the World Bank in the framework of the 2007 FSAP Update. The authorities need to organize a IAIS and a IOPS baseline assessment as soon as practicable. Subsequently, the authorities need to organize IOSCO, IAIS and IOPS factual updates about every two years in order to regularly assess the progress of the two Commissions in achieving compliance with the Principles, in conjunction with the implementation of the FTA between EU and Ukraine.

V: Adaptation of Ukrainian Professional Securities Market Participants, NBFIs and Securities Issuers to the EU Single Market in Financial Services: Challenges and Opportunities

219. This Part (i) examines the implications of the integration of Ukraine in the EU single market in financial services for professional securities market participants, NBFIs and securities issuers, and (ii) identifies priority areas for the authorities to support the adaptation of Ukrainian professional market participants, NBFIs and securities issuers to integration in the EU single market in financial services.

V.1 Cross-cutting Implications for Market Participants

220. Integration in the EU single market in financial services will have major cross-cutting implications for market participants.

221. *First*, all securities market professional participants and NBFIs will be required to disclose their ultimate controllers, both Ukrainian residents and foreigners, to the regulatory authorities. In turn, the regulatory authorities will be required to assess the reputation of these ultimate controllers. At the same time, the regulatory authorities will be required to assess the reputation and experience of all persons who direct the business of securities market professional participants and NBFIs. In practice, the licenses of all securities market professional participants and NBFIs will need to be re-validated by the regulatory authorities. The latter will need to carry out a detailed economic, fiscal and criminal background check of ultimate controllers of regulated entities and of persons who direct these entities, and to examine the professional qualifications and experience of all persons who direct these businesses.

222. *Second,* all securities markets professional participants and NBFIs belonging to a financial conglomerate will be subject to supplementary supervision, directly or indirectly In the case of financial conglomerates whose parent is a regulated entity outside the EU single market or a mixed financial holding company with its head office outside the EU single market, and in case the parent is not subject to equivalent supplementary supervision in the third country, the regulatory authorities may require the creation of a sub-holding company with its head office in a EU Member State, and apply supplementary supervision to the EU-registered sub-holding company.

223. *Third,* all securities market professional participants and NBFIs will be required to implement enhanced anti-money laundering measures, including due diligence of ultimate controllers of their clients, and enhanced customer due diligence in cases of cross-border banking relationships with institutions outside the EU, or in cases of transactions or business relationships with politically exposed persons residing in third countries.

V.2 Impact on Investment Firms

224. Integration in the EU single market in financial services will lead to a ***consolidation of the Ukrainian brokerage industry.*** Small brokerage firms will find it very difficult to meet the enhanced disclosure, conduct of business, governance, capital adequacy, financial and operational risk management, and reporting requirements established by the EU Directives. Large players are expected to face significant compliance costs. For example, a recent study by JP Morgan estimates that Euro 19 bln could be wiped off the market capitalization of eight leading European wholesale banks as a result of the implementation of MiFID, due to downward pressure on profits resulting from increased competition, and due to the costs of implementing client suitability, higher transparency and best execution arrangements. MiFID could also be a threat to the integrated banking model, because the retail banking networks will be able to subsidize the investment banking divisions to a lesser degree as a result of increased possibilities to outsource to cheaper third party providers. In addition, the loss of captive private banking volumes could result in a significant decline in margins (See JP Morgan (2006) pp 10-12).

225. The impact of integration in the EU single market in financial services remains uncertain with respect to ***systemic internalizers***. (A systematic internalizer is an investment firm dealing on own account to execute client orders outside a regulated market or a multilateral trading facility). A recent study of the Italian market showed that about 9% of the order flow was internalized as of end-2005 (See Anolli and Petrella (2007), p 13). On the one hand, systematic internalization could be limited by the associated costs for banks. Specifically, the JP Morgan study estimates that the potential savings from internal exchanges would not exceed 2% of the overall cost of trading. On the other hand, if, following the removal of the concentration rule, exchanges are seen to be inefficient or charge excessive fees, they could lose market share in the countries where their effective monopoly is ended. In addition, under MiFID, internalizing banks could capture new revenues from trade information, because they are no longer required to submit the trade information on their internal trades to the exchanges for information, and are free to publish data reports through MTFs or through data vendors (See Casey and Lannoo (2006) pp 6-7).

V.3 Impact on Exchanges

226. Integration in the EU single market in financial services will have major implications for Ukrainian exchanges, in particular (i) increased competition from other channels on the trade information side; (ii) impact of EU and ECB initiatives on the settlement side; (iii) impact of market developments in the investment firm industry; (iv) competition from MTFs; and.(v) increased competition among regulated markets. (See Casey and Lannoo (2006) pp 7-9).

227. *First*, Ukrainian exchanges are likely to be affected by ***increased competition from other channels on the trade information side.*** Prior to MiFID, exchanges were the predominant source of market data as a result of the concentration rule imposed by regulatory authorities. Investment firms paid exchanges a fee to report OTC trades, and bought back the re-packaged information from information providers against a fee, resulting in a squeeze on their margins, both on the revenue and on the cost side. Under MiFID's open architecture for trade information, investment firms are no longer required to report trade information to the exchanges for information, but are free to publish data reports outside the exchanges through MTFs or through data vendors. As a result, MiFID will challenge an important revenue source for the exchanges, estimated at 12% of revenues for the six largest exchanges in the EU (See JP Morgan (2006) pp 1-2).

228. *Second*, Ukrainian exchanges are likely to be affected by ***EU and ECB initiatives on the settlement side.*** *First*, the European Code of Conduct for Clearing and Settlement (see above) commits providers to unbundle prices and accounting of clearing and settlement activities, and to offer these services on a pan-European basis. This could have major implications for the vertically integrated ("silo") exchange model. *Second*, the ECB proposes to establish a European-wide clearing and settlement platform, which could eliminate the need for any other settlement platform for securities transactions denominated in euro at the level of central securities depositories (CSDs). This could

have major implications for vertically integrated exchanges, as well as for bond settlement platforms (See Godeffroy (2006) p 3).

229. *Third*, Ukrainian exchanges are likely to be affected by ***market developments in the investment firm industry,*** whose net impact are still uncertain. On the one hand, as mentioned above, exchanges are likely to be under pressure from systematic internalizers, although the degree of systematic internalization is uncertain at this early stage. On the other hand, exchanges could generate new sources of revenue selling in-house matching services to banks that may not have the in-house IT expertise to become systematic internalizers.

230. *Fourth*, Ukrainian exchanges are likely to be affected by ***the development of MTFs.*** As of February 2008, there were 40 MTFs on the EU single market, of which 24 were based in London, 3 in Milan, 2 in Brussels, and 2 in Paris. However, the impact of the development of MTFs on exchanges is uncertain at this early stage. On the one hand, MTFs could enjoy a comparative advantage in specific markets or business segments such as the market for new high-growth or high-tech firms, or for the reporting of trading data. On the other hand, exchanges could establish MTFs to facilitate the execution of complex trades that are unfit for entry into electronic order books. They could also benefit from increased trade transparency requirements in OTC markets.

231. *Fifth*, the abolition of the trade concentration rile and the implementation of the best execution rule under MiFID will increase ***competition among Ukrainian exchanges.*** Regulated markets across the EU compete fiercely to attract liquidity through improving trading efficiency and reducing fees. Trading efficiency on these markets is measured in milliseconds. The entry of Ukraine into the EU single market will lead to a major consolidation of the exchange industry in Ukraine, and only exchanges offering cutting-edge trading platforms that are closely inter-connected or integrated with major Euro-Atlantic exchanges are likely to survive.

V.4 Impact on Advisory Firms and Solution Providers

232. Integration in the EU single market in financial services will have major implications for Ukrainian advisory firms and solution providers. On the demand side, the MiFID Directive requires that investment firms develop a best execution policy that is regularly tested by the investment firms for robustness, against which clients can hold the investment firm accountable. This requirement is likely to result in the expansion of ***algorithmic trading systems*** that are programmed to hunt for best prices across a wide range of execution venues based on pre-set parameters in terms of price/cost, speed of execution, market impact, or any combination of these criteria. On the supply side, the increase in the amount of previously unavailable market data resulting from more stringent transparency requirements and the development of new market venues generated by MiFID will enhance the quality of algorithmic trading solutions (See Casey and Lannoo (2006) pp 9-10).

233. These developments are likely to encourage the development of trading solution providers, as well as data vendors, data consolidators/disseminators, connectivity solution providers, and data management providers.

V.5 Impact on NBFIs

234. Integration of in the single EU market in financial services will bring considerable opportunities and challenges for NBFIs.

235. ***UCITSs*** will have access to a broad pool of savings and will be able to diversify their portfolios across a wide range of assets in the single market. However, they will also face direct competition from UCITSs operating from established asset management centers such as Luxembourg and Ireland. To survive in this highly competitive environment, Ukrainian UCITSs will need to raise their disclosure, conduct of business, governance, risk management, compliance management and reporting standards to the best in the market, or else will see their client base migrate to UCITSs registered in established asset management centers.

236. ***Insurance companies*** will have access to a broad pool of savings and will be able to diversify their portfolios across a wide range of assets in the single market. However, they will face direct competition from large insurance companies already established on the single market. In addition to raising their disclosure, conduct of business, governance and reporting standards to the best in the market, Ukrainian insurance companies will need to meet the capital adequacy and risk management standards required by Solvency II as the latter are phased-in by the regulatory authorities. Smaller insurance companies could face major difficulties in meeting these requirements, resulting in a sweeping consolidation of the industry.

237. ***IORPs*** will gain the opportunity to offer their services to client sponsoring entities across the single market, and will be able to diversify their asset portfolios across a broad range of assets on the single market. As in the case of other NBFIs however, they will also face stiff competition from large IORPs already established on the single market, that will be able to attract Ukrainian sponsoring entities. Ukrainian IORPs will therefore need to raise their disclosure, conduct of business, governance, risk management and reporting standards to the best in the market in order to survive in the competitive environment of the single EU market.

V.6 Impact on Securities Issuers

238. Integration in the EU single market will also have far-reaching implications for securities issuers. On the one hand**,** securities issuers will have access to a vast pool of liquidity in the single market. On the other hand, they will compete head-on for the attention of investors with other issuers in similar asset classes across the single market. Ukrainian securities issuers will therefore need to raise the quality of their issuances in order to reap the benefits of financial market integration.

(i) The ***Government*** will need to issue domestic debt securities at market prices across a broad maturity spectrum in direct competition with issuances by other sovereigns on the EU single market, both in order to secure a stable source of funding for short-term liquidity management and long-term investment financing, and in order to develop a risk-free yield curve with liquid benchmarks that can be used as a reliable basis to price non-government debt securities;

(ii) ***Ukrainian sub-national governments*** will need to improve the reliability and transparency of their budgets in order to compete with issuances by other sub-national issuers on the EU single market, in order to mobilize the financing required to finance local infrastructure rehabilitation and investment needs; and

(iii) ***Ukrainian corporations*** will need to improve the quality of their governance and financial reporting in order to compete with issuances by other corporate issuers on the EU single market in order to finance their expansion on the single market for goods and services.

V.7 Priority Actions for the Authorities

239. To support the adaptation of market participants to integration in the EU single market, the authorities should focus on the following priorities:

(i) ***Re-validate the licenses of all professional securities market participants and NBFIs***, specifically enforcing the reputation test for the ultimate controllers of regulated entities and the reputation and professional experience tests for persons who direct the business of regulated entities, in accordance with the relevant EU Directives;

(ii) ***Implement supplementary supervision of financial conglomerates,*** specifically enforcing the capital adequacy, intra-group transaction, and risk concentration requirements for regulated entities in financial conglomerates, and the management qualification requirements at the level of financial conglomerates, in accordance with the relevant EU Directive;

(iii) ***Enforce enhanced anti-money laundering measures,*** in particular customer due diligence of ultimate controllers of customers, and enhanced customer due diligence in case of cross-border banking relationships and in cases of politically exposed persons in third countries in accordance with the relevant EU Directive;

(iv) ***Implement the switch to risk-based supervision over the medium-term,*** progressively enforcing the prudential requirements of the CRD and of the

Solvency II Directive Proposal following the Basel II three-pillar supervisory structure;

(v) ***Implement a Trade Reporting System (TRS) and enforce enhanced regulations against market abuse*** in accordance with the relevant EU Directive;

(vi) ***Establish a Central Securities Depository (CSD)***, specifically adopting the new Depository Law, establishing the All-Ukrainian Securities Depository (AUSD) as CSD, carrying out the merger between AUSD and MFS, adopting a state-of-the-art post-trading platform at MFS; and ensuring that AUSD meets the Principles established under the European Code of Conduct for Clearing and Settlement;

(vii) ***Develop a long-term government bond yield curve with liquid benchmarks*** to compete with other issuers on the single market in order to provide long-term funding for public investments in domestic currency and to provide a risk-free reference for the pricing of non-government debt securities;

(viii) ***Reform the legal and regulatory framework for sub-national government (SNG) borrowing*** to improve the stability and transparency of SNG finances and enable them to compete with other sub-national issuers on the ingle market in order to finance local infrastructure investments;

(ix) ***Adopt the joint stock company law and enforce disclosure of the identity of significant shareholders and/or persons or entities entitled to exercise voting rights on behalf of shareholders*** to protect minority investors and enable corporate issuers to compete with other issuers on the single market to finance their investments; and

(x) ***Enhance and enforce business and financial reporting requirements*** for all publicly traded issuers and their controlled undertakings, including undertakings over which a natural person or legal entity has the power to exercise, or actually exercises, dominant influence or control, in accordance with the relevant EU Directive; and adopt legislation requiring widely-traded public joint stock companies, and public interest institutions (i.e. banks, insurance companies) to prepare financial reports in compliance with International Financial Reporting Standards (IFRS).

VI: A Summary Multi-Year Action Plan

240. A summary multi-year action plan to achieve integration of the Ukrainian capital market in the EU single market in financial services is presented in Table 4 below.

Table 4: Multi-Year Summary Action Plan

Policy Area	**End-2008**	**Mid-2009**	**End- 2009**	**Mid-2010**	**End-2010**	**End-2011**	**2015-2018**
I:Approximation							
Phase 1: Legal Gap Analysis							
S1: Securities (-MiFID) + UCITSs	X						
S2: MiFID		X					
S3: Insurance, IORPs, holdings, conglomerates, money laundering		X					
Phase 2: Level 1 Directives							
S1: Securities + UCITS				X			
S2: Insurance, IORPs, holdings, conglomerates, money laundering				X			

	End 2008	Mid-2009	End-2009	Mid-2010	End-2010	End-2011	2015-2018
Phase 3: Level 2 Implementing Measures							
Ultimate controllers Persons who direct business					X		
Securities (-MiFID) + UCITS + IORPs						X	
Holdings, conglomerates, money laundering						X	
Risk-based supervision of investment firms and insurance						X	X
MiFID							X
II: Mutual recognition of regulators							

	End-2008	**Mid-2009**	**End-2009**	**Mid-2010**	**End-2010**	**End-2011**	**2015-2018**
Amendments to Law on Financial Services	X						
SCSSM Framework Law			X				
SCRFSM Framework Law			X				
SCSSM Twinning Program	X	X	X	X	X	X	X
SCRFSM Twinning Program	X	X	X	X	X	X	X
SCSSM Recognition							X
SCRFSM Recognition							X
III: Market adaptation							
Revalidate licenses					X	X	

	End-2008	**Mid-2009**	**End-2009**	**Mid-2010**	**End-2010**	**End-2011**	**2015-1018**
Enforce supplementary supervision of financial conglomerates						X	X
Enforce enhanced anti-money laundering measures						X	X
Switch to risk-based supervision of investment firms and insurance companies						X	X
Implement TRS					X	X	X
Implement enhanced surveillance of market abuse						X	X
Adopt CSD law		X					
Establish CSD			X				
	End-2008	**Mid-2009**	**End-2009**	**Mid-2010**	**End-2010**	**End-2011**	**2015-1018**

Develop long-term government bond yield curve	X	X	X	X	X	X	X
Reform SNG borrowing framework			X				
Adopt JSC Law	X						
Enforce disclosure of ultimate controllers of significant shareholders					X	X	X
Enhance and enforce business and financial reporting requirements for issuers and their controlled undertakings			X	X	X	X	X

Technical Annexes

Technical Annex I: The Evolution of the Ukrainian Securities Market and NBFIs from 2003 to the Present

A: Market activity

A.1. Equity market

A.1.1. Listed companies

Listed companies comprise a small proportion of the total number of joint stock companies. As of July 2008, there were about 31 thousand of joint stock companies in Ukraine. The majority of them (about 21 thousand) were functioning in the form of a Closed Joint Stock company. Circulation of shares of CJSCs is complicated as such shares can not be sold on exchanges, and shareholders typically have to offer their shares to other shareholders before selling them to outsiders. About 10 thousand of joint stock companies were open joint stock companies whose shares can be sold freely. Shares of about 1 thousand open joint stock companies were admitted for circulation on stock exchanges and trading platforms.

Table TA1: Equities allowed for circulation on organized market

	2003	2004	2005	2006	2007
Number of equities allowed for circulation on organized market	N/A	N/A	1,410	4,344	1,134
Number of equities in the first tier of listing	N/A	N/A	N/A	N/A	14
Number of equities in the second tier of listing	N/A	N/A	N/A	N/A	41

Source: State Commission for Securities and Stock market

Only a handful of companies qualified for listing in the first and second tiers. Companies in the 1st Tier, according to the Regulation of the SCSSM #1542 passed in 2006, are expected to have annual gross revenue of at least UAH 100 million, as well as UAH 100m in assets and UAH 100m capitalization.

Table TA2: PFTS Listing Requirements for Equities

Basic Requirements for Equities listed in the 1st and 2nd Tiers of the PFTS Exchange Register

	1st Tier	2nd Tier
Minimum value of the issuer's net assets, UAH m	100	50
Minimum last financial year revenue, UAH m	100	50
Minimum term of business activity of the issuer	3 years	1 year
Absence of losses	2 out of 3 last years	Last year
Minimum number of shareholders	500	100
Minimum capitalization, UAH m	100	50
Minimum number of trades for each of the last 6 months	10	10

Minimum average monthly turnover for the last 6 months, UAH m	1	0.25
Maximum spread size, %	15	50

Source: PFTS Stock exchange, 2008

A.1.2. Market capitalization

The capitalization of Ukrainian stock market grew up rapidly from about UAH 25 bn. to around UAH 560 bn. over 2003-2007, due to low base, strong growth of the economy and improved corporate governance.

Table TA3: Equity market of Ukraine

	2003	2004	2005	2006	2007
Market capitalization (PFTS only) UAH bn.	25.6	71.1	147.1	222.8	564.6
Secondary equity market turnover (volume of deals executed by brokers), UAH bn	76.99	138.77	179.79	225.65	283.54
Secondary equity market turnover (all exchanges) UAH bn.	0.84	1.84	4.48	6.95	13.6
Secondary equity market turnover (PFTS only) UAH bn.	0.5	1.1	3.3	5.9	10.1
Number of equities traded (PFTS only)	134	113	177	229	231
Secondary equity market concentration (Top-10 in per cent of total) (PFTS only) %	N/A	80.0	45.77	40.07	42.5
For reference: GDP, UAH bn.	267.3	345.1	441.5	544.2	712.9

Source: State Commission for Securities and Stock market, PFTS Stock exchange

A.1.3. Secondary market turnover

Secondary market turnover is dominated by over-the-counter (OTC) market. The total secondary equity market turnover is close to 40% of GDP, as measured by volume of deals executed by brokers. The turnover on the organized market (exchanges) remained at around 1%-2% of GDP in recent years, with vast majority of trades taking place on PFTS stock exchange.

A.1.4. Secondary market concentration

The equity market remains fairly concentrated. The top 10 mostly traded equities provided for about 40% of the total turnover of equities on the PFTS in 2007.

A.1.5. Investor structure

The main investors on the Ukrainian equity market are domestic legal entities, which include banks, insurance companies, pension funds and investment funds.

Table TA4: Investor structure

	2003	2004	2005	2006	2007
Inscribed stock held by foreign investors – legal entities, nominal value, UAH bn	5.64	6.21	7.21	7.36	11.96
Inscribed stock held by foreign investors – physical entities, nominal value, UAH bn	0.13	0.16	0.16	0.17	0.23

Inscribed stock held by domestic investors – legal entities, nominal value, UAH bn	66.73	85.3	101.06	113.93	136.18
Inscribed stock held by domestic investors - physical entities, nominal value, UAH bn	12.5	13.97	16.3	15.27	19.6

Source: State Commission for Securities and Stock market

A.1.6. Initial Public Offerings

Classical Initial Public Offerings (IPOs) have not taken place on the Ukrainian equity market yet, which may be due to limited investor base and low liquidity.

A.2.Bond market

A.2.1. Government bond market

A.2.1.1. Primary market

A.2.1.1.1. Auctions

The primary market for government bonds remains rather limited as measured by the number of auctions and the amount of placement. The policy of the Ministry of Finance (MOF) on domestic government bonds issuance has been focused on the cost of domestic borrowing for the budget. Thus, the supply of government bonds on the primary market has been restricted subject to a pre-defined yield at placement (price ceiling). This has resulted in failed primary auctions when the pre-defined yield at placement proposed by the Ministry of Finance was below the market interest rate. During the fall, the MOF is planning to issue at market to fund the budget. This is to be followed by the introduction of primary dealers and possible use of reverse repos to cut the cost of borrowing at market.

Table TA5: Primary market for government bonds

	2003	2004	2005	2006	2007
Number of auctions held	172	102	25	37	28
Amount raised, UAH m	1,161	2,203	7,153	1,597	3,622

Source: National Bank of Ukraine

A.2.1.1.2. Bonds outstanding, by maturity

The maturity of government bonds ranges from 12 months to 5 years.

Table TA6: Domestic government bonds outstanding by maturity

	2003	2004	2005	2006	2007
5-year bonds, UAH m	N/A	2,109.9	3,416.0	3,177.0	2,927.0
4-year bonds, UAH m	N/A	184.4	947.2	516.9	438.8

3-year bonds, UAH m	N/A	629.5	1,321.3	2,373.8	3,898.0
2-year bonds, UAH m	N/A	332.5	1,384.5	1,627.8	575.8
18-months bonds, UAH m	N/A	1,349.6	2,509.2	-	1,307.0
1-year bonds, UAH m	N/A	203.8	445.3	-	-
Total, UAH m	N/A	4,809.7	10,023.5	7,695.4	9,146.5

Source: Ministry of Finance of Ukraine

A.2.1.2. Secondary market trading

The secondary market for government debt has demonstrated significant turnover dynamics over 2003-2007, suggesting high demand for high-quality low-risk debt instruments in the economy.

Table TA7: Secondary market turnover for government bonds
Includes cash and refinancing of banks

	2003	2004	2005	2006	2007
Total, UAH bn., of which	3.4	16.0	20.3	34.8	54.3
NBU, UAH bn.	N/A	N/A	2.8	1.5	0.6
Economic entities, UAH bn., of which	N/A	N/A	17.5	33.3	53.7
Organized market (exchanges), UAH bn	N/A	N/A	3.9	8.5	2.6

Source: National Bank of Ukraine

A.2.1.3. Yield curve

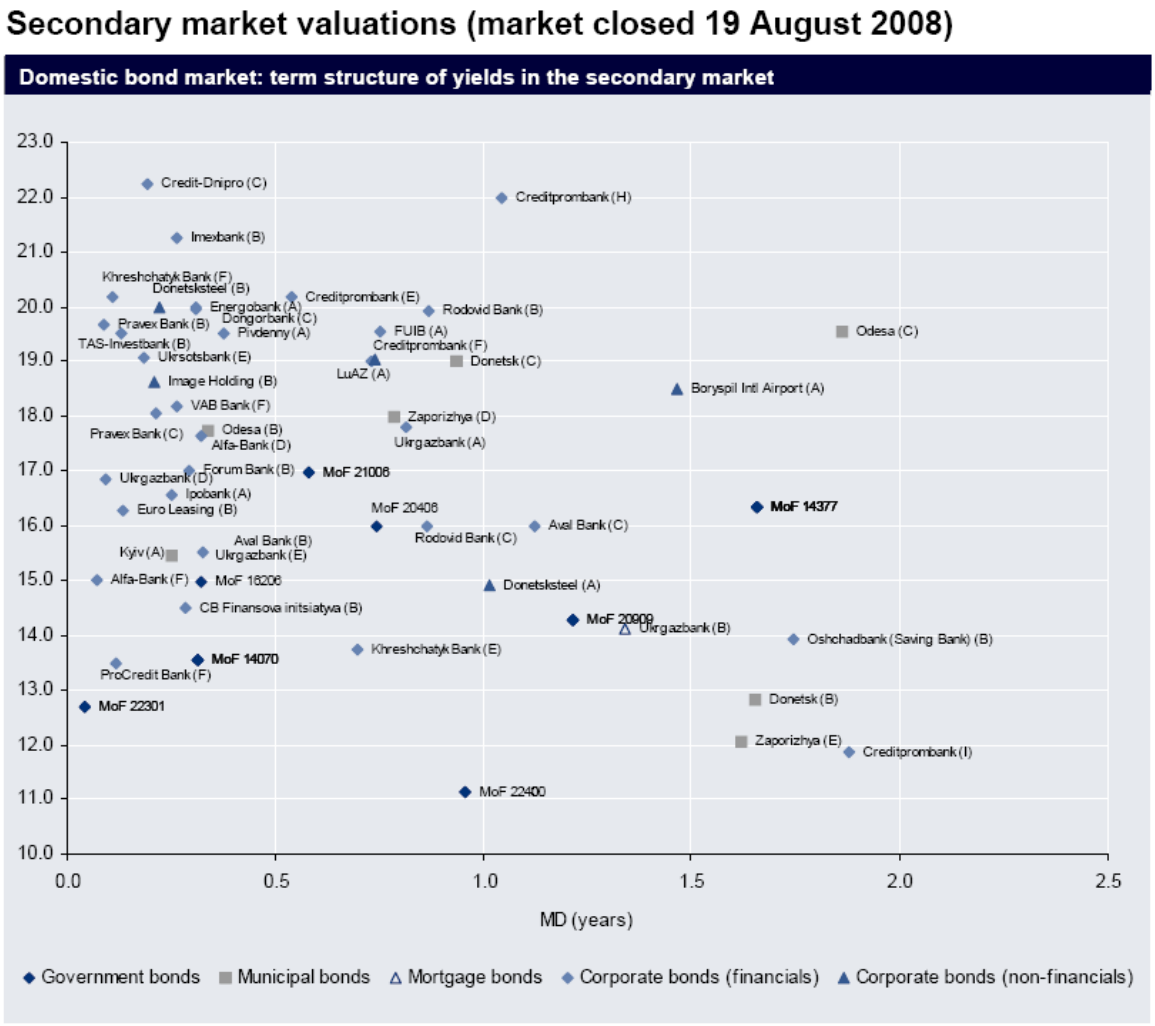
There is no yield curve that is calculated officially, either by the Ministry of Finance or the National bank of Ukraine. However, data on quotations for liquid government bonds is available from main market participants. The yield on domestic government bonds in Aug 2008 was around 14.5% p.a.

Table TA8: Government bond quotes (market closed 19 August 2008)

PFTS	Issuer name	Coupon	Maturity/	Price				Yield (%)				Trade volume
Ticker		rate (%)	put date	Bid	Ask	Last	Avg	Bid	Ask	Last	Avg	(UAH)
16206	Ministry of Finance	13.61	31-Dec-08	99.52	100.5			14.37	11.82			0
20406	Ministry of Finance	14.4	30-Jun-09	98.76	101.21			15.92	12.85			0
20909	Ministry of Finance	11.94	30-Dec-09	96.63	101.36			15.5	11.36			0
21006	Ministry of Finance	6.48	1-Apr-09	94.71				16.04				0
22301	Ministry of Finance	9	3-Sep-08	99.87	100.01			11.12	9.06			0
22400	Ministry of Finance	9.4	2-Sep-09	99.09				10.73				0
22509	Ministry of Finance	9.5	28-Sep-11	85.12				16.54				0
14070	Ministry of Finance	7.12	17-Dec-08	97.91	98.81			13.75	10.93			0
14377	Ministry of Finance	6.59	23-Jun-10	86.28				16.01				0

Source: PFTS, ING, "Ukraine's financial markets snapshot", ING Wholesale Banking, August 20, 2008.

Figure FA1. Debt market: yield curve, benchmarks and bond quotes



All data as of close prices for last trading session. Corporate bonds with at least UAH100m outstanding are depicted.

Source: PFTS, ING

Source: Ukraine's financial markets snapshot, ING Wholesale Banking, August 20, 2008.

A.2.1.4. Investor structure (foreign, domestic, institutional, retail)

Table TA9: Government bonds investor structure

	2003	2004	2005	2006	2007
NBU, UAH m	N/A	N/A	N/A	0	0
Domestic investors, UAH m, of which	N/A	N/A	N/A	4761.0	7149.6
Banks, UAH m,	N/A	N/A	N/A	3960.0	5601.2
Other, UAH m,	N/A	N/A	N/A	800.8	1462.3
Foreign investors, UAH m	N/A	N/A	N/A	2525.0	2080.4

Total, UAH m	N/A	N/A	N/A	7285.8	9359.2

Source: National Bank of Ukraine

A.2.2. Municipal bond market

A.2.2.1. Primary market

A.2.2.1.1. Issuers

Typical issuers of domestic municipal bonds are small to medium sized cities. The biggest borrower cities were Kyiv, Odessa, Kharkiv, and Donetsk, each with populations over 1 million. Individual issuance size is small and reflects limited but increasing credit worthiness. Such municipalities could benefit from pooling to reduce borrowing costs.

Table TA10: Issuance of municipal bonds

	2003	2004	2005	2006	2007
Volume of registered municipal bonds issues, UAH m	150.0	45.0	350.0	83.5	156.3

Source: State Commission for Securities and Stock market

A.2.2.1.2. Bonds outstanding, by issuer and maturity

The total volume of municipal bonds outstanding as of August 2008 was around UAH 0.6 bn. Maturity of municipal bonds ranges from 1 to 5 years.

Table TA11: Bonds outstanding issues by Ukrainian municipalities (as of Aug 2008)

Issuer (city)	Security	Amount issued, UAH m	Maturity date
Berdyansk	Berdyansk, 1-A	10.0	27.08.2012
Borispol	Borispol, 1-A	9.0	16.07.2013
Chercassy	Chercassy, 1-A	5.0	27.12.2010
Donetsk City	Donetsk City, 1-C	50.0	05.09.2011
Donetsk City	Donetsk City, 1-B	45.0	11.07.2010
Ivano-Frankovsk	Ivano-Frankovsk, 1-A	5.5	28.02.2011
Kyiv	Kyiv, 1-A	150.0	25.11.2008
Komsomolsk	Komsomolsk, 1-A	8.0	03.08.2009
Lugansk	Lugansk, 1-A	10.0	29.10.2012
Lugansk	Lugansk, 1-B	19.3	29.10.2012
Lutsk City	Lutsk City, 1-B	10.0	27.04.2011
Lutsk City	Lutsk City, 1-D	10.0	24.04.2013
Lutsk City	Lutsk City, 1-A	10.0	17.12.2009
Lutsk City	Lutsk City, 1-C	10.0	25.04.2012
Lviv City	Lviv City, 1-B	42.0	19.12.2012
Lviv City	Lviv City, 1-A	50.0	20.07.2012
Odesa	Odesa, 1-B	70.0	31.12.2008
Odesa	Odesa, 1-C	30.0	31.12.2010
Vinnitsa City	Vinnitsa City , 1-B	8.0	30.12.2008
Vinnitsa City	Vinnitsa City , 1-C	4.0	30.05.2009
Vinnitsa City	Vinnitsa City , 1-D	6.0	30.12.2009

Vinnitsa City	Vinnitsa City , 1-E	9.0	30.12.2010
Vinnitsa City	Vinnitsa City , 1-F	10.0	29.12.2011
Zaporozhie	Zaporozhie, 1-D	20.0	07.07.2009
Zaporozhie	Zaporozhie, 1-E	10.0	06.07.2010
Total		610.8	

Source: C-bonds

A.2.2.2. Secondary market

A.2.2.2.1. Trading volume

Table TA12: Secondary market for municipal bonds.

	2003	2004	2005	2006	2007
Volume of deals executed by brokers, UAH bn	0.16	0.98	2.23	2.85	4.31
Turnover for municipal bonds (PFTS only), UAH bn	0.01	0.89	0.67	0.99	0.74

Source: State Commission for Securities and Stock market, PFTS stock exchange

A.2.2.2.2 Concentration

The secondary organized market for municipal bonds remains very concentrated. The share of turnover of two most traded municipal bonds of the PFTS stock exchange has been about 50%. The most traded municipal bonds were those issued by cities of Kharkiv Kyiv, and Odessa.

Table TA13: Concentration of secondary market for municipal bonds

	2003	2004	2005	2006	2007
Total number of municipal bonds traded (PFTS only)	N/A	3	9	15	16
Share of two most traded municipal bonds in total municipal bonds turnover (PFTS only) %	N/A	99.4	54.8	48.4	52.0

Source: PFTS Stock exchange

A.2.2.3 Spreads

Information from market participants on secondary market valuation of municipal bonds suggests that the difference in yields between a municipal bond and a government bond with the same (or similar) time to maturity is rather low as compared to that of corporate bonds. The yield on municipal bonds in Aug 2008 was around 14.7% p.a., implying that the spread over government bonds was on average just about 20 bps. Moreover, municipal bond yield sometimes is even below government bond yield with similar time to maturity. This may be due to the perception that municipal bonds are low risk securities, similar to government bonds. Although the government provides no sovereign guarantee for municipal bonds, every issue of municipal bonds must be approved by the Ministry of Finance.

Table TA14: Municipal bond quotes (market closed 19 August 2008)

PFTS	Issuer name	Coupon	Maturity/	Price	Yield (%)	Trade

Ticker		rate (%)	put date	Bid	Ask	Last	Avg	Bid	Ask	Last	Avg	volume (UAH)
OKYIV	Kyiv(A)	14	25-Nov-08	99.92	100.25			14.98	13.73			0
OLUGB	Lugansk(B)	10.4	31-Oct-11	100	102.6			10.81	9.8			0
OLUGA	Lugansk (A)	10.4	31-Oct-11	100	104.72			10.81	9			0
ODONCB	Donetsk (B)	11.75	11-Jul-10	99.57	99.72			12.54	12.45			0
OODESB	Odesa (B)	13	31-Dec-08	98.5	99.4			17.6	15			0
OODESC	Odesa (C)	14	31-Dec-10	91	100			19.68	14.47			0
OZAPRD	Zaporizhya (D)	11.5	7-Jul-09	95.27				18				0
OZAPRE	Zaporizhya (E)	12	6-Jul-10	99.25	100.2			12.82	12.22			0

Source: PFTS, ING, "Ukraine's financial markets snapshot", ING Wholesale Banking, August 20, 2008.

A.2.2.4. Investor structure (foreign, domestic, institutional, retail)

While there is no official data on investor structure regarding municipal bonds, mostly banks invest in these instruments.

A.2.3. Corporate bond market

A.2.3.1. Primary market

A.2.3.1.1. Issuers

Table TA15: Issuance of corporate bonds

	2003	2004	2005	2006	2007
Volume of registered corporate bonds issues, UAH m., of which	4,241.9	4,106.6	12,748.3	22,070.8	44,480.5
Banks, UAH m	329.2	217.9	2,564.7	4,994.0	18,869.4
Insurance companies, UAH m	7.0	112.0	41.9	85.0	50.6
Other, UAH m	3,905.7	3,776.7	10,141.7	16,991.8	25,560.5

Source: State Commission for Securities and Stock market, PFTS stock exchange

A.2.3.1.2. Bonds outstanding, by issuer and maturity

As of August 2008, there were 1191 corporate bonds outstanding, issued by 467 companies, with total amount UAH 55.9 bn. Maturity of corporate bonds typically ranges from 1 to 5 years.

A.2.3.2. Secondary market

A.2.3.2.1. Trading volume

Table TA16: Secondary market for corporate bonds.

	2003	2004	2005	2006	2007
Volume of deals executed by brokers, UAH bn	9.01	21.28	32.62	62.38	134.73

Turnover for corporate bonds on organized secondary market (PFTS only), UAH bn	2.00	7.00	6.49	11.87	17.4

Source: State Commission for Securities and Stock market, PFTS stock exchange

A.2.3.2.2. Concentration

About 50% percent of turnover in corporate bonds on PFTS stock exchange is provided by 20 most traded corporate bonds.

Table TA17: Concentration of corporate bonds market

	2003	2004	2005	2006	2007
Number of corporate bonds traded (PFTS only)	46	98	146	208	236
Share of 20 most traded corporate bonds in per cent of total (PFTS only) %	N/A	76.6	72.2	64.5	48.6

Source: State Commission for Securities and Stock market, PFTS Stock exchange, own estimates

A.2.3.3. Spreads

Yield on corporate bonds ranges from 12% p.a. to over 30% p.a. as risk premium differs widely across companies. The average yield on municipal bonds in August 2008 was around 18.5% p.a., implying that the spread over government bonds was on average about 400 bps.

A.2.3.4. Investor structure (foreign. domestic, institutional, retail)

While there is no official data on investor structure regarding corporate bonds, local investment companies and banks buy these securities. Additionally, nearly every issue is includes a put after one year effectively making all corporate bonds one - year instruments.

A.2.4. Mortgage bonds

A.2.4.1. Primary market

A.2.4.1.1. Issuers

The market for mortgage bonds is at initial stage in Ukraine. Mortgage bonds have so far been issued by three institutions. Ukgazbank was the first Ukrainian bank to issue covered mortgage bonds in 2007 in the amount of UAH 50 m. In the month of August 2008, Khreschatyk Bank issued mortgage covered bonds in the amount of UAH 70 m and the State Mortgage Company (SMI), Ukraine's mortgage liquidity facility, issued mortgage covered bonds totaling UAH 200 m. The two recent bonds are being placed.

A.2.4.1.2. Bonds outstanding, by issuer and maturity

The maturity of Ukrgazbank covered bond issue is 3 years. The maturity for the Khreschtyk Bank and the SMI's covered bond is 3 years.

A.2.4.2. Secondary market

A.2.4.2.1. Trading volume

The trading volume for the Ukrgazbank mortgage bond on the PFTS Stock exchange was UAH 126 m in 2007. Secondary market trade has not yet begun for covered bonds issued by the SMI and Khreschatyk bank.

A.2.4.3. Spreads

The yield on Ukrgazbank mortgage bond in August 2008 was around 14% p.a., that was below the average yield on government bonds of 14.5%, reflecting low risk of mortgage bonds.

Table TA18: Mortgage bond quotes (market closed 19 August 2008)

PFTS	Issuer name	Coupon rate	Maturity/	Price				Yield (%)				Trade volume
Ticker		(%)	put date	Bid	Ask	Last	Avg	Bid	Ask	Last	Avg	(UAH)
OUGZBB	Ukrgazbank (B)	10.5	25-Feb-10	96.05	97.3			14.03	13.03			0

Source: PFTS, ING, "Ukraine's financial markets snapshot", ING Wholesale Banking, August 20, 2008.

A.2.4.4. Investor structure (foreign, domestic, institutional, retail)

There is no data on investor structure regarding Ukrgazbank mortgage bond and the most recent issues by Khreshatyk and the SMI.

A.2.5. Asset-backed securities

Asset-backed securities have not been issued in Ukraine.

B: Market infrastructure

B.1. Exchanges (ownership structure, scope, M&A incl. cross-border)

There were 7 stock exchanges and 2 trading information systems in 2007. Although the organizers of trade should facilitate both free of payment (FOP) and delivery versus payment (DVP) mechanisms, DVP is almost not used in practice, and almost all trades are FOP, with the money side of the transactions settled outside trading platforms. Counterparties manage the resulting settlement risk by having the stronger party in the deal demanding prepayment or pre-delivery from the least creditworthy counterparty.

Table TA19: Stock exchanges and trading information systems

Exchange	Ownership	Volume of trades in 2007, UAH m
PFTS	Collective (association)	30,769
South-Ukrainian trade information system	Collective (association)	2,237
Innex	Closed joint stock company (24.983% owned by Warsaw Stock Exchange, Poland)	962
Kyiv International stock exchange	Open joint stock company	444
Perspectiva	Limited liability company	437
Ukrainian International stock exchange	Closed joint stock company	128
Ukrainian stock exchange	Closed joint stock company	81
Ukrainian interbank currency exchange	Closed joint stock company	58
Pridneprovsk stock exchange	Closed joint stock company	35
Crimean stock exchange	Closed joint stock company	0
Total		35,150

Source: State Commission on securities and stock market, PFTS, South-Ukrainian trade information system, Innex, Kyiv International stock exchange, Perspectiva, Ukrainian International stock exchange, Ukrainian stock exchange, Ukrainian interbank currency exchange, Pridneprovsk stock exchange, Crimean stock exchange

B.2. Multilateral trading facilities (MTFs)

The concept of "Multilateral trading facilities (MTFs)" as defined by MiFID has not been developed in Ukraine up to date.

B.3. Systematic internalizers

A systematic internalizer is an investment firm dealing on own account to execute client orders outside a regulated market or a multilateral trading facility. The concept of "Systemic internalizers" as defined by MiFID has not been developed in Ukraine up to date. However, the scope of OTC trade in Ukraine is rather high, suggesting significant potential for development of systemic internalizers.

B.4. Securities clearing and settlement system

Immobilized and dematerialized corporate securities are kept with depositories, which function based on a two-tiered holding system introduced by law. For this tiered structure to provide legal certainty concerning the holders' rights in securities deposited with custodians, the law provides that the transfer of rights in all registered securities is effective as soon as the transfer takes place in an account provided by a custodian and the custodian's records are the proof for the rights of the holder of the securities.

Clearing and settlement services for government securities have been conducted by the Depository owned and operated by the National Bank of Ukraine. All government

securities in Ukraine are dematerialized and can be transferred in book-entry form through the Depository. By law, securities may be issued in physical or dematerialized form in Ukraine. In a successful legislative reform, all government securities have been dematerialized since 1995. Consequently, depositing the government securities in the depository of the NBU became compulsory in 1995 when the NBU and the Treasury decided to issue dematerialized government securities. The nominal value of the government debt held at the depository of the NBU reached UAH 8.8 billion at the end of Q2 2008. All state securities issued after the law are fully dematerialized. The settlement of the government bonds occurs in DVP mechanism. The finality of settlement at the books of the NBU is protected as well as the payments transferred through the System of Electronic Payments in the event of bankruptcy of a participant.

Clearing and settlement services for domestic corporate and private securities have been conducted by private-owned depository MFS since 1997. The MFS is a, user--and-exchange-owned organization, in the form of an open joint stock company with about 90 stockholders. The total value of securities (shares, corporate and municipal bonds) accounted by the MFS (nominal value) reached UAH 270 billion at the end of Q2 2008.. The MFS offers DVP settlement services, but in the great majority of cases market participants settle securities on a free-of-payment basis.

The National Depository of Ukraine (NDU) has been assigning ISIN number since 1999 to all government and private isecurities. NDU is open joint stock company owned by the state at 86%. The NDU is funded from the state budget. It has received a full license for depository clearing and settlement activities in 2008 and has opened accounts for issuers and custodians, although the number of securities registered at NDU is very small as compared to that of MFS.

B.5. Custodians (bank-affiliated, independent)

There were 214 custodians in 2007, 109 of which were banking institutions. Corporate stock and bonds are usually in registered form and kept with registrars. Only a small fraction of corporate securities is dematerialized and held with securities depositories. The vast majority is not dematerialized and the record of ownership for documentary registered securities is kept with registrars.

B.6. Financial brokerages (bank-affiliated, independent)

The official statistics does not separate financial brokerages form other traders. The number of traders has been around 800 over 2003-2007.

Table TA20: Market infrastructure

	2003	2004	2005	2006	2007
Stock exchanges	8	8	8	8	7
Trading information systems	2	2	2	2	2
Multilateral trading facilities (MTFs)	-	-	-	-	-
Systemic internalizers	-	-	-	-	-
Traders	871	780	795	805	779

Financial brokerages, of which	…	…	…	…	…
bank-affiliated	…	…	…	…	…
independent	…	…	…	…	…
Custodians, of which	122	140	161	180	214
bank-affiliated	…	…	…	…	109
independent	…	…	…	…	105
Depositories	2	2	2	2	2
Depository for government bonds	1	1	1	1	1
Registrars	361	367	352	351	369
Issuers which maintain registry on their own	739	598	346	357	304
Asset managers	32	91	159	224	326
SROs	11	13	13	13	11

Source: State Commission on securities and stock market, Ukrainian association of investment business

C: Institutional investors

C.1. Non-state pension funds

Non-state pension funds (NSPF) have emerged in 2003 and remain small. The number of registered NSPFs went up to 96 of which 54 were active at the end of 2007. Their net assets at the end of 2007 reached UAH 278 million. Securities of all types constituted nearly 52% assets of non-state pension funds in 2007.

C.2. Insurance companies

Insurance industry is the largest amongst non-banking financial institutions as measured by assets. The total assets of insurance are about 5% of GDP. The number of insurance companies increased from 283 in 2000 to 446 in 2007, and insurance premiums grew from about 1.3% GDP to over 2.5% of GDP over the same period. About 40% of assets of insurance companies in 2007 were invested in securities, mostly in equities (37%).

C.3. Undertakings of Collective Investment in Transferable Securities UCITs)

The Institutions of collective investment have grown up rapidly due to a number of factors, including dramatic growth of the stock market and demand for savings instruments other than bank deposits. The net assets of non-venture funds reached about UAH 3.3 bn in 2007, up from UAH 1.2 bn. About 70% of assets of non-venture institutions of collective investment were invested in securities.

C.4. Private equity funds

Assets of venture funds have reached UAH 36.5 bn in 2007 up from UAH 15.8 bn in 2006. About 57% of assets of venture funds in 2007 were invested in securities.

Table TA21: Institutional investors

	2003	2004	2005	2006	2007
Insurance companies					

Number of insurance companies	357	387	398	411	446
Total assets (UAH m)	10,457	20,013	20,920	23,995	32,213
Premium revenues (UAH m)	9,135	19,431	12,854	13,830	18,008
Investment funds and mutual funds of investment companies (old type)					
Number of investment funds and mutual funds of investment companies	109	137	200	…	N/A
Net assets (UAH m)	302	191	215	…	N/A
Institutions of Collective Investments (Investment Funds) (Non-venture)					
Number of Institutions of Collective Investments (Investment Funds)	9	30	64	109	184
Total net assets (UAH m)	…	82	400	1,180	3,330
Venture Institutions of collective investments (Investment funds)					
Number of venture funds	23	73	218	410	650
Net assets (UAH m)	…	1,533	4,624	…	..
Total assets (UAH m)	…	…	…	15,771	36,451
Pension funds					
Number of pension funds	…	21	54	79	85
Total net assets (UAH m)	…	11	46	137	318

Sources: State Commission for Regulation of Financial Services Markets in Ukraine; State Commission on Securities and Stock Exchange; Ukrainian Association of Investment Business.

Annex Table TA22: Corporate bond quotes (market closed 19 August 2008)

PFTS	Issuer name	Coupon	Maturity/	Price				Yield (%)				Trade volume
Ticker		rate (%)	put date	Bid	Ask	Last	Avg	Bid	Ask	Last	Avg	(UAH)
OHYPBA	Ipobank(A)	15	26-Nov-08	99.96	100.18			15.98	15.15			0
ODGBC2	Dongorbank (C)	15.5	18-Dec-08	99.48				18				0
ODGBB3	Dongorbank (B)	12.75	18-Nov-08	98.86	99.36			17.95	15.9			0
ODGBA3	Dongorbank (A)	12.75	18-Nov-08	99	99.35			17.37	15.92			0
OCREDA	Credit-Dnipro (A)	14	13-Apr-09		99.27				16			0
OELZB	Euro Leasing (B)	13	9-Oct-08	99.78	99.93			15	14			0
OCLBA	Calyon Bank Ukraine (A)	12	16-Jul-09	96.89				16.52				0
OBXRE	Khreshchatyk Bank (E)	13	17-May-09	97.12	99.86			18.11	13.83			0
OBVLC	Aval Bank (C)	13.5	21-Jan-10	96.71				16				0
OCREDB	Credit-Dnipro (B)	14	13-Apr-09	100.96				13.1				0
OFORB	Forum Bank (B)	11	10-Dec-08	98.34	99.22			17	14			0
OFNINB	CB Finansova initsiatyva (B)	14	8-Dec-08	100.04				14.51				0
OFNINA	CB Finansova initsiatyva (A)	17.5	13-Jul-09	100				18.66				0
OEXPBA	Express Bank (A)	15	11-Jun-09	99.52	101.1			16.53	14.29			0
OESAA	European Insurance	15.5	10-Feb-09	100.01	100.33			16.4	15.65			0

	Alliance (A)											
COKPBE	Creditprombank (E)	13.25	23-Mar-09	97.35				18.99				0
COPUMB	FUIB (A)	15.5	22-Jun-09	98.18	99.58			18.98	16.98			0
COKPBI	Creditprombank (I)	11.5	20-Oct-10	100.13				11.93				0
OBVLB	Aval Bank (B)	9.63	21-Jan-09	97.31	98			15.72	14.03			0
COKPBF	Creditprombank (F)	11.5	9-Jun-09	95.2	96.17			18.96	17.5			0
COENRA	Energobank (A)	14	18-Dec-08	98.66	98.95			18.95	18			0
COKPBH	Creditprombank (H)	11.25	21-Oct-09	90.42	98.71			22	13			0
COUSCE	Ukrsotsbank (E)	12	28-Oct-08	99.14	99.54			16.9	14.85			0
OALFF	Alfa-Bank (F)	10	15-Sep-08	99.44	99.8			15.99	12.28			0
OALFD	Alfa-Bank (D)	13	23-Dec-08	99.23	99.88			15.96	13.97			0
OALFC	Alfa-Bank (C)	13	10-Dec-08	98.7	99.39			18	15.65			0
OBPVA2	Pivdenny (A)	12.5	12-Jan-09	98.19	98.52			17.96	17.04			0
OZUKBA3	Credobank (A)	13.2	20-Feb-09	97.89	99.24			18.5	15.5			0
OTSIBA	TAS-Investbank (A)	10.75	3-Nov-08	98.55	102.34			18.01	1.09			0
OSCHDB	Oshchadbank (Saving Bank) (B)	10.5	12-Aug-10	98.01	99.01			12.13	11.51			0
ORODBB	Rodovid Bank (B)	12.5	3-Aug-09	95.1				19.09				0
OPRXBC	Pravex Bank (C)	13.5	8-Nov-08	99.37	99.75			17.01	15.31			0
OPRXBA	Pravex Bank (A)	13.5	11-Dec-08	99.16	99.45			16.98	16			0
OUGZBD	Ukrgazbank (D)	13	23-Sep-08	99.79	100.27			15.34	11.24			0
OVBNF	VAB Bank (F)	14	1-Dec-08	99.15	99.92			17.81	15			0
OUPRBB	Ukrainian professional bank (B)	15	29-Jun-09	99.84				16.04				0
OUPRBA	Ukrainian professional bank (A)	14	29-Dec-08	98.59				18.89				0
OTSCBA	Swedbank (A)	10.5	13-Oct-08	99.44	99.77			14.27	12.25			0
OUGZBE	Ukrgazbank (E)	13	23-Dec-08	99.5	99.83			15.12	14.11			0
OUGZBA	Ukrgazbank (A)	16	16-Jul-09	99.81	99.97			17.22	17.01			0
OPRXBB	Pravex Bank (B)	12.5	21-Sep-08	99.56	99.78			16.94	14.9			0
OKPBD	Creditprombank (D)	14	18-Aug-08	99.9				17.8				0
OKPBC	Creditprombank (C)	15.5	16-Jul-09	98.05				18.99				0
OPCBF	ProCredit Bank (F)	13	2-Oct-08	100.08	100.36			13	11			0
OIMEXB	Imexbank (B)	13.5	1-Dec-08	98.22	98.79			20.71	18.53			0
OIMEXA	Imexbank (A)	15	22-May-09	91.6	107.79	96.45	96.45	30	5	21.49	21.49	99,530.00
OMGBE	Megabank (E)	13.75	8-Dec-08	98.67	98.72			18.99	18.83			0
ONRBD	NRB-Ukraine (D)	15.5	22-Dec-08	99.8	100.46	98.83	99.25	16.98	14.97	20.06	18.74	10,111,350.00
OCPFB	Cherkasy Battery Farm (B)	14	11-Nov-08	98.77	99.21			20.44	18.43			0
ODMTA	Domotehnika (A)	15	26-Aug-08		100.59				4.13			0
ODDZA	Drohobych bit (dolotnyy)plant (A)	16	18-May-09	99.78	100.14			17.32	16.76			0
OCITYA	City'com (A)	14.75	5-Jan-09	97.45	98.45			23	20			0
CODSTA	Donetsksteel (A)	13	5-Oct-09	99.28	99.28			14.38	14.38			0
OGNGF	Concern	11	28-Aug-08	99.72	100			16.51	11.34			0

	Galnaftogaz (F)											
OGNGE	Concern Galnaftogaz (E)	13.5	27-Jul-09	97.77				17.01				0
ODRNB	Druzhba Narodiv Nova (B)	14	18-Aug-08	100.02	100.1			13.84	11.18			0
OFZFA	Fozzy-Food (A)	16	11-Sep-08	99.56				22				0
OFORAA	Fora (A)	16	16-Feb-09	98.25	100.54			21	15.77			0
OENAVB	Energoautomatika (B)	14.5	15-Dec-08	98.87	99.47			18.97	16.97			0
OGNGD	Concern Galnaftogaz (D)	13.5	26-Jun-09	97.96				16.98				0
COSVTA	Soyuz-Victan Trade (A)	14	13-Mar-09	98.38	99.66			17.96	15.39			0
COLSFA	Lyustdorf(A)	16	18-May-09	97.49	104.04			21	10.96			0
COKRVB	Karavan (B)	15	25-May-09	97.31				20				0
OAGMTA	Agromat (A)	18	13-Jul-09	99.52	100.31 1	1.8	101.8	19.89	18.82	16.84	16.84	3,116,841.52
COFSHC	Furshet (C)	13.5	15-Apr-09	96.72				19.99				0
COFSHB	Furshet (B)	13.25	11-Feb-09	98.25	99.07	97.92	97.89	17.93	16.02	18.7	18.79	5,854,404.00
COFSHA	Furshet (A)	13.5	3-Dec-08	98.97	99.49	98.58	98.57	17.85	15.97	19.28	19.32	20,180,600.00
CODSTB	Donetsksteel (B)	12.5	12-Nov-08	98.42	99.09			20	17			0
OAMSC	Amstor (C)	14	11-Sep-09	94.63	105.93			21	8.55			0
OIBOYA	Iboya (A)	16	2-Feb-09	98.91				19.66				0
OAVKA2	AVK Concern (A)	13	15-Dec-08	98.21	99.29			19.5	15.91			0
OATMB	Atlant-M (B)	15	9-Mar-09	97.52	98.94			21	18			0
OATMA	Atlant-M (A)	13.5	8-Dec-08	98.05	99.96	100.04	100.04	21	14.31	14.02	14.02	10,218,500.00
OAMSF	Amstor (F)	14	12-Dec-08	97.93	103.93			21.78	2.72			0
OAMSD	Amstor (D)	14	12-Sep-08	99.44	100.43			21.01	9.95			0
COVINB	Vinnifruit Invest (B)	16	15-Dec-08	99.79	100.03			17.57	16.78			0
OAMSB	Amstor (B)	14	11-Jun-09	97.89	106.89			17.78	5.72			0
OAMSA	Amstor (A)	14	11-Mar-09	97.85	103.85			19.09	7.51			0
OAGMTB	Agromat (B)	15	13-Oct-08	99.66	99.98			17.94	15.94			0
OAMSE	Amstor (E)	14	9-Dec-11	99.65	103.93			14.89	13.14			0
OSBMB	Spetsbudmontazh (B)	15	23-Jun-09	93.24	104.24			25.88	10.25			0
OTAVRC	Tavriya-V (C)	16	28-Jan-09	99.85				17.36				0
OSUMHA	Sumykhimprom (A)	19	8-Jun-09	99.69	100.48			20.83	19.64			0
OHLPD	Concern Khlibprom (D)	12	25-Aug-08	99.65	99.93			20	14			0
OZRTCB	Grain Trading Co. (B)	16	6-Oct-08	98.87	99.98			25	17			0
OUTSTA	YutiSt (A)	14	19-Mar-09	97.33	99.29			20	16.08			0
OPDILA	Podillya (A)	17	29-May-09	98.76	99.35			20	19.09			0
OUAHA	Ukrainian Automobile Holding (A)	15	6-Apr-09	99.57	100.57			10.53	8.83			0
OINMD	Intermarket (D)	15.5	13-Mar-09	92.71	102.71			32.46	11.2			0
OKRTB	Kernel-Trade (B)	15	6-Oct-08	99.98	100.32			15.89	13.62			0
OKKOA	Kyiv-Konti (A)	13	10-Nov-08	99.47	99.94			15.94	13.91			0
OKGSTA	Kyivmiskbud-1 (A)	14	12-Dec-08	100.54	100.63			12.9	12.61			0
OINME	Intermarket (E)	15.5	18-Apr-09	94.24	103.24			27.09	11.05			0
OKRVNA	Karavan (A)	16	6-May-09	98.22				19.94				0
OIMHLB	Image Holding	13	6-Nov-08	99.2	99.7	99.34	98.43	17.52	15.2	16.88	21.22	15,252,000.00

	(B)							
OIMHLA	Image Holding (A)	16	1-Dec-08	99.45	99.99	18.96	16.96	0
OINSPA	Insakharprom-K (A)	16	23-Apr-09	94.43	100.65	27.14	15.87	0
OOMAVB	Omega-Avtopostavka (B)	18	13-Jul-09	96.91	100.72	23.55	18.27	0
OKRTA	Kernel-Trade (A)	15	11-Sep-08	99.89	100.24	16.95	12.97	0
OMTIA	MTI (A)	12.5	11-Nov-08	99.19	99.91	16.58	13.43	0
OMABA3	Boryspil Intl Airport (A)	10	19-Apr-10	90.58	92.44	17.5	16	0
OLUAZA	LuAZ (A)	14	15-Jun-09	97.03	97.69	19	18.02	0
OKZMOA	Kostyantynivsky ZMO (A)	17	7-Dec-09	97.3	102.3	20.77	15.93	0
ONIDNA	Nidan+ (A)	18	2-Jun-09	96.9	101.8	24.41	16.81	0

Listed are corporate bonds with at least UAH25m outstanding.
Source: PFTS, ING, "Ukraine's financial markets snapshot", ING Wholesale Banking, August 20, 2008.

Technical Annex II: Transposition Status of EU FSAP Directives (as of June 20, 2008)

pursuit of the business of credit institutions			OK	OK	OK	OK	OK	OK	OK	OK	OK	CP	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK
Directive on the taking up, pursuit and prudential supervision of the businesses of electronic money institutions.	Directive 2000/46/EC	27/04/2002	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK
Directive amending the insurance directives and the ISD to permit Information exchange with third countries	Directive 2000/64/EC	17/11/02	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK
Directive on the reorganisation and winding-up of Insura nce undertakings	Directive 2001/17/EC	20/04/03	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK
Directive amending the money laundering directive	Directive 2001/97/EC	15/06/03	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK
Two directives on UCITS	Directive 2001/107/EC,	13/08/03	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK
	Directive 2001/108/EC	13/08/03	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK
Directives amending the solvency margin requirements in the insurance directives	Directives 2002/12/EC repealed by 2002/83/EC	20/09/03	OK	OK	EX	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	EX	OK	OK	OK	OK
	Directive 2002/13/EC	20/09/03	OK	OK	EX	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	EX	OK	OK	OK	OK
Directive on financial collateral arrangements	Directive 2002/47/EC	27/12/03	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK
Directive amending the 4th and 7th Company Law Directives to allow fair value accounting	Directive 2001/65/EC	1/01/04	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK
Directive on the taxation of savings income in the form of interest payments	Directive 2003/48/EC	1/01/04	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK
Directive on the reorganisation and winding-up of banks	Directive 2001/24/EC	5/05/04	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK
Directive on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate.	Directive 2002/87/EC	11/08/04	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK
Directive on the Distance marketing of Financial Services	Directive 2002/65/EC	9/10/04	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK
Directive supplementing the Statute for a European Company with regard to the envolvement of employees	Directive 2001/86/EC	10/10/04	EX	OK	EX	OK	OK	OK	OK	OK	OK	OK	EX	OK	EX	OK	OK	OK	OK	OK	EX	OK	OK	OK	EX	EX	OK	EX	OK
Directive on insider dealing and market manipulation	Directive 2003/6/EC	12/10/04	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK
Directive modernising the accounting provisions of the 4th and 7th Company Law Directives	Directive 2003/51/EC	1/01/05	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK
Directive on insurance mediation	Directive 2002/92/EC	15/01/05	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK
Directive on prospectuses	Directive 2003/71/EC	1/07/05	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK
Directive on the prudential supervision of pension funds	Directive 2003/41/EC	23/09/05	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK
Directive on Take Over Bids	Directive 2004/25/EC	20/05/06	OK	OK	EX	OK	EX	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	EX	OK	OK	OK	OK
Directive on the taking up and	Directive 2006/48/EC	31/12/06																												

Action	Measure taken	Transposition Deadline	AT	BE	BG	CY	CZ	DE	DK	EE	EL	ES	FI	FR	HU	IE	IT	LT	LU	LV	MT	NL	PL	PT	RO	SE	SI	SK	UK
Directive on the capital adequacy of investment firms and credit institutions	Directive 2006/49/EC	31/12/06	OK	OK	OK	OK	OK	OK	OK	OK	OK	CP	OK	OK	CP	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK
Transparency directive	Directive 2004/109/EC	20/01/07	OK	OK	OK	OK	CP	OK	OK	OK	OK	OK	OK	OK	CP	OK	OK	OK	OK	OK	OK	NC	NC	OK	OK	OK	OK	OK	OK
Directive on Markets in Financial Instruments (update of ISD)	Directive 2004/39/EC, [illegible] COM/2000\729	31/01/07	OK	OK	OK	OK	NC	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	OK	CP	OK	OK	OK	OK	OK	OK
Money laundering directive	Directive 2005/60/EC	15/12/07	CP	NC	EX	EX	CP	NC	EX	EX	NC	NC	NC	NC	EX	NC	EX	EX	NC	CP	NC	NC	NC	EX	EX	NC	EX	CP	EX

*) The Commission can always initiate infringement proceedings under Article 226 of the Treaty on the basis of non-compliance of national implementing measures or incorrect

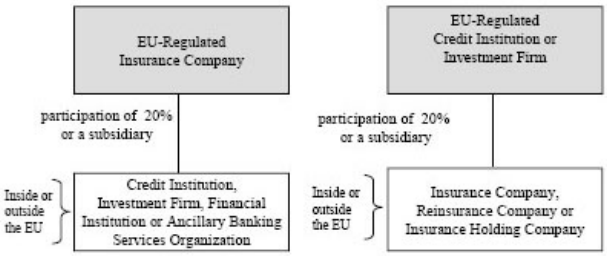
Legend:

CP: partially notified to the Commission
D: derogation =OK
EX: notification received and under examination by the Commission
NA: not applicable =OK
NC: no notification received by the Commission
OK: notification received and checked by the Commission - or no ratification required = OK

Source: European Commission

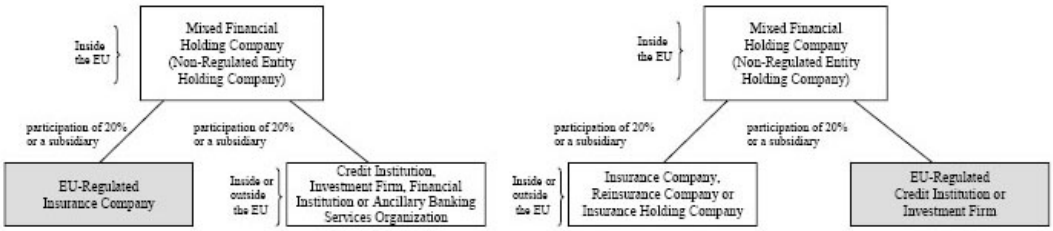
Technical Annex III: Financial Conglomerates Subject to Supplementary Supervision

(a) Group headed by an EU-Regulated Entity



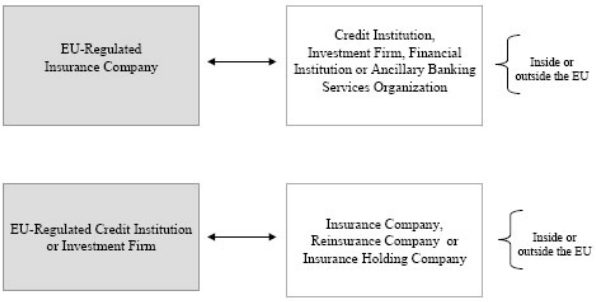
- *Banking plus investment services sector and insurance sector must each be significant* (10% or at least 6 billion Euro test).

(b) Group headed by a Mixed Financial Holding Company with EU Head Office



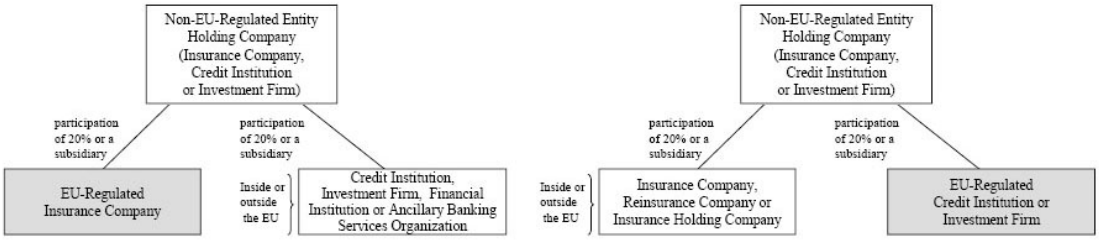
- *Banking plus investment services sector and insurance sector must each be significant* (10% or at least 6 billion Euro test).
- *Group must be mainly engaged in the financial sector* (40% of group test).

(c) Horizontal Financial Conglomorate



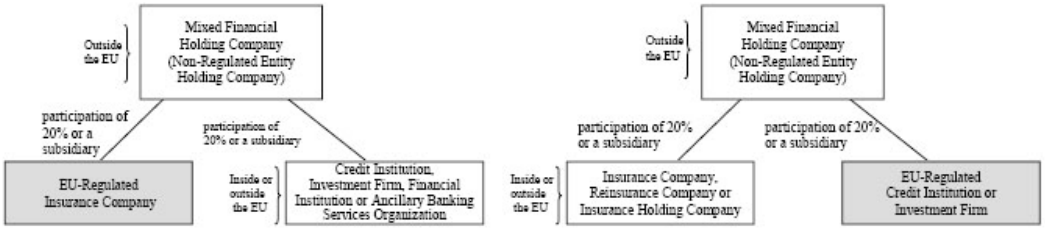
- *Banking plus investment services sector and insurance sector must each be significant* (10% or at least 6 billion Euro test).
- *Group must be mainly engaged in the financial sector* (40% of group test).

(d) Group headed by a Non-EU-Regulated Entity



- *Banking plus investment services sector and insurance sector must each be significant* (10% or at least 6 billion Euro test).
- *Group must be mainly engaged in the financial sector* (40% of group test).

(e) Group headed by Mixed Financial Holding Company with Non-EU Head Office



- *Banking plus investment services sector and insurance sector must each be significant* (10% or at least 6 billion Euro test).
- *Group must be mainly engaged in the financial sector* (40% of group test).

Source: Gruson (2004)

Technical Annex IV: Ukrainian Securities Market and NBFI Laws and Regulations to be approximated with EU Directives

I: Market in General

- Law of Ukraine On Securities and Stock Market (2006)
- Law of Ukraine On State Regulation of the Securities Market in Ukraine (1996)
- Law of Ukraine On Privatization of State Property (1992)
- Concept for Functioning and Development of the Ukrainian Securities Market adopted by the Verkhovna Rada of Ukraine (1995)
- Decree of the President of Ukraine #1648/2005 of Nov. 11, 2005 On the Resolutions of the Council for the National Security and Defense of Ukraine "On Measures to Improve the Investment Environment in Ukraine" dated 29 June 2005 and "On Measures to Ensure Guarantees and to Improve the Effectiveness of Ownership Right Protection in Ukraine" dated 28 October 2005, and:
  - Action Plan to improve the investment Environment in Ukraine approved by this Presidential Decree (Nov. 11, 2005)
  - Main Directions for Stock Market Development in Ukraine for 2005-2010 approved by this Presidential Decree (Nov. 11, 2005)
- Resolution of the Cabinet of Ministers of Ukraine #152-r of March 29, 2000 On Setting by the SSMSC the Securities Registration Fee
- Resolution of the Cabinet of Ministers of Ukraine #419-r of July 25, 2002 On Setting of Fee for Services Provided by the SSMSC
- Resolution of Cabinet of Ministers of Ukraine #131-r of March 7, 2006 On Approval of the Action Plan to Implement General Guidelines of Ukraine Stock Market Development in 2006-2010
- Decree of the Cabinet of Ministers of Ukraine #802 of June 7, 2006 On Setting the Validity Term for Licenses to Perform Certain Types of Activities on Securities Market & Approving the Licensing Fee
- Resolution of Cabinet of Ministers of Ukraine #976-r of Nov. 8, 2007 On Approval of the Concept of State Targeted Economic Program of Capital Market Modernization in Ukraine
- Resolution of the State Commission on Securities and Stock Market #345 of May 26, 2006 On the Approval of the Procedure and Terms of Licensing On the Realization of Certain Kinds of Professional Activity in the Stock Market, Renewal of License, Issue of Duplicate and Copy of License, registered with the Ministry of Justice of Ukraine on July 28, 2006 #890/12764
- Resolution of the State Commission on Securities and Stock Market #432 of June 23, 2006 On Approval of the Procedure of the Suspension and the Annulment of a License For Specific Professional Stock Market Activities, registered with the Ministry of Justice of Ukraine on August 11, 2006 #976/12850

- Resolution of the Securities and Stock Market State Commission #162 of April 17, 2003 On Approval of the Procedure for Control over Compliance with Licensing Requirements to the Professional Activity on the Securities Market, registered with the Ministry of Justice of Ukraine on May 12, 2003 #358/7679

- Order of the State Committee of Ukraine on the Regulatory Policy and Entrepreneurship #52 of April 21, 2003 On Approval of the Procedure for Control over Compliance with Licensing Requirements to the Professional Activity on the Securities Market, registered with the Ministry of Justice of Ukraine on May 12, 2003 #358/7679

- Resolution of the Securities and Stock Market State Commission #1344 of November 21, 2006 On the Definition of the Information Which Belongs to Insider Information Registered with the Ministry of Justice of Ukraine on January 23, 2007 #50/13317

- Resolution of the Securities and Stock Market State Commission #2381 of December 27, 2007 On Approval of the Regulation for Calculation of Liquidity Rates Limiting the Risks of Stock Market Professional Activity, registered with the Ministry of Justice of Ukraine on January 28, 2008 #61/14752

- Resolution of the State Commission for Securities and Stock Market #2272 of December 11, 2007 On Approval of Rules of the Review of Cases of the Violation of Requirements of the Legislation on the Securities Market, and the Application of Sanctions, registered with the Ministry of Justice of Ukraine on February 12, 2008 #120/14811

- Resolution of the Securities and Stock Market State Commission #1048 of March 27, 2007 On Approving The Measures to Implement Principal Foundations of Prudential Oversight on the Stock Market

- Resolution of the Securities and Stock Market State Commission #144 of May 18, 2001 On Exercising State Control Over Activities of Stock Exchanges, Depositories and Trading and Information Systems, registered with the Ministry of Justice of Ukraine on June 15, 2001 #518/5709

- Resolution of the Securities and Stock Market State Commission #302 of July 8, 2003 On approval of the Rules of Conducting Inspections of the Activities of Issuers and Self-Regulating Organizations on the Securities Market, registered with the Ministry of Justice of Ukraine of July 8, 2003 #658/7979

- Resolution of the Cabinet of Ministers of Ukraine on Approval of the Concept for Protection of Financial Services Consumer Rights in Ukraine (to be adopted)

II: Securities Issuers

- Law of Ukraine On Business Associations (1991) or Joint Stock Company Law (to be adopted)

- Decree of the President of Ukraine #280/2002 of March 21, 2002 On Measures for Corporate Governance Development;

- Resolution of the Securities and Stock Market State Commission #571 of December 11, 2003 On Approval of the Principles of Corporate Governance

- Resolution of the Securities and Stock Market State Commission #1591 of December 19, 2006 On Approving the Regulation on the Disclosure of Information by Issuers of Securities, registered with the Ministry of Justice of Ukraine on February 5, 2007 #97/13364

- Resolution of the Securities and Stock Market State Commission #1528 of Dec. 19, 2007 On Approval of the Policy of Preparation of Audit Opinions to be Submitted to the State Commission for Securities and Stock Market for the Disclosure Purposes by Issuers and Professional Stock Market Members, registered with the Ministry of Justice of Ukraine on January 23, 2007 #53/13320

- Resolution of the Securities and Stock Market State Commission #942 of Apr.26, 2007 On Approval of the Share Issue Registration Procedure, registered with the Ministry of Justice of Ukraine on June 12, 2007 #619/13886

- Resolution of the Securities and Stock Market State Commission #322 of July 17, 2003 On Approval of the Regulation On the Procedure of Issue of Corporate Bonds of Enterprises, registered with the Ministry of Justice of Ukraine on Aug. 13, 2003 #706/8027

- Resolution of the Securities and Stock Market State Commission #387 of Feb. 22, 2007 On Approval of the Joint Stock Company Authorized Capital Increase (Reduction) Procedure, registered with the Ministry of Justice of Ukraine on March 28, 2007 #280/13547

- Draft Resolution of the Securities and Stock Market State Commission On Approval of the Principles of Corporate Governance of Ukraine (to be adopted)

III: Stock exchanges, Trade Organizers

- Resolution of the Securities and Stock Market State Commission #347 of May 26, 2006 On Approval of Licensing Conditions for the Exercise of the Professional Stock Market Activities Being Stock Market Trade Organization Activities, registered with the Ministry of Justice of Ukraine on August 11, 2006 #974/12848

- Resolution of the Securities and Stock Market State Commission #1542 of December 19, 2006 On Approval of Regulation on Functioning of Stock Exchanges, registered with the Ministry of Justice of Ukraine on January 18, 2007 #35/13302

- Resolution of the Securities and Stock Market State Commission #212 of June 11, 2002 On Approval of Regulation on the Procedure for Information Disclosure and Filing Administrative Data on the Trade Organizers' Operation, registered with the Ministry of Justice of Ukraine on August 21, 2002 #696/6984

IV: Traders (Broker/Dealers)

- Resolution of the Securities and Stock Market State Commission #346 of May 26, 2006 On Approval of Licensing Conditions for the Exercise of the Professional Stock Market Activities Being Securities Trading Activities, registered with the Ministry of Justice of Ukraine on August 4, 2006 #938/12812

- Resolution of the Securities and Stock Market State Commission #1449 of Dec.12, 2006 On Approval of Rules (Conditions) of Exercise of Securities Trading Activities: Brokerage, Dealing, Underwriting, Securities Management Activities, registered with the Ministry of Justice of Ukraine on January 23, 2007 #52/13319

- Resolution of the Securities and Stock Market State Commission #279 of June 8, 2004 On Approval of the Regulation on the Procedure of Preparing of Administrative Data Concerning the Activity of Securities Traders and Filing Relevant Documents with the Securities and Stock Market State Commission, registered with the Ministry of Justice of Ukraine September 9, 2004 #1122/9721

V: Depositories

- Law of Ukraine On the National Depository System and Specific Features of Electronic Circulation of Securities (1997);

- Resolution of the Securities and Stock Market State Commission #349 of May 26, 2006 On Approval of Licensing Conditions for the Exercise of the Professional Stock Market Activities Being Depository Activities, registered with the Ministry of Justice of Ukraine on August 11, 2006 #975/12849

- Resolution of the Securities and Stock Market State Commission #999 of October 17, 2006 On the approval of the Regulation on Depository Activities implemented, registered with the Ministry of Justice of Ukraine on November 27, 2006 #1238/13112

- Resolution of the Securities and Stock Market State Commission #1001 of October 17, 2006 On the approval of the Regulation on Settlement and Clearing Operations Under Securities Contracts, registered with the Ministry of Justice of Ukraine on November 13, 2006 #1198/13072

- Resolution of the Securities and Stock Market State Commission #371 of August 31, 2004 On the Approval of the Regulation On the Procedure of Compiling Administrative Data as to Depository Activities by a Securities Depository and Filing the Relevant Documents with the Securities and Stock Market State Commission, registered with the Ministry of Justice of Ukraine on 4 October 2004 #1253/9852

- Resolution of the Securities and Stock Market State Commission #278 of June 8, 2004 On the Approval of the Regulation on Compiling the Administrative Data on the Activities of the National Depository of Ukraine and on Filing the Corresponding Documents with the Securities and Stock Market State Commission, registered with the Ministry of Justice of Ukraine on November 24, 2004 #1490/10089

VI: Custodians

- Resolution of the Securities and Stock Market State Commission #4 of January 17, 2006 On approval of Regulation on the Procedure of Compiling the Administrative Data by the Depository Institutions Which Carry Out Depository Activity of a Securities Custodian, and Submission of Relevant Documents to the Securities and Stock Market State Commission, registered with the Ministry of Justice of Ukraine on April 4, 2006 #378/12252

VII: Registrars

- Resolution of State Securities and Stock Market Commission #348 of May 26, 2006 On Approval of Licensing Conditions For the Exercise of the Professional Stock Market Activities Being Depository Activities in the Form of the Maintenance of the Register of Holders of the registered Securities, registered with the Ministry of Justice of Ukraine on August 11, 2006 #973/12847

- Resolution of the State Commission on Securities and Stock Market #1000 of October 17, 2006 On approval of the Regulation on the Procedure of Record Keeping in the Registries of Holders of Registered Securities, registered with the Ministry of Justice of Ukraine on January 22, 2007 #49/13316

- Resolution of the State Commission on Securities and Stock Market #290 of June 24, 2003 On the Approval of the Regulation On Compiling Administrative Data as to Activities on Maintenance of the Registers of Holders of the Registered Securities and Filing the Relevant Documents with the Securities and Stock Market State Commission, registered with the Ministry of Justice of Ukraine on July 29, 2003 #655/7976

VIII: Collective Investment Institutions

- Law of Ukraine on Collective Investment Institutions (Share and Corporate Investment Funds) (of March 15, 2001)

- Decree of the President of Ukraine #55/94 of Feb. 19, 1994 On investment funds and investment companies

- Resolution of the Securities and Stock Market State Commission #341 of May 26, 2006 On approval of Licensing terms to engage in stock market professional activities – activities of institutional investors' assets management (asset management activities), registered with the Ministry of Justice of Ukraine on July 24, 2006 #864/12738

- Resolution of the Securities and Stock Market State Commission #1227 of Nov. 2, 2006 On Approval of the Policy On Specific Features of the Exercise of Institutional Investors' Asset Management Activities, registered with the Ministry of Justice of Ukraine on November 30, 2006 #1252/13126

- Resolution of the Securities and Stock Market State Commission #216 of August 1, 2002 On Approval of the Regulation On the Procedure of Filing Information Concerning Operating Results of Collective Investment Institutions (Unit and Corporate Investment Funds) by Asset Management Companies, registered with the Ministry of Justice of Ukraine on August 21, 2002 #697/6985

- Resolution of the Securities and Stock Market State Commission #520 of Oct. 4, 2005 On Approval of the Regulation On the Procedure of Filing Financial Results of Activity of Entities Providing Activity on Asset Management of Institutional Investors (Asset Management Activity), registered with the Ministry of Justice of Ukraine Oct. 27, 2005 #1273/11553

- Resolution of the Securities and Stock Market State Commission #104 of March 18, 2002 On Approval of the Regulation on the Procedure of Net Assets Valuation of Investment Funds and Mutual Funds of Investment Companies, registered at the Ministry of Justice of Ukraine on April 24, 2002 #392/6680

- Resolution of the Securities and Stock Market State Commission #12 of Jan.11, 2002 On Approval of the Regulation on the Composition and Structure of Assets of the Collective Investment Institution, registered at the Ministry of Justice of Ukraine on Feb. 06, 2002 #108/6396

- Resolution of the Securities and Stock Market State Commission #196 of July 2, 2002 On Approval of the Policy of the Structure and Size of Expenses to Be Reimbursed at the Expense of Assets of a Collective Investment Institute, registered with the Ministry of Justice of Ukraine on July 22, 2002 #600/6888

- Resolution of the Securities and Stock Market State Commission #201 on July 2, 2002 On Approval of the Regulation on the Procedure for Determining the Net Value of the Assets of the Collective Investment Institution (Share and Corporate Investment Funds), registered with the Ministry of Justice of Ukraine on July 24, 2002 #606/6894

- Resolution of the Securities and Stock Market State Commission #9 Jan. 8, 2002 On approval of the Regulation on the Procedure of Registration of Issue of Share Investment Fund Investment Certificates When the Certificates are Placed by the Way of Private Offer, registered at the Ministry of Justice of Ukraine on Jan. 29, 2002 #71/6359

- Resolution of the Securities and Stock Market State Commission #10 Jan. 8, 2002 On approval of the Regulation on the Procedure of Registration of Issue of Share Investment Fund Investment Certificates When the Certificates are Placed by the Way Public Offer, registered at the Ministry of Justice of Ukraine on Jan. 29, 2002 #72/6360

- Resolution of the Securities and Stock Market State Commission #1585 Dec. 21, 2006 On approval of the Regulation on the Procedure of Registration of Issue of Shares with the Purpose of Providing Activity on Collective Investment of Corporate Investment Fund, registered at the Ministry of Justice of Ukraine on Jan. 20, 2007 #46/13313

IX: Financial Instruments

- Law of Ukraine On Mortgage Bonds (of Dec. 22, 2005)

- Resolution of State Securities and Stock Market Commission #234 of 11.04.2006 Approval of the Procedure of the Registration of the Issue of Ordinary Mortgage Bonds, the Issue Prospectus, the Mortgage Bond Issue Outcome Report, the Redemption and the Reversal of the Registration of the Issue of Mortgage Bonds, registered with the Ministry of Justice of Ukraine on 26 June 2006 #746/12620

- Resolution of State Securities and Stock Market Commission #2009 of Oct. 9, 2007 On Approval of the Procedure And Conditions of Issue And Annulment of a Mortgage Cover Management Activities License, registered with the Ministry of Justice of Ukraine on Nov. 19, 2007 #1285/14552

X: SROs

- Draft Resolution of the Securities and Stock Market State Commission of Dec. 27, 2007 Regulation on Self-Regulatory Organizations of Stock Market Professional Participants

XI: Insurance

- Law of Ukraine On Insurance (1996)

- Resolution of the State Commission for Regulation of Financial Services # 40 of Aug 28, 2003 On approval of Licensing conditions for insurance activity, registered in the Ministry of Justice on Sept 15, 2003 # 805/8126

- Resolution of the State Commission for Regulation of Financial Services # 2875 of Nov 26, 2004 On approval of Rules for placing insurance reserves for life insurance, registered in the Ministry of Justice on Dec 22, 2004, # 1626/10225.

- Resolution of the State Commission for Regulation of Financial Services # 3104 of Dec 17, 2004 On approval of Rules for formation, accounting and placing insurance reserves for non-life insurance, registered in the Ministry of Justice on Jan 10, 2005 #19/10299

- Resolution of the State Commission for Regulation of Financial Services # 6817 of Feb 15, 2007 On approval of Regulation for publishing by information by insurers regarding insurance contracts, concluded in the system f non-state pension provision, registered in the Ministry of Justice on Mar 2, 2007 #179/13446

XII: Occupational pension funds

- Law of Ukraine On non-state pension provision (2003)

- Law of Ukraine On mandatory state pension insurance (2003)

- Resolution of the State Commission for Regulation of Financial Services # 424 of Apr 2, 2008 On approval of Procedure for calculation and accounting of profit (loss) from investing assets of non-state pension fund, registered in the Ministry of Justice on June 18, 2008 #540/15231

- Resolution of the State Commission for Regulation of Financial Services # 1100 of June 22, 2004, On approval of Regulation for providing reports on non-state provision of pensions by administrators of non-state pension funds, registered in the Ministry of Justice on July 19, 2004 # 898/9497

- Resolution of the State Commission for Regulation of Financial Services # 118 of Nov 13, 2003 On approval of Licensing conditions of administering non-state pension funds, registered in the Ministry of Justice on Jan 12, 2004

- Resolution of the State Commission for Regulation of Financial Services #3100 of Dec 16, 2004 On approval of Regulation for publishing of information on activity of a non-state pension fund, registered in the Ministry of Justice on Dec 30, 2004 # 1672/10271

XIII: Acquisition and increase of holdings in the financial sector

- Economic code of Ukraine (2003)

- Law of Ukraine On economic companies (1991)

- Law of Ukraine On Securities and Stock Market (2006)

- Law of Ukraine On Banks and banking Activities (2001)

- Law of Ukraine On Financial Services and State Regulation of Financial Services Markets (2001)

XIV: Financial conglomerates

- Law of Ukraine On industrial-financial groups (1995)

XV: Money laundering

- Law of Ukraine "On Preventing and Counteracting Legalization (Laundering) of Proceeds from Crime"

- Law of Ukraine "On Banks and banking Activities"

- Law of Ukraine "On Procedure for Settlement in Foreign Currency"

- Resolution of the Cabinet of Ministers "On System of Currency Regulation and Currency Control"

- Customs Code of Ukraine

- Law of Ukraine "On Insurance"

- Law of Ukraine "On Financial Services and State Regulation of Financial Services Markets"

- Guidelines on Procedure for Opening, Use and Closing of Accounts in the National and Foreign Currency, approved by Resolution #492 of the NBU Board dated November 12, 2003

- Regulations on Opening and Operating of Correspondent Accounts by Resident and Non-resident Banks in Foreign Currency and of Correspondent Accounts by Non-resident Banks in Hryvnia, approved by Resolution #118 of the NBU Board dated March 26, 1998

- Regulations on Procedure for Pay-card Issuance and Operations Therewith, approved by Resolution #137 of the NBU Board dated April 19, 2005

- Rules for Money Transfer by Natural Persons within and beyond Ukraine under Current Currency Non-trade Operations and Receipt of this Money in Ukraine, approved by Resolution #496 of the NBU Board dated December 29, 2007

- Guidelines on Inter-bank Money Transfer in Ukraine in the National Currency, approved by Resolution #320 of the NBU Board dated August 16, 2006

- Guidelines on Procedure for Organizing and Conducting Currency Exchange Operations in the Territory of Ukraine, approved by Resolution #502 of the NBU Board dated December 12, 2002

- Regulations on Conducting Transactions with Bank Metals by Authorized Banks, approved by Resolution #325 of the NBU Board dated August 6, 2003

- Guidelines on Transfer of Cash and Bank Metals via the Customs Border of Ukraine, approved by Resolution #148 of the NBU Board dated May 27, 2008

- Rules for Issuing to Authorized Banks of Individual Licenses for Export of Foreign Banknotes, Bank Metals and of Special Permits for Import of Foreign Banknotes, Blank Check Forms and Bank Metals, approved by Resolution #227 of the NBU Board dated July 9, 1997

- Regulations on Procedure for NBU Issuance of Individual Licenses for Residents' (Legal Entities and Natural Persons') Placement of Foreign Exchange Assets on Accounts outside Ukraine, approved by Resolution #485 of the NBU Board dated October 14, 2004.

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