



Technical Assistance Consultant's Report

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Kyrgyz Republic: Supporting Banking Sector and Capital Market Development (Financed by the Japan Special Fund)

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Asian Development Bank

INTRODUCTION AND BACKGROUND

1. This Report provides a summary and commentary of events that have occurred and actions that have been completed for the purpose of implementing TA Project 4747 - KGZ regarding the capital markets and the regulatory framework of the non-bank financial sector. It builds upon and, where necessary, reviews the events, issues and timing discussed in the Inception Report.¹

2. TA Project 4747 – KGZ: Supporting Banking and Capital Market Development is part of a program of technical assistance that the Asian Development Bank (ADB) agreed to provide to the Government of the Kyrgyz Republic in conjunction with an ADB Financial Sector Program Loan which is intended to promote the development of the banking and capital market sectors of the Kyrgyz Republic. In the capital markets sector, a major focus of the work carried out has been to strengthen the capacity of the Agency responsible for regulating and supervising the capital markets and non-bank financial sector, including the design and conduct of a training program taking into account international best practices in securities regulation and the preparation of a new “NBFSA Framework Law” intended to provide the regulator with sufficient powers, functions, responsibilities, and autonomy to perform its duties in line with international best practices.

3. Accordingly, the TA Project is intended in large part to provide policy guidance and assist the State Agency on Financial Supervision and Reporting (SAFSR) and its successor organization the Service on the Supervision and Regulation of the Financial Market (SSRFM) (collectively referred to as “the Service”) to achieve international best practices in the regulation of the capital markets and the non-bank financial sector and to create a more efficient and dynamic capital market under the reforms embodied in the policy matrix agreed under the lending program between the Government and the ADB.² In addition to providing policy, legal and technical advice to the new Service, the TA Project also contemplated providing advice to the Financial Sector Regulatory Working Commission (Regulatory Working Commission) and the Advisory Committee on Privatization through the Capital Market (ACPCM).

4. It should be noted that the Government has changed four times over the past twelve months. The current Government has been in place since May 2007. Further, the status of the Service was unclear and has changed on two occasions this year for a period of several months each time and even now all Members of the Executive Board of the Service, with the exception of the Chairman, serve on an acting basis only. In this regard, a Decree of the President dated 10 October 2007 changed the Chairman’s position from acting to permanent.

5. Further, it appears that the lack of continuity in the government apparatus and changes in staff assigned to perform specific functions related to the implementation of the policy matrix over the past year have hindered the ability of the Regulatory Working Commission and the ACPCM to function in an effective manner. It has also impacted upon the timing of implementation of the reform agenda with respect to the enactment of a new Law on the Securities Market and a new NBFSA Framework Law which is intended under the reform

¹ See: Inception Report for the Capital Market and Non-Bank Financial Sector, 21 April 2007.

² The policy matrix uses the term NBFSA, which stands for Non-Bank Financial Services Authority. This is essentially another name for SAFSR or the Service and the name used to designate the non-bank financial services regulator in Kyrgyz Republic.

agenda to codify the powers, functions and status of the regulator of the non-bank financial sector in line with international best practice. It is noteworthy that these two laws are at the heart of the policy and regulatory initiatives embodied in the reform agenda agreed between the Government and ADB and the TA Project.³

6. Under the TA Project, a Memorandum of Understanding (MOU) was prepared by the International and Domestic Team Leaders in September 2006 for consideration by the members of the Regulatory Working Commission. The proposed MOU is intended to define the powers, functions and operational procedures of the Regulatory Working Commission, the Secretariat and provide for the formation of working groups to carry out on-going activities, including the formulation of regulatory and supervisory policy by the Commission and implementation of decisions of the Commission with respect to such policy matters.⁴ We understand that the MOU is still under consideration by the members of the Regulatory Working Commission.

7. As noted in the Review Mission Report of 14 June 2007, the members of the Regulatory Working Commission have met only two times since its formation in April 2006 under Presidential Decree No. 163.⁵ This situation has impeded the work of the Consultants under the TA Project insofar as there has been no counterpart for the Consultants to liaise with on key aspect of the program.

8. In contrast, the Service carried out its mandate within the scope of the reform program embodied in the policy matrix and the TA Project subject to on-going legal and political constraints, including several changes to the legal status of the Service. In particular, the Chairman and members of the Service actively participated in the TA Project training programs and they were readily available to meet with the Consultants. The Chairman also chaired and actively participated in three high-level seminars which focused on the regulatory reform agenda and the proposed new Law on the Securities Market. Further, the Service (and SAFSR) established internal Working Groups within the Service to consider the proposed new Law on the Securities Market and the proposed NBFSA Framework Law.

9. Further, the Service (and SAFSR) relied upon an Expert Council which included representatives of the securities industry to provide valuable input and advice on the proposed new Law on the Securities Market (see discussion at paragraphs 74-83 below). Indeed, the Consultants were able to discuss the findings of the SAFSR Working Groups and the Expert Council with the Chairman of the Service and members of the Working Groups. The Domestic

³ In early May 2007, for example, the Domestic and International Team Leaders met with officials of the Government to attempt to determine the status of the draft Law on the Securities Market, which had been circulated and approved by the Government for submission to the Parliament. It was learned that although the Government had considered and approved the draft Securities Law, it could not be submitted to the Parliament at that time on procedural grounds. The delays in the enactment of a new Law on the Securities Market limited the advice that could be provided to the SAFSR and its successor organization related to the establishment of a national markets system or a unified stock exchange and the development and implementation of self regulatory programs since the regulator of the securities markets does not have the power to do so under existing law and the stock exchanges were not motivated to undertake such a commitment in the absence of a clear legal mandate.

⁴ It should be noted that in September 2006, a draft MOU was prepared under TA 4747: KGZ for consideration by the Regulatory Working Committee. It appears to be still under consideration but has not been signed. As discussed later in this report, a bi-lateral agreement between the Service and the National Bank Kyrgyz Republic (NBKR) on cooperation and information sharing was agreed and signed on 17 August 2007. It should be noted that a draft bilateral MOU was prepared by the International Team Leader under the TA Project in May 2007. At that time, the possible need for a tri-lateral agreement among the Service, NBKR and the Ministry of Finance (MOF) was also considered. However, because of the sensitivity of information sharing, it was felt that a separate MOU between members of the Regulatory Working Commission would be more appropriate.

⁵ See: Aide Memoire in respect of the Loan Review Mission dated 14 June 2007, at page 2.

Consultants have also been able to attend numerous meetings of the board of the Service (and SAFSR) at which substantive legal and regulatory matters were discussed. It is interesting to note, in this regard, that the domestic experts attended a meeting of the Board of the Service on 11 October 2007 where the proposed NBFSA Framework Law was formally discussed for the first time. In particular, the board focused on budget issues raised by the draft Framework Law in relation to the recently enacted Law on Inspections.

10. As discussed more fully below, the Service in one form or another has existed since the start-up of the TA Project. However, the status of the Service has changed several times during 2006 and 2007 as a result of re-organizations of the Government and the adoption of a new Constitution. These changes have affected not only the status of the Service but also its ability to have legislation introduced to the Parliament on a timely basis, in the form of the draft Law on the Securities Market and the draft Framework Law prepared under the TA Project. Further, the uncertainty surrounding the status of the Service has also impacted upon the ability of the Service to play a meaningful role in promoting structural and institutional reforms in the operation of the securities market.

Establishment of new Supervisory and Regulatory Agency

11. A new Agency to regulate the non-bank financial sector, called the State Agency on Financial Supervision and Reporting (SAFSR) was authorized by a Decree of the President of the Kyrgyz Republic (Presidential Decree No. 419) dated 30 September 2005. This was followed by a Regulation of the new Agency, which was approved by a Resolution of the Government (No. N 551) on 6 December 2005. Finally, the structure and staffing of the new Agency was approved by a Decree of the Prime Minister (No. 606) dated 14 December 2005.⁶ As discussed later in this report, decrees have also been enacted to establish a Regulatory Working Commission⁷ and the ACPCM⁸ as mandated by the policy matrix.

12. The first Board meeting of the Executive Committee of the SAFSR was held in January 2006. The SAFSR, and its successor organization the SSRFM (the Service), is governed by an Executive Committee (or Board) comprised of five members as follows: (i) Chairman; (ii) Deputy Chairman; (iii) Member -- Head of the Securities Markets Department; (iv) Member – Head of the Non-Bank Financial Institutions Department; (v) Member – Head of the Accounting and Audit Department. In addition to the five member Executive Committee, or Board, the Agency was authorized to have 90 professional staff at its head office and about 30 professional staff at regional locations.

13. The ADB's reform program, as set forth in the policy matrix, called for the establishment of a non-bank financial sector regulatory authority (NBFSA), or similar entity, to regulate the securities market, insurance sector, non-state private pension funds and other non-bank

⁶ Decree of the Prime Minister of Kyrgyz Republic, dated December 14, 2005 (N 606) – List of Members of the Staff of the State Agency on Financial supervision and Reporting under the Government of Kyrgyz Republic.

⁷ The policy matrix called upon the Government to strengthen coordination and cooperation among the existing regulatory and supervision bodies by establishing a financial sector Regulatory Working Commission with high level participation from the National Bank of Kyrgyz Republic (NBKR), the Ministry of Finance (MOF) and the new Agency for the Supervision of the Non-Bank Financial Sector (SAFSAR). Further, the proposed new Framework Law prepared by the Consultants under TA 4747: KGZ also embodies the concept of a Regulatory Council comprised of representatives of NBKR, MOF and the new agency for supervision of the non-bank financial sector.

⁸ The policy matrix called upon the Government to establish an Advisory Committee on Privatization through the Capital Market to, among other things, review the financial and ownership information to be provided for the enterprises considered for privatization and determine which enterprises are most suitable for a public offering of securities through the stock exchange.

financial activities. In the view of the Consultants, it will be important beyond the time frame of this TA Project to ensure that the powers, functions, responsibilities, governance and autonomy (including the authority to achieve self-funding⁹) of the Agency (Service) responsible for the supervision of the NBF sector are eventually codified in the envisioned Framework Law in line with international norms. Clearly, this is not the case at present and limits the current effectiveness of the Agency.

14. Interestingly, the enactment of the proposed NBFSA Framework Law is strongly supported by the World Bank – IMF Financial Sector Assessment Report of December 2006 for Kyrgyz Republic. The Team Leader had the occasion to meet with the World Bank's Team of Experts at the Service (i.e., successor agency to the SAFSR) in Bishkek on 4 April 2007. It was apparent from this meeting that the views of the World Bank Financial Sector Team were in substantial agreement with the reforms embodied in the ADB's policy matrix and in line with the views of the Team Leader under TA 4747: KGZ on the way forward to make the Service a more effective organization, including the need for further capacity building and the need to enact the proposed new Framework Law and a modern Securities Law in line with international best practices.

Change of name and status of the SAFSR

15. On 16 March 2007, the President of the Kyrgyz Republic issued a Decree concerning organizational measures for the structure of the Government of the Kyrgyz Republic. Under this Decree, which relates to 8 executive authorities of the Government, the name of the former State Agency on Financial Supervision and Reporting (SAFSR) was changed to the Service on Supervision and Regulation of the Financial Market (SSRFM) of the Kyrgyz Republic.

16. It is understood from the wording of the Presidential Decree that the SSRFM retains the same overall status¹⁰ as its predecessor and does not have any more operational independence or budgetary resources than the former SAFSR. This is notwithstanding efforts over the last 12 months by the former SAFSR to be upgraded to a National Agency as soon as possible¹¹. It is reasonably clear, therefore, that this Decree does not upgrade the status of the SSRFM to that of an agency with an appropriate degree of operational autonomy and budget resources to supervise the securities markets and intermediaries, as envisaged by ADB Program Loan policy matrix.

17. The legal status of the SSRFM has been clarified by an Implementing Regulation, which was implemented by Government Decree and came into force on 24 July 2007. Apart from this Implementing Regulation, it is also worth noting that Paragraph 8 of the Presidential Decree of 16 March 2007 requires a draft Law to be prepared for submission to the Government in relation to each of the executive authorities named in the Decree regulating their status, organization and activities. This requirement appears to lay the foundation for a framework law to be prepared of the type that has been developed under the current TA Project setting out the status, structure and powers of a single National Agency to Regulate and Supervise the Non-Bank

⁹ In this regard, it should be noted that the Agency collected fees from the registration of securities of about \$200 thousand in FY2006, whereas its approved annual budget is only about \$50 thousand. The excess goes to the government budget.

¹⁰ As a Service, it is understood that the Agency would have a little more practical independence than its predecessor, even though it is still technically under the Government. The Director of the former Agency will be known as Chairman of the new Service. The governing body will consist of five members including the Chairman.

¹¹ The SAFSR prepared a draft Decree with the assistance of ADB's Domestic Legal Experts that would allow the President to confer the status of a National Agency on the SAFSR.

Finance Sector (NBFSA Framework Law). Although the draft NBFSA Framework Law would confer on the current SSRFM the status of a National Agency with a high degree of operational and financial independence from the Government, it remains to be seen whether the Parliament will adopt a law which would confer such status on the SSRFM.

18. Further changes are contemplated in the near future which could further impact upon the status of the Service. In this regard, a referendum on a new Constitution is scheduled for 21 October 2007 which could affect the future status of the Service and other Government agencies. Until the referendum on the Constitution takes place, key provisions set forth in the draft NBFSA Framework Law cannot be finalized by the Service, since the referendum could impact upon the powers, governance, and autonomy of the Service or a similar entity contemplated under the draft NBFSA Framework Law. In other words, the final version of the proposed Framework Law must be consistent with the Constitution.

19. The lack of clarity in the status of the Service and its predecessor organizations has hindered its ability to implement policy changes with respect to the structure and operations of the securities market and to promote the enactment of appropriate legislation which would enhance its powers to do so. Accordingly, there is an urgent need to clarify the status of the Service in the form of a new Framework Law which would enable the Service, or similar entity to evolve into a state-of-the art non-bank financial services regulator. The Consultants believe that the status of the Service, or similar entity should be comparable to the National Bank Kyrgyz Republic, or similar to the FSA found in the United Kingdom or Kazakhstan¹².

20. A further decree affecting the status of the Service was enacted in April 2007, so as to require the Government (Cabinet) to approve Implementing Regulations drafted by the Service to clarify its powers and functions as the successor organization to the SAFSR. This resulted in the delay of several important matters, including the submission of the Law on the Securities Market and the Framework Law to the Government (Cabinet) and/or the Parliament for approval.

21. On the legal side, our work has built upon a revised draft Law on the Securities Market prepared in 2005 by the International Legal Expert under TA Project RSC – C51250 (KGZ). The revised draft Law was prepared with a view to making the current law more consistent with international best practice in securities market regulation, as reflected in the Principles of the International Organization of Securities Commissions (IOSCO). It is also designed to be consistent with the regulatory and capital market development reforms contained in the policy matrix. Finally, it should be noted that the Service (both in its form as the SAFSR and the SSRFM) and the former State Securities Commission of Kyrgyz Republic has given ample opportunity for the stock exchanges and other securities market participants to provide input into the drafting of the proposed new Securities Law at various stages over the past two years.

Implications for Regulatory and Capital Market Development Policy

22. Since many of the capital market development policy and regulatory initiatives contemplated under the program are contingent upon the adequacy of the Securities Law, the International and Domestic Team Leaders have spent a considerable amount of time working closely with the team's Legal Experts and the Service to ensure that the proposed revised draft Securities Law is consistent with the policy matrix and meets the development needs of the Kyrgyz capital market.

¹² Indeed, under the TA Project, ADB made it possible for officials of the Service to visit the FSA in both the United Kingdom and Kazakhstan.

23. The Domestic Team Leader and the Domestic Legal Experts of the TA Project have also made themselves available on several occasions to meet with staff and or/members of Parliament to explain the intricacies of the proposed new Law on the Securities Market. Thus, for example, as a follow-up to the 28 September 2007 high level roundtable discussions held in Bishkek on the draft Law on the Securities Market, the Domestic Legal Experts met with the Director and staff of the Budget and Finance Committee of the Parliament on 8 October 2007 to discuss the draft Law.

24. It is also noteworthy that the International and Domestic Team Leaders accompanied Director Toichubekov of the Service and two Members of Parliament, including the Deputy Speaker of the Parliament on a fact finding mission to Kazakhstan designed to gain a better understanding of the effects of recent amendments to the Kazakhstan Securities Law and to gain a first hand understanding of the operations of the Kazakhstan FSA. The Consultants believe that the on-site mission to Kazakhstan was able to demonstrate the importance of enacting a modern Securities Law in the Kyrgyz Republic to facilitate capital mobilization and economic development.

25. It should also be noted that the Domestic Team Leader and Domestic Legal Experts also organized a high-level seminar program at Lake Issyk-Kul to discuss the proposed draft Securities Law in mid-September 2006. This seminar was attended by senior staff and leadership of the then SAFSR, and staff of other Government ministries, the Office of the President, and the Parliament. The discussion proved useful in increasing understanding of the relevant parties to the key provisions of the proposed new Securities Law (See discussion of training and capacity building below).

Regulatory Working Commission and the ACPCM

26. To assist with implementation of the reform agenda, two Decrees of the President were drafted with the assistance of the Domestic Legal Experts under the TA Project to establish (1) the Financial Sector Regulatory Working Commission (Regulatory Commission) and (2) an Advisory Committee on Privatization through the Capital Market (ACPCM). Since their creation, however, the Regulatory Commission and the ACPCM have each had occasion to meet only twice. As noted, this has limited the effectiveness of both bodies.

27. As a result, the ADB Review Mission conducted from 7-14 June 2007, recommended that both bodies meet on a more frequent basis and more fully take on the functions contemplated in the policy matrix agreed between the Government and ADB. It was also recommended that appropriate working groups be organized to carry out the work of the two Commissions.¹³

28. The Consultants on several occasions have met with the staff experts of the Office of the President and the Office of the Prime Minister involved in policy initiatives related to the reform

¹³ It should be noted that under the TORs for the TA Project, the Team Leader is tasked with the duty to advise the Regulatory Working Commission and the ACPCM with respect to on-going activities. In this regard, the Team Leader has prepared a Memorandum of Understanding (September 2006) for consideration by the members of the Commission and a formal letter providing policy advice to the Chairman of the ACPCM with respect to the activities of the Commission. However, the MOU has not been agreed to by the members of the Commission. Further, the Chairman of the ACPCM was replaced shortly after the policy guidance was provided to the Chairman in the form of a letter dated

agenda, to discuss the potential role of the Regulatory Working Commission, the proposed MOU and the ACPCM.

Financial Sector Regulatory Working Commission

29. As noted, the policy matrix called for the creation of a Financial Sector Regulatory Working Commission (Regulatory Working Commission) to facilitate cooperation and coordination among financial sector regulators. As specified in the Decree of the President, the Commission is comprised of the Minister of Finance, Chairman of National Bank of Kyrgyz Republic (NBKR) and the Director of the SAFSR (now the Chairman of the Service), and, as ex-officio member, the Office of the President and the Office of Prime Minister.¹⁴

30. As envisioned by the policy matrix, the Regulatory Working Commission was to be administered by a Secretariat staffed and financed jointly by the Ministry of Finance and Economy, the NBKR and the SSRFM. The Secretariat was to have responsibility for supporting the activities of the Regulatory Commission in coordinating the Banking Sector and Capital Market Development Program, and to participate in the working groups established by the Regulatory Commission. While the Secretariat has functioned for a period of time, it has largely been inactive.

31. The main objectives of the establishment of the Regulatory Working Commission were to: (i) facilitate and coordinate the development, regulation and supervision of the financial sector; and (ii) act as a steering committee with respect to the implementation of the ADB reform agenda as set forth in the policy matrix agreed between the Government and the ADB.

32. The Secretariat¹⁵ to the Regulatory Commission is the entity responsible for submitting periodic, quarterly and final reports to the ADB on the various components of the Banking Sector and Capital Markets Program, as identified in the policy matrix. As noted in the Review Mission Report, it has not fulfilled this obligation.

¹⁴ See: Draft MOU prepared under TA 4747: KGZ. Under Section II entitled Membership of the Regulatory Council, Section 2.2.1 states that: "Two additional non-voting ex-officio members of the Regulatory Council may be appointed on a temporary or permanent basis to be comprised of a representative of the Office of the President (i.e., Head of Strategic Development Department) and a representative of the Office of the Prime Minister (i.e., Head of the Economic Development and Trade Department) of the Kyrgyz Republic."

¹⁵ Staff members who are assigned to the Secretariat remain employees of the Agencies represented on the Secretariat.

Memorandum(s) of Understanding

33. A second tranche loan condition requires that the regulatory bodies represented on the Regulatory Working Commission sign a Memorandum of Understanding (MOU) that outlines their cooperation and coordination in the areas of supervision and enforcement. Under the TA Project, two draft MOU(s) were prepared: (i) an MOU for the five members of the Regulatory Working Commission and (ii) a bilateral MOU covering information sharing arrangements and cooperation between the NBKR and the Service (Agency).

34. In preparing a draft MOU for consideration by the five members of the Regulatory Working Commission, the Consultants took into account the relevant provisions of the draft Framework Law describing the status, powers and functions of a Regulatory Council, as contemplated by the draft Law. This was intended to facilitate continuity between the work of the Regulatory Working Commission, which has already been established by Presidential Decree, and the provision for a Regulatory Council under the NBFSA Framework Law once adapted by Parliament.

35. Further, the MOU prepared for consideration by the Regulatory Working Commission contained a provision calling upon the NBKR and the Service to enter into a separate bilateral MOU on information sharing and mutual cooperation between the two respective agencies responsible for conducting the day to day regulation and supervision of the finance sector in Kyrgyz Republic. The bilateral MOU between the NBKR and the Service which was prepared by the Consultants in May 2006 was signed on 12 August 2007. It is expected to foster greater cooperation in the day to day supervision of the financial sector.

36. The main functions of the Regulatory Working Commission, as set forth in the draft MOU, are to be comparable to the envisioned Regulatory Council under the proposed Framework Law. Namely, the main functions would be to:

- (i) share information and views among its members, and conduct liaison with other relevant state agencies;
- (ii) identify important issues and trends in the finance sector, including the impact of economic and technological developments;
- (iii) develop policy proposals for the reform and development of the financial sector in Kyrgyz Republic;
- (iv) develop and review law reform proposals to improve and harmonize regulatory and reporting requirements applicable to finance sector participants, having regard to the need to make overall regulation and reporting more efficient, fair and effective;
- (v) facilitate the resolution of any issues resulting from the overlap of members' regulatory and supervisory responsibilities; and
- (vi) coordinate regulatory and supervisory responses of its members to actual and potential cases of financial instability and the enforcement of contracts involving international financial institutions.

37. As specified in the policy matrix, the Secretariat to the Regulatory Working Commission was expected to submit periodic quarterly and final reports, as appropriate, to the Asian Development Bank on the various components of the Banking Sector and Capital Market Development Program as identified in sections (I)-(III) of the Policy Matrix agreed between the Government of Kyrgyz Republic and ADB.

Advisory Committee on Privatization through the Capital Markets

38. A Decree on the establishment of an Advisory Committee on Privatization through the Capital Markets (ACPCM) has been signed by the President of the Kyrgyz Republic. However, there was some delay in reaching agreement on the content of the Decree to establish the Advisory Committee. As a result, it was not possible on the Inception for the Team Leader to meet with the Chairman or members of the ACPCM. Subsequently, however, the Domestic and International Team Leader met with the Chairman of the ACPCM and provided advice on the work of the Advisory Committee with respect to the reform agenda embodied in the policy matrix.

39. As set out in the policy matrix, the ACPCM is tasked with responsibility to: (i) consider the feasibility of requiring that the Government gradually reduce state holdings to less than 50 percent over a three to five year period for any non-strategic open or closed JSCs that have been profitable for two of the last three years, through sale to public shareholders via the stock exchange at prices reflecting their fair market value; and (ii) submit an interim report with recommendations within six months of the first meeting of the ACPCM and a final report within nine months, following an opportunity for formal public comment on the interim report.

40. Accordingly, the ACPCM was given the important task of reviewing financial and ownership information of the enterprises to be considered for privatization and to determine which enterprises are most suitable for a public offering of securities through the stock exchange. In this regard, it would seem that some of the larger enterprises with good governance and prospects in terms of future earnings may also be suitable for an international offering of securities and listing on an international financial center, such as the London Stock Exchange's Alternative Investment Market (AIM).

41. The Consultants met with and advised the Chairman of the ACPCM¹⁶ that the disclosure of basic financial and ownership information in an organized fashion would be useful to prospective investment bankers and others in considering which enterprises among those being considered for privatization are the most suitable for a public offering of securities, including:

- (i) name and location of the company;
- (ii) industry status;
- (iii) target date for potential privatization (if known);
- (iv) total assets;
- (v) total revenue (last fiscal year);
- (vi) shareholders' (owners') equity (total assets less total liabilities);
- (vii) net profit (loss) before taxes for the last three fiscal years;
- (viii) number of employees;
- (ix) bank loans outstanding;
- (x) loans or advances from the State or State controlled entities;
- (xi) ownership structure: (a) percent of company shares owned by the State;
(b) percent of shares owned by executives, managers and employees of the company; (c) percent of shares owned by other domestic persons or

¹⁶ See: Letter of Terry M. Chuppe, Team Leader, TA 4747: KGZ to Mr. Kumanbek M. Ukolov, Chairman of the ACPCM, dated 27 February 2007. The letter was follow up to a meeting with Mr. Ukolov requesting advice on matters related to the work of the Committee, including actions needed to facilitate an international offering of securities by a state-owned enterprise to be privatized.

- legal entities; (d) percent of shares owned by foreigners; and (e) listing or unlisted trading status;
- (xii) does the company comply with International Accounting Standards: Yes or No;
- (xiii) date of last external audit; and
- (xiv) name of the auditing firm.

42. It was also pointed out to the then Chairman of the ACPCM that the above, or similar information, should also be of use to a Committee, or subcommittees established as working groups to consider the feasibility of requiring that the Government gradually reduce state holdings to less than 50 percent over a three to five year period for any non-strategic open or joint stock company that has been profitable for two of the last three years by sale to public shareholders through the stock exchange at prices reflecting their fair market value. Moreover, basic financial and ownership information should be of value to the public in commenting on the interim report and final report of the ACPCM. In accordance with the policy matrix, it should be noted that the Government was expected to draft and submit to the Parliament a privatization program based upon the recommendations of the ACPCM.

43. The reports and recommendations of the ACPCM could also be expected to be of value in raising the interest of international investors and investment banks in considering potential companies for investment through an international offering of securities. In this regard, investment banks have expressed the need for reliable information in order to form a factual basis to determine their ability to participate in an international public offering of securities. Further, the quality of investor protection, as embodied in the Securities Law, and corporate governance practices in the country of a prospective issuer are of great interest to international investment banks and potential foreign investors. Likewise, the quality of regulation and clarity of the functions and powers of the regulator are of considerable importance to foreign investors and international investment banks, which must meet high fiduciary standards and practice due diligence in conducting fact finding and research in respect of a potential issuer of securities.¹⁷

44. Accordingly, it was pointed out to the ACPCM that further actions would be highly desirable over the near term, as provided for in the policy matrix, to build a stronger capital market and regulatory regime to enhance investor confidence and to facilitate privatization through the public offering of securities, including:

- (i) Enactment of the Framework Law substantially in the form drafted by the legal experts under TA 4747: KGZ to enhance the powers, functions, autonomy and independence of the regulator of the capital markets and non-bank financial sector in line with international best practices;
- (ii) Enactment of a new Law on the Securities Market that: (i) contains provisions which are substantially in compliance with the minimum principles developed by the International Organization of Securities Commissions (IOSCO); and (ii) contains a mandate for the establishment of an integrated national market system in securities (NMS) for at least all listed and most actively traded securities; and

¹⁷ The quality of the legal framework and regulation which form the basis for issuance of securities was emphasized during the London Study Tour fact finding mission sponsored by the ADB during the period 18-23 June 2007.

- (iii) Improve accounting, auditing and governance practices as applied to public companies, including joint stock companies with 500 or more shareholders, any company that has offered securities to the public, and other companies that provide financial services under a license issued by the Service (Agency).

45. Finally, the Consultants believe that, by working together, ACPCM and the Service would be able to develop a sound strategy to gradually reduce state holdings in joint stock companies through public share offerings in the capital market, both domestic and international. In this regard, the lessons learned on the London study tour fact finding mission could be applied to the work of the ACPCM, so as to facilitate due diligence requirements of investment bankers. However, the pace of actions and reforms needed to move forward has been slow to date. In this regard, it was noted in the Review Mission Report of 14 June 2007 that a privatization report was submitted by the Government to the Parliament without inputs from the ACPCM.

Capital Market Development Policy and Strategy

Achieving a National Market System

46. In June 2006, at the request of the Member-Director of the Securities Division of the Service, the Team Leader provided advice and prepared a strategy on the development of the capital market, including actions needed to achieve the envisioned National Market System (NMS) in securities, as called for in the policy matrix.¹⁸ The capital market development strategy was considered a long-term process taking into account that the powers of SAFSR were weak under the existing Securities Law and that a new Law on the Securities Market would be needed in order to provide the regulator with a clear mandate to establish a national market in securities, which could link the existing three stock exchanges into a single market (in the absence of reaching agreement to establish a single unified stock exchange). It should be noted that the Team Leader advised the SAFSR that Kyrgyz Republic was too small to support the operation of three stock exchanges, some of which do not appear to function as full fledged stock exchanges but merely as trading platforms for conducting securities transactions on a fragmented basis which limits the ability of the securities markets to foster price discovery in a transparent and efficient manner..

47. Such a capital market might be comprised of a single national stock exchange and securities depository with adequate provision for access by non-members; or, alternatively, a national market system (NMS) comprised of one or more stock exchanges and/or trading platforms linked together to achieve a unified securities market with transparent pricing and adequate safeguards for the protection of investors. In order to provide a sound legal basis for achievement of the reform agenda, it is critical that the final draft Law on the Securities Market contains an adequate mandate for the establishment of an NMS, or similar entity.¹⁹

48. In terms of achieving the envisioned NMS, the most important next step will be for the Parliament to enact a new Securities Law containing a mandate for the NMS. The policy matrix also envisions that the SAFSR, or its successor organization, will hold hearings or round table

¹⁸ See: Capital Market Development Strategy for Kyrgyz Republic, which was prepared by Consultant Terry M. Chuppe, Team Leader under TA4747: KGZ, June 2006.

¹⁹ The exact structure of the market could be determined largely by competitive forces within the mandate of the Law. However, differences in the economic functions performed by various categories of securities market professionals including broker, dealer, underwriter, stock exchange, and or other types of trading platforms should be clearly recognized.

discussions on the establishment of the NMS. This could be done within 60 days of enactment of a Securities Law containing such a mandate. An Expert Working Group should also be organized to assist in the deliberations. The Expert Working Group on the Establishment of the National Market System and Related Regulatory Policy Matters should be chaired by the Member – Head of the Securities Division of the Service – to develop an appropriate strategy and proposed rules to achieve this objective. In this regard, the NMS strategy could build upon the capital market development strategy of the SAFSR which was prepared with the aid of ADB technical assistance under the TA Project in June 2006. One of the most important objectives of the envisioned NMS, or a unified securities exchange, would be to reduce the harmful effects of market fragmentation.

Secondary Market in Government Securities

49. The Team Leader under TA 4747: KGZ recognized that the time might be right to consider the feasibility of including treasury bills and government bonds in a stock exchange trading market environment. Further, the Consultants recognized the importance of properly defining Exempt Securities (i.e., treasury bills and government bonds) under the proposed Law on the Securities Market and the need for proper regulation and supervision of secondary market trading. Finally, it should be noted that the capital market strategy prepared for the SAFSR following the Inception Mission recognized the importance of achieving a critical mass of securities and investment products, including Government securities and investment funds in the Kyrgyz capital market.

50. Accordingly, the Team Leader with ADB concurrence participated in a training workshop sponsored by the Division of Debt Management of the MOF and the European Union on Government securities and debt management. In May 2006, the Team Leader also participated as a speaker in a similar seminar sponsored by the MOF and EU. In September 2006, the Team Leader also gave a presentation on Capital Market Development and Securities Markets Regulatory Reform at a Regional Seminar on Debt Management and Government Securities Markets sponsored by the MOF and the International Monetary Fund (IMF). This presentation followed by one day the high-level seminar on the proposed new Securities Law sponsored by ADB and SAFSR at Lake Issyk-Kul. In this regard, it is also noteworthy that the Domestic Team Leader participated in the joint MOF-IMF Regional Seminar at Lake Issyk-Kul.

51. In relation to the trading of Government Securities on a stock exchange, a Memorandum of Understanding was signed by the NBKR, the Kyrgyz Stock Exchange, and the Service which would permit pilot trading to take place on the stock exchange. However, trading has not yet begun. This might reflect the high concentration of government securities holdings in a few commercial banks which would limit the ability for trading in the secondary market. By contrast, it should be noted that there is active secondary market trading and a REPO market in government securities on the Kazakhstan Stock Exchange.

Capacity Building – Training Seminars and Study Tours

Training Workshops and Seminars

52. Building capacity through training is an important part of the Consultants' TORs under the TA Project. Accordingly, the International Team Leader in cooperation with the other team members designed a training program consisting of twelve workshops and seminars to enhance capacity in the regulation and supervision of the securities market and intermediaries. The training program was designed by the entire consultant team over a period of several weeks

following the conduct of interviews of the staff of the Securities Division to determine skill levels and experience and to gain input from the staff on their perception of future training needs. In particular, the International and Domestic Legal Experts made a significant contribution to designing training programs that took into account the best practice principles of the International Organization of Securities Commissions (IOSCO) and through the conduct of training workshops on legal, regulatory and enforcement issues for the management and staff of the Service.

53. It became clear in the early stages of the TA Project that significant capacity building was needed both in terms of international best practices but also with respect to the regulatory policy considerations underlying the draft Law on the Securities Market. The seminars related to the draft Securities Law not only provided valuable training with respect to best practice in designing a modern securities law but also provided valuable opportunities to gain feedback on the content of the draft Law from the management and staff engaged in the design and implementation of regulations governing the supervision of the securities markets and intermediaries. On this basis, it was agreed that the Legal Experts would conduct seminars on the regulation and supervision of securities markets, including the public offerings of securities under the draft Law on the Securities Market and a seminar on IOSCO principles of compliance and enforcement.

54. Accordingly, the Domestic and International Legal Experts played a leading role in the design and conduct of the Workshop at Lake Issyk-Kul in June 2006, during which the Experts made a number of presentations on international best practice principles of regulating public offerings of securities, as well as the current and proposed regulation of such activities under Kyrgyz law. These presentations generated considerable discussion, with the result that some staff of the Agency and securities industry participants became more receptive to the reforms proposed in this area under the draft revised Law on the Securities Market. Since the International Legal Expert did not participate in the mission in September/October 2006, the conduct of the seminar on compliance and enforcement was deferred until March/April 2007. During this mission, the Domestic and International Legal Experts conducted a combined seminar on the topic of IOSCO Principles of Compliance and Enforcement and the proposed NBFSF Framework Law.

55. The training program consisted of both high level training conferences designed for senior staff of SAFSR, other government ministries, and private sector officials from stock exchanges and securities market intermediaries involved in policy formulation and decision making. The seminars conducted at SAFSR were intended to serve the needs of the legal, regulatory and supervision staff. Since a new Securities Law was in the process of being drafted, the Consultants felt it was very important to conduct training on how the draft new law differs from the existing securities law and how it would, if enacted, impact upon the current regulation and supervision approaches of the SAFSR (Service). As noted, throughout the training program, considerable emphasis was placed on international best practices in securities regulation, compliance and enforcement as defined under IOSCO Best Practices of Securities Regulation. In view of the importance of accounting, auditing and financial statement analysis to both the supervision of securities market intermediaries and the regulation of public companies, these topics were also included in the training program.

56. Under the TA Project, the following training workshops, seminars and round table discussions were conducted on securities regulation, supervision and enforcement topics:

- (i) Two day high level workshop at Lake Issyk-kul on the regulation of the public offering of securities and related topics (23-24 June 2006)
- Regulation of public offerings of securities;
 - International best practices in regulating public offerings of securities;
 - Current legal framework for regulation of public offerings of securities in Kyrgyz Republic;
 - Increasing supply and demand for securities;
 - Role of the investment banker in underwriting and distribution of securities – international practices;
 - Public offering process: case study – Kyrgyzstan;
 - Public offering process: case study – Australia;
 - Accounting and audit standards for companies with public shareholders;
 - Public offerings of government securities in Kyrgyz Republic;
 - Improving the legal basis for public offerings of securities in Kyrgyz Republic; and
 - Panel discussion of legal and regulatory reforms under the proposed new Securities law.
- (ii) A two day high level workshop and round table discussion was held at Lake Issyk-Kul on the content of the proposed new Securities Law for Kyrgyz Republic and the rationale for modernizing the law (11-12 September 2006). This workshop was a hands-on working session designed for top-level policy makers and officials of SAFSR which considered the major provisions of the revised draft Law on Securities Markets. It also highlighted how the new draft Securities Law differs from the existing law and the reasons for change. The roundtable discussion was chaired by Director Toichubekov of SAFSR and Terry M. Chuppe, International Team Leader under ADB TA 4747: KGZ. Mr. Shamshien, Head of the Securities Division and member of the SAFSR Executive Board and the Domestic Legal Experts under TA 4747:KGZ gave substantive presentations on the new Securities Law.
- (iii) SAFSR (Service) Training seminar on the development and regulation of the securities market under the ADB regulatory reform program (September 2006);
- (iv) SAFSR (Service) Training seminar on the legal basis for regulation under the existing Securities Law of Kyrgyz Republic (October 2006);
- (v) SAFSR (Service) Training seminar on the content of the proposed new securities law and the rationale for changing the law (October 2006);
- (vi) SAFSR (Service) Training seminar on Introduction to International Financial Reporting Standards (November 2006);
- (vii) SAFSR (Service) Training seminar on Introduction of International Auditing Standards (November 2006);
- (viii) SAFSR (Service) Training seminar on Financial Statement Analysis (November 2006);
- (ix) SAFSR (Service) Training seminar on Compliance and Enforcement of the Securities Law – an international perspective (April 2007); and

- (x) One day high level seminar and round table discussion conducted at the Holiday Hotel in Bishkek on 28 September 2007 on the draft Law on the Securities Market and the capital markets policy reform agenda. The seminar was chaired by Director Toichubebov and included a presentation by Mr. Jurgen Conrad, Senior Economist of ADB on issues related to capital market development within the Asia region and a presentation by the Team Leader of the TA Project which focused on the ADB's policy reform agenda for Kyrgyz Republic. Interestingly, the presentations by the Domestic Legal Experts on the proposed new Law on the Securities Market heightened the interest of the staff of the Budget and Finance Committee of the Parliament for follow-up meetings on the proposed new securities law.²⁰

57. Finally, a training workshop on supervision of securities broker-dealer intermediaries will be conducted for the management and staff of the Service on 24 October 2007. This workshop will form the basis for amending policy and procedures of the Service in respect of supervision practices (i.e., on-site inspections and off-site monitoring) taking into account the new Law on Inspections which came into force in September 2007 and the international best practices embodied in the draft Law on Securities Markets and the draft Framework Law. The workshop will be conducted by the International Team Leader and the Domestic Legal Experts and will include a discussion of the new Regulation on conduct of inspections by the Service which has been drafted by the Domestic Legal Experts to conform to the powers granted to the Service under the new Law on Inspections which came into force in September 2007. It should be noted that the seminar will build upon the earlier seminar of the Legal Experts on compliance and enforcement, which are important components of a comprehensive supervision program.

Specialized Training Program on Accounting and Audit Practices

58. In addition to the basic training provided on accounting and auditing in the above program, the Domestic Accounting Expert also provided in-depth training for the staff of the Accounting and Audit Division and for selected enterprises that are in the process of implementing international accounting standards. This training also included preparation and distribution of manuals on accounting and auditing best practices.

Missions to Kazakhstan on Securities Markets Development and Regulation

59. Two fact finding missions to Kazakhstan were conducted under TA 4747: KGZ. The visits to Kazakhstan included meetings with the Kazakhstan Financial Services Authority (KFSA) and the Kazakhstan Stock Exchange. The first fact finding mission to Kazakhstan focused on learning first hand about the lessons to be learned from that country's experience in developing its capital market and establishing a Financial Services Authority. The second visit was for the benefit of members of Parliament of Kyrgyz Republic. Both visits were productive in that the Kazakhstan FSA (KFSA) and the financial community displayed a strong interest in providing valuable information and insights into securities market development and regulation. It seems safe to say that the practical experience gained through the visits to Kazakhstan has had some effect in promoting consideration of the proposed new Securities Law within the Kyrgyz Government and its introduction to Parliament.

²⁰ At the request of the Division of Finance and Budget of the Parliament, a follow-up meeting was held with the Domestic Legal Experts on 8 October 2007. It is expected that additional meetings will be held from time-to-time to facilitate consideration of the proposed Law on Securities Markets by the Parliament.

60. During the visits to Kazakhstan, KFSA officials pointed out that considerable effort had been made in recent years to modernize the securities market and its regulation in Kazakhstan, including the corporate governance practices of public joint stock companies and smaller companies. It was clear from the presentations made that Kazakhstan has made considerably more progress with its legal and regulatory reform agenda than the Kyrgyz Republic²¹ has made with its own reform agenda in the financial services arena. In this regard, it was pointed out that at one time Kazakhstan had three stock exchanges, but that it has now evolved into a single securities market with one stock exchange offering a variety of financial products and instruments, including a secondary market in Government securities and repurchase agreements traded on the Kazakhstan Stock Exchange. It is interesting to note that the Kazakhstan Stock Exchange has a 25 percent ownership interest in the Kyrgyz Stock Exchange

Study Tour of UK Capital Markets and Financial Services Regulation

61. The Study Tour to London was intended to help build capacity by increasing the knowledge and understanding of senior staff of the Service about the practical aspects of regulating and supervising the non-bank financial sector and capital markets. It was also intended to enable them to learn first hand about the functions and operations of financial intermediaries such as investment banks and their roles in the public offering of securities, including the prospects for an international offering of shares of a Kyrgyz Republic or a Government debt instrument. In this regard, it should be noted that the Kyrgyz Republic does not currently have a full service investment bank and only limited experience in the underwriting of securities. In addition, until now there have not been any international offerings of securities by private issuers or former state-owned enterprises.

62. Accordingly, the main objectives of the visit to London were to:

- (i) Learn first hand about the operation of the U.K. Financial Services Authority (FSA), including governance, rule making, and self-funding arrangements;
- (ii) Establish a basis for future cooperation with the UK's FSA, including possible training and/or internships for Agency staff member(s) in the area of regulation and supervision; and discuss possible future protocol arrangement with the UK's FSA to enhance cooperation and understanding;
- (iii) Learn about the operation of the London Stock Exchange's Alternative Investment Market (AIM) and issues related to capital raising through the initial public offering of securities (IPOs) and the listing of companies from emerging securities markets on AIM, based in part on the recent experience of companies from Kazakhstan and Russia; listing standards and corporate governance requirements; locating a listing sponsor; and gauging investor demand;
- (iv) Meet with UK experts on the conduct of the financial services business, especially in respect of corporate finance, investment banking services and fund management;

²¹ It is perhaps noteworthy that one of the Members of Parliament who participated in the fact finding mission to Kazakhstan has introduced legislation to modernize the Securities Law of Kyrgyz Republic based at least in part on the important legal work undertaken with the support of TA 4747: KGZ.

- (v) Study the role of the international securities lawyer and other securities market professionals in the public offering of securities; meeting listing standards and corporate governance practices; due diligence; special considerations with respect to the privatization of SOEs; use of Rule 144A and similar arrangements; international debt securities offerings; credit ratings and shelf-registration procedures;
- (vi) Learn first hand about the application of international accounting standards (IFRS) and corporate governance practices with respect to listed companies and others; the application of such standards and best practices standards to companies from emerging securities markets, especially in respect of companies seeking a international listing on the LSE, or the Alternative Investment Market (AIM).

63. The members of the study tour fact finding mission were well received in London.²² The fact finding mission included visits to four leading international investment banks, the London Stock Exchange, the UK Financial Services Authority, an international credit rating agency, an international law firm with experience in Central Asia and other participants in the financial services markets. It should be noted that the Kyrgyz Ambassador to London and the staff of the Kyrgyz Embassy displayed a keen interest in the work of the study tour fact finding mission. It should also be noted that the Embassy staff attended several of the meetings with London capital market institutions. Further, the Embassy staff were of great assistance in arranging appropriate meetings and making the Study Tour a success.

64. It is expected that the study tour fact finding mission to London will have long-term favorable impact on the Kyrgyz Republic in the event that the legal and regulatory framework for the country are improved in line with international best practice. In particular, it can be expected to increase the prospects for raising capital in London's international capital market and in attracting foreign participation in the Kyrgyz capital market. Further, the meeting with the UK FSA also helped participants in the study tour gain a better understanding of international best practice in financial services regulation and the importance of sound regulatory practices to capital formation. It also displayed the importance of the capital market and the financial services sector in the growth and development of London and in making the City of London an attractive location to conduct the international financial services business. Further, the Study Tour helped reinforce the importance of the ADB's reform agenda, including the importance of a modern Securities Law to investment banks and others contemplating doing business in the Kyrgyz Republic, or assisting in the raising of capital through an international public offering of securities.

Work of the Legal Experts

65. Following the Inception Mission for TA Project 4747 – KGZ, the International Legal Expert conducted a review of the revised draft Law on Securities Markets, which had been prepared by a Working Group of local experts, including the TA Project Domestic Legal Experts, appointed by the State Agency on Financial Supervision and Reporting (SAFSR) to review and customize the initial draft Law prepared by the International Legal Expert. The International Legal Expert subsequently returned to Bishkek from 18 June to 8 July 2006 to work with the Team Leader and Domestic Legal Experts on the TA Project. During this time, the Team Leader and the International and Domestic Legal Experts participated in a two day Workshop on Public

²² See: Report of Mr. Almaz Sarybev, the Domestic Team Leader under TA 4774: KGZ to Jurgen Conrad, Senior Economist and Task Manager under TA 4747: KGZ.

Securities Offerings, which was held at Lake Issyk-Kul. The Legal Experts gave presentations and participated in discussions on the principles underlying the draft revised Law on Securities Markets. They also conducted preparatory work on a Framework Law to set out the structure, powers and functions of a National Agency for regulating and supervising the Non-Bank Finance Sector (NBFSA Framework Law).

66. Following this Mission, the International Legal Expert spent home office time preparing a draft of the proposed NBFSA Framework Law and an accompanying explanatory memorandum. This draft was transmitted to Bishkek in mid-August 2006 for translation into Russian prior to a proposed third visit to Bishkek by the International Legal Expert from 17 September to 14 October 2006. The International Legal Expert also prepared slides for a compliance and enforcement seminar, to be conducted on this visit. It should be noted that the International Legal Expert postponed his third visit due to security concerns in Bishkek. During this time period, the International Team Leader who was already in the field participated with the Domestic Legal Experts in a high level seminar at Lake Issyk-Kul to discuss the revised draft Law on Securities Markets.

67. Following discussion with the Team Leader and the Domestic Legal Experts, it was agreed that the International Legal Expert would re-schedule his next visit for March/April 2007. The Domestic Legal Experts, in particular, felt that this would be an appropriate time to discuss issues related to the progress and finalization of the draft Law on the Securities Market for submission to Parliament, taking into account ongoing developments in the review and finalization of the draft Law by the SAFSR and discussions at the Lake Issyk-Kul seminar on the revised draft Securities Law.

68. Accordingly, the International Legal Expert conducted a third visit to Bishkek from 21 March to 8 April 2007. Immediately prior to this visit, the International Legal Expert conducted a review of the current version of the draft revised Law on the Securities Market and recommended amendments to improve clarity and the realization of the objectives of the draft Law. It also emerged from these discussions that the current draft Law had been returned to the former SAFSR (see below) in February 2007, pending clarification of the legal status of the SAFSR, following changes to the Government in December 2006. During this visit, the International Legal Expert also spent time with the Team Leader and Domestic Legal Experts reviewing outstanding issues with respect to the draft revised Law on the Securities Market. A discussion of the current status of the draft Law and the major issues that have affected the finalization of the draft Law are set out below. The ability of the draft Law to meet the relevant conditions of the First Tranche conditions of the Program Loan is also discussed.

69. Apart from discussions on the draft revised Law on the Securities Market, the International Legal Expert spent time on the third visit discussing progress on the development of the NBFSA Framework Law and its relationship to the draft revised Law on the Securities Market. The Expert also participated with the Domestic Legal Experts in conducting a seminar for staff of the Service on international principles of compliance and enforcement in respect of securities regulation. During this visit, the Legal Experts also spent time discussing and identifying the normative legal acts (regulations, procedures etc.) that would need to be reviewed, replaced or added to give effect to the draft Law on Securities Markets once it is adopted by the Parliament.

70. It is important to note that the two Domestic Legal Experts have spent considerable time over the period of the Project assisting the SAFSR, its successor the Service and their Working Groups (including the Expert Council of industry representatives which reports to the Agency)

review and understand the objectives of the draft revised Law on the Securities Market. This has often required them to explain and defend the relevant international best practice principles contained in the draft Law. The International Legal Expert has provided support during this period by email and telephone, where clarification of the wording or intention of the draft Law was necessary.

71. The International Legal Expert joined the International Team Leader and Domestic Experts in Bishkek for his final visit under the TA Project from 24 September to 12 October 2007. The main purpose of this visit was to assist the Project Team review progress with the implementation of the Project TORs and discuss and agree on further legal work²³ that the Domestic Legal Experts could usefully carry out before the official end of the Project and beyond.

Draft revised Law on the Securities Market

72. Following the preparation in June and July 2005 of a draft revised Law on the Securities Market²⁴ for consideration by the then State Commission on Securities Markets (SCSM), a Russian language version of the draft Securities Law was, as noted above, discussed at a high level stakeholder seminar conducted by the SCSM at Lake Issyk-Kul in September 2005. Following this seminar, a revised version of the draft Law was prepared by a Working Group established by the SCSM (SCSM Working Group)²⁵ taking into account views expressed by stakeholders of the draft Law. Apart from having the opportunity to express their views at the Lake Issyk-Kul seminar, professional participants of the securities market had the opportunity to make their views known through the Expert Council under the SCSM, which discussed the draft Law at its meeting in November 2005 and also through their professional association, which discussed the draft Law following the Lake Issyk-Kul seminar.

73. Following the finalization of the draft revised Law by the SCSM Working Group, it was provided to the Ministry of Justice for review. After this review and the amendment of the draft Law to take its findings into account, it was expected that the draft Law would be submitted to the Government for consideration, with a view to being submitted to Parliament.

74. During the Inception Mission for TA Project 4747-KGZ, the Domestic Legal Experts provided a briefing for the International Experts about the approach taken by the SCSM Working Group to reviewing and modifying the ADB sponsored draft revised Law on the Securities Market to better suit local conditions. As a result of a review of this draft revised Law undertaken by the International Legal Expert following the Inception Mission, it was apparent that the SCSM Working Group had considerably modified the original draft Law, to the extent that it would not meet the international best practice requirements of the TA Project TORs or the relevant condition of the ADB Program Loan First Tranche Conditions.

²³ The four items agreed were (i) Working with the Experts of the Parliamentary Finance and Budget Committee to understand the draft Law on the Securities Market; (ii) Working with the Board Members and Staff of the Service on Supervision and Regulation of the Financial Market (SSRFM) to understand and approve the draft NBFSA Framework Law for submission to Parliament; (iii) Assisting the International Team Leader to prepare and conduct a Seminar on Supervision of the Securities Market and Financial Intermediaries (i.e. securities firms); and (iv) Working with the SSRFM to finalize and adopt a Regulation to implement the Law on Inspections in respect of the activities of the SSRFM.

²⁴ This draft was prepared under ADB TA Project RSC – C51250 (KGZ): Securities Market Development.

²⁵ The SCSM Working Group, which was chaired by Mr. Alexander Zulzasky, a Director of the SCSM at the time, comprised 9 members, including 4 ADB appointed experts, 3 State Commission legal staff and a representative of the stock exchanges of Kyrgyz Republic.

75. Further discussions on the draft revised Securities Law took place during the second visit of the International Legal Expert from 18 June to 8 July 2006, including a workshop on the international principles of public securities offerings which was conducted at Lake Issyk-Kul in late June 2006. This was followed in mid-September 2006 by the high-level seminar on the draft Securities Law conducted at Lake-Issyk-Kul for Executive Board members of SAFSR, senior staff of SAFSR and other government ministries, members of the Parliament and their staff. The seminar, which was chaired by Director Toichubekov and the International Team Leader, was lively and well informed. Nevertheless, some issues of importance remained unresolved. Accordingly, SAFSR resolved in October 2006 to convene a new Working Group of experts to further review the draft Law on the Securities Market. The new Working Group of experts agreed to re-instate a number of provisions that had been omitted from the previous draft Law. At the same time, it was agreed that the draft Law should incorporate some new provisions, for example, to allow all issues and offerings of securities (including private issues and offerings) to be registered with the SAFSR.

76. The SAFSR Working Group completed a fifth draft of the revised Law on the Securities Market by the end of 2006. This draft was sent to the Prime Minister's Office, which returned the draft to the SAFSR in mid February 2007. This was due to the fact that the SAFSR had lost its legal status, following changes to the Government and the office of Prime Minister. In view of the time that was expected to elapse between this act and the new legal recognition of the SAFSR, it was decided by the Executive Board of the former SAFSR to circulate the revised draft Law to the Expert Council under the former SAFSR for consideration. The Expert Council in turn invited professional participants to submit any comments on the draft revised Law by 26 March 2007. As a result, written comments were received from the Kyrgyz Stock Exchange, Central Asian Stock Exchange and one stock broking firm. In addition to these comments, the former SAFSR Executive Board had received detailed comments from its own Securities Department.

77. The International Legal Expert and the International Team Leader met with the Domestic Legal Experts to discuss the main comments received by the former SAFSR in late March 2007. After reaching a consensus on what comments should be taken into account, for the purpose of making further amendments to the draft revised Law, it was resolved to discuss the main points with the Director of the former SAFSR with a view to finalizing a draft of the revised Law for presentation to Parliament.

78. At a meeting with Chairman Toychubekov of the former SAFSR (by this time known as the Service on the Supervision and Regulation of the Financial Market) on 28 March 2007, the Director advised that it had been resolved that a Member of Parliament would sponsor the draft Law in the Parliament and submit it to the Parliament for consideration as soon as possible²⁶. This approach would obviate the need for the Agency to re-submit the draft Law to the Government for introduction into the Parliament and to navigate the delays and uncertainties of the usual ministerial and public consultation process before the Government could introduce a Bill into the Parliament.

79. At the time of writing this Report, the draft Law was still waiting to be submitted to the appropriate Committee of the Parliament by the sponsoring Deputy of the Parliament. This

²⁶ The Chairman of the SSRFM arranged for the final version of the draft revised Law on the Securities Market (in Russian) to be submitted to the sponsoring Member of Parliament on 3 April 2007 for submission to Parliament. Upon submission to the Parliament, the draft Law will need to be translated into Kyrgyz for consideration by the relevant committees of the Parliament.

delay is unfortunately not unique to this particular proposed law in that there are currently delays in the consideration by Parliament of more than 120 other draft laws or bills. This has been precipitated by the constitutional crisis which has unfolded in Kyrgyz Republic over the preceding 12 months. This situation has seen four Governments since October 2006, including three changes of Government in November 2006, February 2007 and April 2007. Consideration of the legislative program before the Parliament, including the introduction and consideration of the draft Law on the Securities Market, has apparently been deferred pending the outcome of a referendum on the Constitution, which is due to take place on 21 October 2007.

80. The outcome of this referendum will determine the respective roles of the Executive and Legislative branches of Government. In the context of the draft NBFSA Framework Law, it will also determine whether such a supervisory agency can be in the form of a National Agency that reports directly to the President, as permitted under the revived 2003 Constitution, or whether it must report to the Government, as permitted by the now invalidated 2006 Constitution. Depending on the outcome of the referendum, it is also possible that there may be a new parliamentary election before the end of 2007, further prolonging the uncertainty currently surrounding legislative reforms of all kinds.

81. The draft Law on the Securities Market is pending in Parliament. However, it will need to be discussed by various Committees of the Parliament, including the Financial and Budget Committee of the Parliament, and then debated in the Parliament. In this way, the draft Law will be further exposed to public scrutiny. To facilitate discussions, the Domestic Legal Experts have prepared briefing materials for the benefit of Members of Parliament and their staffs and the relevant Parliamentary Committee. The Domestic Team Leader and Legal Experts have made themselves available to staff and Members of Parliament to answer questions about the revised Draft Securities Law, as appropriate. In this regard, it should be noted that a staff member of the Parliament who attended the 28 September 2007 high level seminar at the Holiday Hotel requested a follow-up meeting with the domestic Legal Experts to receive a more in-depth briefing on the Law and Securities Markets. As noted earlier, a follow-up meeting was held on 8 October 2007 with the Director and staff of the Budget and Finance Committee of the Parliament.

Policy matrix legal conditions

82. Under the Policy Matrix for the current ADB Finance Sector Program Loan to Kyrgyz Republic, the former SAFSR was required to submit to the Government of Kyrgyz Republic by September 2006 a draft revised Law on the Securities Market which is substantially in compliance with minimum IOSCO best practice principles of regulation and supervision of securities markets and contains a mandate for the establishment of an integrated national market system. This first tranche condition is supported by a second tranche condition that the same draft Law be submitted to the Parliament.

83. A draft revised Law on the Securities Market was submitted to the Government last year within the time frame set by the relevant first tranche policy condition of the ADB Program Loan. Although this draft Law has since been revised (and improved upon further), the draft Law that was then submitted to the Government appeared to meet most (if not all) of the best practice requirements referred to in Policy Loan Condition F.18 and contained a form of mandate for the creation of an integrated national securities market. Of the remaining requirements (regarding the regulation of investment funds, the independence and powers of the Agency and co-operation with other domestic and foreign regulators), all but the provisions regulating investment funds are contained in the draft Framework Law on the Structure, Functions and

Powers of the proposed National Agency on Supervision and Regulation of the Financial Market (NBFSA Framework Law). Although some of these provisions are also contained in the revised draft Law on the Securities Market, this treatment is not adequate to meet the requirements of Condition F.18 and the provisions of the Framework Law will be a necessary and important adjunct to the Law on the Securities Market for the purpose of ensuring substantial compliance with all the relevant IOSCO principles.

84. In the area of investment funds, the former SCSM and professional participants resisted from the beginning the idea of incorporating a chapter on the regulation of investment funds in the draft revised Law on the Securities Market. This was largely due to the fact that a separate Law on Investment Funds already existed, notwithstanding that this law is largely deficient in terms of meeting international best practice. In the end, the Experts made it clear that the SCSM or its successors should seek a separate review of the Law on Investment Funds as soon as possible and seek appropriate amendments to that Law. At the same time, the draft revised Law on the Securities Market recognizes that certain provisions of the Law would apply to interests in investment funds. In particular, it is clear that public offers of interests in investment funds must comply with the relevant disclosure requirements of the Law. Furthermore, the draft revised Law also regulates the licensing of investment fund managers and imposes restrictions on what entities may be licensed to carry on such activities.

85. Since the submission of a draft revised Law on the Securities Market to the Government last year, a further draft revised Law was prepared and finalized on 2 April 2007. It was proposed to submit the draft Law to the Parliament on 4 April 2007 which would have allowed the successor to the SAFSR to meet Policy Loan second tranche condition S.19.²⁷ In fact, the draft Law was submitted to the sponsoring Deputy of the Parliament in May 2007 for submission to Parliament. He has not yet been in a position to submit the draft Law to the relevant committee of the Parliament, for the reasons discussed above. On matters of substance, it is the view of the International Legal Expert that this draft Law is superior to the one that was submitted to the Government last year, in that it not only corrects mistakes contained in that draft Law but also makes enhancements and contains some acceptable compromises that would ensure greater private sector support for the draft Law. This is likely to be important to ensuring that the draft Law is supported and passed by a majority of the Parliament.

86. It is also important to note that the process of translating drafts of the Law from English into Russian and back to English has affected the readability of the draft Law in English. It has been a challenge during this TA project to achieve a reasonable and consistent standard of translation into both Russian and English. Once the final version of the draft Law has been adopted, it would be desirable if an official English translation could be produced for the benefit of ADB, foreign investors and other interested parties. In the meantime, it is proposed that an accurate consolidated translation of the final draft of the Law submitted to Parliament should also be produced for the records of the TA Project.²⁸

87. In the period between the third and fourth missions of the International Legal Expert, the Domestic Legal Experts prepared a detailed explanatory memorandum on the draft Law for the benefit of Members of Parliament and relevant Parliamentary Committees. This memorandum

²⁷ At the time of preparing this report, the SSRFM and Domestic Team Leader had advised that the draft revised Law on the Securities Market would be submitted by the SSRFM to the relevant Member of Parliament for submission to the Parliament, as soon as the SSRFM had obtained its legal credentials to take such action.

²⁸ Since the changes to the last draft of the Law which was translated into English are not very substantial, this could be done by simply translating those changes and inserting them in the most current English version of the draft Law.

and accompanying table summarizes the main provisions of the draft Law, including amendments that have been made during the course of the development of the draft Law and discussion on significant issues. Once the draft Law is submitted to the Parliament and the Financial and Budget Committee of the Parliament for consideration, it would also be desirable if the Domestic Legal Experts were available to participate in the deliberations of the Parliamentary Committee, and help members of Parliament and their staff to understand the legal and regulatory purposes of particular provisions of the draft Law.

Substantive issues arising under final version of revised draft Law

88. It is worth noting a few significant issues that arose for consideration in finalizing the final version of the draft revised Law on the Securities Market. Some of these issues resulted in changes to the draft Law while others were not accepted. For example, it was proposed by some members of the Securities Department of the former SAFSR that the permitted legal form of a licensed stock exchange should be a non-commercial organization rather than a joint stock company. The circumstances surrounding the legal status of stock exchanges are complicated by the fact that the Kyrgyz Law on Joint Stock Companies, which used to permit joint stock companies to be “not for profit”, was amended in 2003 to remove the “not for profit” category. This situation is further complicated by the fact that all the current stock exchanges are not only in the form of joint stock companies, but also have a rule preventing the distribution of profits to members, effectively making them “not for profit” joint stock companies. After discussion with the other experts, however, it was agreed to retain the current reference to joint stock companies in the Law, so this would provide flexibility for stock exchanges to operate on a “for profit” basis in the future if permitted to amend their current rules specifying that they are “not for profit”.²⁹

89. At the request of the Securities Department of the former SAFSR, Article 10 of the draft Law was omitted on the basis that the powers of inspection it contains are largely set out in a new Law on Inspections of Commercial Entities, which was signed by the President on 25 May 2007 and entered into force on 8 September 2007³⁰. It is also important to note that a provision conferring strong inspection powers is contained in the draft NBFSA Framework Law. Subject to the possibility that the ability to carry out un-announced inspections under the NBFSA Framework Law may be inconsistent with the new Law on Inspections and need to be amended, the domestic legal experts are satisfied that the two laws are consistent.

90. While it would be desirable, in terms of meeting international best practice, for the NBFSA Framework Law to retain a power to conduct un-announced inspections of regulated entities (where there is a reasonable suspicion that a regulated entity is in substantial non-compliance with a significant requirement of the law), this is a decision that would need to be made during the parliamentary consideration of the draft Law. At the request of professional participants, it was also agreed that the Chapter of the draft revised Law regulating the control and takeover of public companies could be moved from the draft revised Law on the Securities Market and included in proposed amendments to the Law on Joint Stock Companies. It is anticipated that this amendment would proceed with proposed amendments being considered and prepared under an EBRD TA Project (see below).

²⁹ As such, they currently act as non-commercial organizations.

³⁰ The domestic legal experts have also prepared an implementing Regulation for the SSRFM to enable the SSRFM to give effect to the requirements of this Law with respect to its inspection and supervisory obligations under the laws and regulations it administers.

91. Another important issue which has been taken into account in the final draft revised Law on the Securities Market is the need for the Law to contain a mandate for the Agency or Service to take suitable measures to implement an integrated national market in securities. While it is arguable that the previous draft of the proposed new Law on Securities Markets contained an adequate provision in Article 1.2 of that draft, it is clear that the provision made in the final draft revised Law is superior and better satisfies the relevant requirement of the ADB Program Loan policy matrix. In particular, the functions of the responsible Agency or Service in Article 7 of the draft revised Law now make it clear that the Agency or Service has the function (and thereby a mandate) to implement such measures, while a similar amendment to the powers of the Agency or Service in Article 8 makes it clear that it has the power to implement this mandate.

92. It is also important to note that the final version of the draft revised Law contains new provisions which require that issuers of securities, which conduct a private offer and placement of securities, must also lodge a disclosure document with the responsible agency for registration. The proposed document would be much shorter than the equivalent disclosure document required to be lodged by an issuer or person making a public offer of securities. While it is unusual by international standards to regulate private offers and placements in this way, it has been acknowledged that the small Kyrgyz market is currently dominated by such transactions and that it would give participants and the responsible agency some comfort to approach them in this way for the foreseeable future. From a supervisory perspective, this approach would also help the responsible agency to monitor such transactions for compliance with the public offering requirements of the law, where a series of related private offers may amount to a public offering.

93. Finally, it is important to note two provisions which have been retained in the draft revised Law, notwithstanding the opposition of some professional participants. The first of these is the provision which prevents organizers of trade (i.e. stock exchanges) from maintaining a rule that prevents their members from belonging to any other organizer of trade. The Chairman of the SSRFM (previously the Director of the SAFSR) has agreed to retain this provision, not only because it would outlaw a restraint of trade by each of the current stock exchanges, but also because it may facilitate the creation of a single Kyrgyz stock exchange for the trading of public issues of securities. The other provision in the draft revised Law that has been retained is a requirement that the disbursement to an issuer of funds raised by the issuer from a public offering cannot occur until the completion of the public offering. One professional participant argued that this is too restrictive, even though it would pose a considerable risk to investors if disbursed funds had to be subsequently returned to investors in the event of the failure of the public offering.

94. Further, the Chairman of the SSRFM has agreed that it is important from an investor protection perspective to ensure that funds were not made available until it is legally clear that the public offering has succeeded. Under the revised draft Law, this would not occur until after the SSRFM has certified the public offering as successful. If a public offering is fully underwritten, it is likely that the offer period would be short enough (e.g. 30 days) to ensure that the issuer does not have to wait very long to take possession of the funds raised by the offering. Any advisers or intermediaries retained by the issuer to advise on or facilitate the public offering could then be paid out of these funds, unless provision had been made for earlier payment from another source.

EBRD assistance on investor protection measures

95. During the second mission of the International Legal Expert in mid-2006, the Expert met with the Coordinator and some local members of an EBRD funded TA Project on Investor

Protection Measures. The International Legal Expert was led to believe from this meeting that the work of the EBRD TA Project would be broad ranging and not focus on investor protection under the Law on the Securities Market. For this reason, it was expected that the EBRD Study would be unlikely to duplicate work already being carried out by ADB in the course of its review of the Law on the Securities Market and related measures.

96. During the International Legal Expert's third visit to Bishkek from 21 March to 11 April 2007, the TA Project had the benefit of seeing a summary of the recommendations for further work which have resulted from Phase One of the EBRD Project. Under Phase One, which was carried out during 2006, the EBRD Project reviewed a number of laws across the non-bank finance sector in Kyrgyz Republic with a view to identifying regulatory and supervisory deficiencies which affect the level of investor protection in Kyrgyz Republic. Under Phase Two, it is proposed to implement the recommendations listed as short term and medium term objectives in an Action Plan.

97. A review of the recommendations for further work contained in the EBRD's Action Plan indicates that most of the proposed actions by the EBRD TA Project relate to different issues from those addressed by the ADB TA Project and are likely to be complementary to the work being undertaken by the ADB TA Project in cases where they relate to the same subject matter or issue. For example, the work the EBRD proposes to carry out with respect to increasing the level of administrative fines that may be imposed under the Law on the Securities Market and improving enforcement of the payment of such fines, both of which would necessitate amendments to the Code of Administrative Liability, would complement the provisions of the draft revised Law on the Securities Market and NBFSA Framework Law to increase the financial and operational independence of the SSRFM and improve its enforcement capacity. In the area of protection of the rights of minority shareholders of a joint stock company, it seems from the EBRD's report that the focus of their work to improve protection of minority shareholders would be to recommend suitable amendments to the Law on Joint Stock Companies, although it is possible they may recommend some minor or consequential amendments to the Law on the Securities Market.

98. The areas of the EBRD Phase One Report and Action Plan, which seem to create overlap between the efforts of the ADB TA Project and the EBRD TA Project, concern the funding and budgetary resources of the responsible regulatory agency and the role and status of self-regulatory organizations (SROs) in the securities market. In the case of funding of the responsible regulatory agency, the EBRD Phase One Report recommends that the relevant laws should be amended to ensure that the responsible regulatory agency has adequate resources to fund its operations and the power to use fees it collects from the registration of public offerings to finance the regulatory and supervisory activities of the agency. This recommendation is already met by Chapter 7 of the draft Framework Law on the Structure, Functions and Powers of the Non-Bank Finance Sector Regulatory Agency (NBFSA Framework Law) which has been prepared under the ADB TA Project. It would, therefore, be preferable in this area if the EBRD concentrated on helping the responsible regulatory agency to develop a Code of Conduct for employees and officers of the Agency, which builds upon the disclosure and other conflict of interest requirements set out in the draft NBFSA Framework Law. Such a Code of Conduct is identified as one of the actions the EBRD proposes to implement under its TA Project.

99. The other area of overlap which appears to result from the current work of ADB and the recommendations of the EBRD Phase One Report is in relation to SROs. The EBRD has correctly identified as a deficiency of the current regulatory framework for the securities market

the lack of any requirements in the Law on the Securities Market requiring professional participants such as trade organizers to have oversight responsibilities with respect to the conduct of their members, including the adoption and enforcement of suitable rules. However, the EBRD's recommendation that the current law be amended to define the status of SROs and their oversight functions has already been addressed by the draft revised Law on the Securities Market prepared under the ADB TA Project. It would be preferable if the EBRD project concentrated on helping the relevant SRO professional participants to draft and implement rules that meet the new requirements in the Law on the Securities Market.

Draft Framework Law to establish a Non-Bank Financial Services Authority (NBFSA) and Working Commission on Financial Sector Policy Formulation and Coordination

100. A major component of the current TA Project has been to draft a framework law (NBFSA framework law) to enshrine in law suitable provisions defining (i) the structure, functions and powers of the Government Agency responsible for regulating and supervising the non-bank finance sector in the Kyrgyz Republic and (ii) the structure, functions and powers of the Working Commission on Financial Sector Policy Formulation and Co-ordination. By doing so, it is intended to strengthen the legal authority, independence and financial autonomy of the existing agency which supervises the non-bank finance sector under the authority of the Government of the Kyrgyz Republic. Until recently, the ability of the former SAFSR to supervise the securities market has been determined by a limited number of presidential decrees and government regulations that have limited the regulator's ability to act decisively and independently.

101. As the former SAFSR has now been replaced by the SSRFM, the decrees and regulations concerning the structure, functions and powers of the former SAFSR no longer have legal application. The Presidential Decree of 16 March 2007 recognizing the new SSRFM sets a requirement that legal arrangements setting out the structure, functions and powers of the SSRFM be implemented within two months of the date of the Decree. In the event, a Government Decree implementing a Regulation, which sets out the powers and mandate of the SSRFM was finally adopted on 24 July 2007. While this Decree gives the SSRFM or Service the necessary legal authority to carry out the functions conferred by the laws it is expected to administer, all members of the Executive Board of the Service, with the exception of the Chairman, were only acting in their positions at the time of this Report. Indeed, the Chairman only received his permanent appointment on 10 October 2007. Although all the members of the Executive Board have the legal authority to carry out their functions, albeit on an acting basis in most cases, they are not in a position to submit the draft Framework Law to the Parliament or the Government, pending the resolution of key constitutional issues surrounding the status of the Service, which is dependent on the outcome of the constitutional referendum on 21 October 2007. Accordingly, the outcome of the constitutional referendum is likely to have a substantial effect on whether the proposed NBFSA will be established with the degree of independence envisaged by the TA Project and Policy Matrix for the Program Loan.

102. There is also a current Decree that established the Regulatory Working Commission, as envisaged by the TORs for the TA Project and Program Loan first tranche condition F.11. The Decree is a fairly basic document that briefly describes the general purposes of the Regulatory Working Commission and its proposed membership. In the area of membership, it provides for the Commission to be chaired by the Head of the Strategic Development Unit of the President's Office and have a membership comprising the heads of the SAFSR (now the SSRFM), the National Bank of Kyrgyz Republic (NBKR), the Ministry of Economy and Finance (MOEF) and the Department of Economic Development of the Prime Minister's Office. This structure appears to be broadly consistent with the policy objective specified in policy condition F.11 of the current

ADB Loan to the Kyrgyz Government under the Banking Sector and Capital Market Development Program, which specifies that the Regulatory Working Commission should have high level participation from at least the NBKR, the MOEF and the SAFSR (now the SSRFM). However, as noted earlier, the Regulatory Working Commission has not functioned as intended in that only two meetings have been held, an MOU has not been agreed to among its members, and the working groups intended to be formed by the Commission and supported by the Secretariat have not been organized to support on-going activities contemplated by the policy matrix reform agenda.

Draft NBFSA Framework Law

103. Following discussions with the International Team Leader, Domestic Legal Experts and other stakeholders about the proposed NBFSA Framework Law during the second Mission to Bishkek from 18 June to 8 July 2006, the International Legal Expert drafted a NBFSA Framework Law. The draft Law sought to make the SAFSR a strong, well resourced and politically independent regulatory agency³¹ in accordance with IOSCO principles of securities market regulation and supervision and ADB Program Loan second tranche conditions S.15 and S.17. It also sought to strengthen and supplement the provisions in the draft revised Law on the Securities Market with respect to the functions and powers of the regulator, enforcement of regulation and co-operation between regulators. In relation to the governance of the new National Agency, the draft took the approach that the Governing Board should be a self-governing body with a total of seven members, two of whom should be external persons who do not hold any executive position within the Agency. In keeping with current arrangements, it was decided that the Chairman should also be the Chief Executive Officer of the National Agency. While the draft Law provides for the members of the Governing Board to make a number of decisions on a collegiate basis (by majority vote), it also allows for executive members to have line responsibility for overseeing the implementation of decisions of the Board³².

104. The NBFSA Framework Law and the accompanying Explanatory Memorandum were subsequently translated into Russian and presented to the former SAFSR for consideration in September 2006. The SAFSR in turn formed an internal Working Group on 12 October 2006 to review the draft Law and make any revisions that they considered appropriate. This Working Group, which was assisted by the Domestic Legal Experts on the TA Project, spent until February 2007 reviewing the draft Law.

105. The Working Group was due to submit its revised version of the draft Law to the Executive Board of the former SAFSR in mid-February 2007 when the SAFSR lost its legal status. The draft Law has since been presented to the Executive Board of the new SSRFM for approval and submission to Ministers of the Government or Parliament. While it is understood that the Executive Board of the Service has the legal authority to formally consider and adopt the draft Law for submission to the Government or Parliament, current constitutional and political uncertainty appears to have substantially affected the willingness of the members of the current Executive Board to take such a step until their own positions and the status of the Service become clearer.

³¹The draft Law seeks to do this by conferring on the Agency the status of National Agency, equivalent in status with the National Bank of Kyrgyz republic (NBKR). In this way, it is intended that it should have its own budget, which is independent of the National Budget as far as possible, and the ability to raise its own funds through the collection of fees, fines and any other legitimate income.

³² Both the International Legal Expert and the Team Leader would have preferred a purely collegiate approach to decision-making and implementation of decisions, but it was decided to incorporate the current approach in the draft Law, in order to ensure support for other more critical aspects of the draft Law.

Key issues Related to the Framework Law

106. It is apparent from talking with the Domestic Legal Experts that the parts of the draft Law which were of most concern to the internal Working Group of SAFSR were the Chapters on the Establishment of a Finance Sector Regulatory Commission (Chapter Eight) and the Establishment of a Regulatory Appeals Tribunal (Chapter Nine). In the case of Chapter Eight, the Working Group thought that the existing Presidential Decree establishing a Coordination Committee to set up a Finance Sector Regulatory Commission was sufficient. Once it became clear that this Decree was only a preliminary measure for coordinating the establishment of the Regulatory Commission by its proposed members, this Chapter was retained in substantially the same form as the original chapter.

107. In the case of Chapter Nine of the draft Law, there was considerable debate about the need for a Regulatory Appeals Tribunal (which would review regulatory decisions of the NBFSA) to have any external members, let alone all or a majority of external members, with sufficient independence from the original decision makers whose decisions are under review. The Working Group ultimately decided to consider two options for the revised draft Law with respect to the membership of the Regulatory Appeals Tribunal. The first of these provides for the Tribunal to have a total membership of five persons, comprising 2 executive members of the Executive Board of the NBFSA, one independent member of the Executive Board of the NBFSA and 2 suitably qualified independent persons from outside the NBFSA. The second option provides for the Tribunal to be made up of 2 members of the Executive Board of the NBFSA (including an executive member and independent member) and 3 suitably qualified independent persons from outside the NBFSA. Unfortunately, it appears that the revised draft Law which has been adopted by the Working Group incorporates the first option only and dispenses with the second option as an alternative. While the first option provides on its face for a bare majority of independent representation on the Tribunal, the second option would be stronger in this regard.

108. Another issue which does not seem to have been addressed by the SAFSR Working Group is the need to consider what other laws (in particular Government Regulations) would need to be amended if the draft NBFSA Framework Law is adopted in its proposed form. The need for consequential amendments to Government Regulations is likely to arise where the draft Law would confer stronger express powers on the NBFSA than are currently conferred by other existing laws or Government Regulations. It is proposed that the two Domestic Legal Experts would further analyze and advise on this issue in respect of relevant areas of the draft Law.

Amendments to the individual sector laws, regulations, by-laws or orders administered by the SAFSR resulting from the adoption of the NBFSA Framework Law and/or the revised Law on the Securities Market

109. An original component of the TA Project was to provide assistance to the SAFSR to draft suitable amendments to individual sector laws that the SAFSR is required to administer, as well as current regulations and rules, which may be required as a result of the adoption of the draft revised Law on the Securities Market and the proposed NBFSA Framework Law. In addition, the policy conditions of the current ADB Loan to the Kyrgyz Government under the Banking Sector and Capital Market Development require the SAFSR to implement new requirements with respect to the regulation and supervision of capital market participants, such as stock exchanges. As such, it was envisaged that assistance would also need to be provided to the

SAFSR to draft suitable provisions to meet these requirements or to review existing draft statutory provisions, regulations, by-laws or orders that have already been prepared by the SAFSR for this purpose.³³

110. The provision of such assistance to the SAFSR under the TA Project during the term of the TA Project has been substantially affected by delays in the preparation and consideration of the draft revised Law on the Securities Market and the NBFSA Framework Law. In accordance with the work plan outlined in the Inception Report, it was intended that the bulk of the work on revising existing statutory provisions, regulations, by-laws and orders would be carried out by the Domestic Legal Experts³⁴, with assistance from the International Legal Expert. However, the Domestic Legal Experts have had little time to focus on such tasks for most of the term of the TA Project, due to ongoing work on the revision and finalization of the two draft Laws. More importantly, it would also be difficult and potentially a waste of effort to undertake these tasks until it is reasonably clear that the draft Laws will be adopted in their proposed form.

111. In these circumstances, the Legal Experts have confined themselves to identifying those existing regulations and by-laws that are likely to be affected by the adoption of the draft Law on the Securities Market and the types of amendments that are likely to be required³⁵. A list of regulations in force under the current Law, which are likely to be affected by the adoption of the Law on the Securities Market, has already been provided with the Inception Report for the TA Project.

112. As noted earlier, the international and Domestic Experts have provided assistance to the management and staff of the former SAFSR during the TA Project by conducting comprehensive training in several topics related to IOSCO principles of securities market regulation and supervision. In the course of providing such training, the Experts have been able to focus on proposed reforms under both the draft revised Law on the Securities Market and the NBFSA Framework Law.

Conclusion and Recommendation

113. Important work has been undertaken by the ADB to lay the foundation for the development of the capital market in the Kyrgyz Republic, in that a modern securities law has been drafted along with an NBFA Framework Law which would provide the basis for a non-bank financial services regulator in line with international best practice. It seems apparent from the fact finding missions to London and Kazakhstan that both laws would be very important to

³³ The SAFSR prepared a new Regulation on the Governance of Securities Market Participants in 2006, which is intended to meet some of the policy conditions of the current ADB Loan to the Kyrgyz Government under the Banking Sector and Capital Market Development Program.

³⁴ It was agreed at the commencement of the TA Project that it would be efficient if new or amended statutory provisions, regulations and rules could be prepared in Russian only, leaving only the most significant ones to be prepared in Russian or English and then translated into the other language for checking purposes.

³⁵ After reviewing the Regulations that are currently in force under the existing Law on the Securities Market, it is likely that most of these Regulations would need to be amended, if not revoked, if the draft Law on Securities Market is adopted in its proposed form. Insofar as the draft Law would clarify what activities can be carried out by the same legal entity, a current Regulation in this area could probably be revoked. On the other hand, many of the existing Regulations, such as the 2002 Regulation on Licensing of Brokers and Dealers would only need to be amended, in particular, so as to remove references to requirements that are now set under the draft Law or to make inconsistent requirements set under the Regulations consistent with new requirements under the draft Law. In some areas, it may also be necessary to adopt new regulations where none currently exist (e.g. to set specific disclosure requirements for public offerings of corporate bonds).

international investors and financial market intermediaries (i.e., investment bankers) if the Kyrgyz capital market is to take-off and contribute to economic development in the years ahead.

114. One of the lessons of other markets such as Vietnam, Malaysia and China is that a proper legal and policy foundation is critical to the development of a reliable and sustainable capital market. It should be remembered that this takes time. In Vietnam, for example, important work was undertaken from the mid-1990s through to mid-2000 which laid the foundation for the stock market to fulfill its realization once economic growth improved and government policy accepted the spirit of proposed ADB reforms to integrate capital market development with the government policy on privatization. This was also supported by international donor technical assistance, including recent work undertaken by the ADB which resulted in the enactment of a revised and modern Law on the Securities Market which took effect on 1 January 2006. As a result, the stock market was ready to take off in 2006 and display remarkable growth in market capitalization.

115. Apart from the fact that capital market development takes time, it also requires political commitment and the adoption of sound policies sustained over time to support the foundation provided by a proper legal, regulatory and policy framework. However, it is well worth the effort. On the policy side, the three markets mentioned above – Malaysia, Vietnam, and China - all benefited from the introduction of favorable tax policies toward the securities market and a close link between privatization policy and capital market development at critical junctures along the way.

116. With the above in mind, it is the opinion of the Consultants that the ADB should continue to support the development of a proper legal and policy framework with the aid of the local experts currently engaged under this TA Project, in the event that resources become available. The next six months could be crucial and the momentum generated through the ideas set forth in the policy matrix reform agenda and the draft laws under review and consideration should not be lost, particularly as it might take another five to seven years to reach the point where we are at today, without further support of international donors such as ADB.

117. While the implementation of proposed legal and policy reforms has been delayed due to unexpected political events which have unfolded over the past 12 months, this only serves to emphasize the need for an NBFA Framework Law or similar law to create a Non-Bank Finance Sector Regulatory Authority, or similar entity (i.e., the Service) with sufficient autonomy, governance and resources to enable it to evolve into a state-of-the art financial services regulator over a three-to-five year period. Such a law would be critical to empower the regulator to conduct its business in an orderly fashion and with a sufficient degree of clarity, certainty and autonomy, as envisaged by the ADB reform agenda and the findings and recommendations of the recent joint World Bank-IMF study of the financial sector of Kyrgyz Republic.

118. On the policy side, the Consultants strongly support the findings of the 7-14 June 2007 Review Mission Report concerning the taxation of securities and privatization policy. With regard to the taxation of securities, the Report states that “Ministry of Finance (MOF) is encouraged to establish a working group through the Regulatory Working Commission comprising experts of MOF and other state bodies, as needed, to review the taxation of interest, dividends, and capital gains and formulate proposals to rationalize the tax regime for securities (S.29). Limited TA can be provided from ongoing projects, as needed.”

119. In relation to privatization policy, the Review Mission Report further states that “the Advisory Committee on Privatization through the Capital Market and the agencies represented

in it are encouraged to intensify their work on developing a policy for the step-by-step privatization of state-owned enterprises through stock exchanges, and formulate proposals that can ultimately be taken into account when formulating a new privatization program (S.30 and S.31).