

ICPS newsletter[®]

The national depository: Should it be private or public?

Key stock market players agree that Ukrainian indicators are largely lagging behind the level acceptable for market economies. As a result, they have indicated their readiness to join efforts to develop the domestic stock market and depository system. However, different players have different opinions on the issue of setting up a consolidated depository, which is one of the key elements of a securities market. Professional market players are dissatisfied with the adoption of the Government Program for Developing a National Depository System. Stakeholder representatives presented their opinions in detail at a roundtable hosted by ICPS

On 21 March 2005, the International Centre for Policy Studies and the State Securities and Stock Market Commission held a seminar on the "Government Program for Developing a National Depository System." The goal was to study the opinions of stakeholders on current problems with developing a national depository system and possible solutions to them. The seminar was attended by professional market players, securities traders, government representatives, Ukrainian and foreign experts, and the media.

Lack of a proper government policy hampers the stock market

Because of problems with the stock market and the depository system today, only 4% of general transactions involving securities are carried out on the organized market, and general capitalization and circulation remain very low. Opaque transactions and closed registers of shareholders stand in the way of foreign investment inflows. According to participants, the root of problems with the Ukrainian stock market is the lack of policy aimed specifically at developing the market.

When Ukraine began to switch to a market economy, a huge number of new stock instruments emerged and many legal entities and private individuals became shareholders. However, there was a delay in development of the necessary registration of ownership rights and transactions with securities. The Government was establishing rules and formulating mechanisms in crisis

mode, which often meant temporary or partial solutions to problems. As a result, different market structures are using different standards and a number of structures are not functioning at all or do so in violation of legislation. In addition, the technical and technological state of stock market infrastructure is way behind the level of developed countries.

According to the majority of the participants in the roundtable, the first goal of government policy in developing a depository system should be to create conditions that satisfy the needs of professional market players in the most effective way. The main criteria for such a system should be reliability, quick service and reasonable cost. The second goal should be to integrate the domestic stock market into the global one. First of all, at the level of infrastructure.

To resolve the market's problems and eliminate the root causes, agreement needs to be reached among all stakeholders, who should combine their efforts and resources and develop and implement a stock market development program. Today, a number of interest groups are represented in Ukraine's stock market:

- the Executive branch, through the State Securities and Stock Market Commission;
- the National Depository of Ukraine;
- the Interregional Stock Union (Mizhregionalniy Fondoviy Soyuz or MFS), a non-government depository;
- professional market players;

Increased social benefits and forex sales push inflation

According to Derzhkomstat data, the Consumer Price Index grew 1.6% in March 2005. One of the factors spurring inflation is the reaction of Ukrainians to the stabilized political situation, says ICPS economist Vitaliy Lukovych.

According to Lukovych, price hikes in March were the beginning of an inflationary trend that will persist throughout June. A consistent Government policy of raising social benefits and minimum wage is generating confidence among the population that their incomes will grow and this, in turn, fosters greater consumption. As of 1 April 2005, the Government began to pay out pensions raised to the minimum subsistence level for the disabled. During Q2'05, it will be paying out the pension supplements that kicked in starting 1 January.

"During the presidential campaign, the inflation sparked by increased social benefits was partly held in check as the general population bought up foreign currency as a hedge against instability," says Lukovych. "Since the situation has stabilized and the Government has begun to talk about a stronger hryvnia, Ukrainians are gradually selling off their foreign currency and are most likely spending this cash on the consumer market."

According to NBU data, in March, private forex sales exceeded purchases by US \$244.3mn.

- issuers of securities;
- investors.

Every stock market needs a central depository

The key component of a stock market development program should be setting up a central depository that will be the core for other structures. A central

depository will increase reliability, reduce the time for relevant services, and establish reasonable fees for those services. Its key functions will be to track the ownership of securities, handle settlements between market players, and set the rules for interaction.

International practice shows that a central depository should be built and function along several principles:

- **INDEPENDENCE:** equal opportunity for all market players and the state to influence the activities of the central depository while preventing the concentration of influence in a few hands;
- **TRANSPARENCY:** independent audits and equal access for all stakeholders to information on the depository's activities;
- **NON-COMMERCIAL:** all profits earned by the central depository are reinvested in developing and improving its infrastructure;
- **STATE SUPPORT:** both political and financial;
- **EQUAL ACCESS** for all market players;
- **CONFORMITY** to international standards and recommendations;
- **FAIR RATE-SETTING**, reflecting a correspondence between the fees and the capacities and needs of market participants;
- **APPLICATION OF PRIOR EXPERIENCE** of those entities already functioning on the market.

Who should own the national depository?

The main dispute between market players and government officials in Ukraine is over which entity should serve as a basis for the national depository: the Interregional Stock Union (MFS), which is privately owned, or the National Depository of Ukraine (NDU), which is a state organization.

The MFS and professional market players want to develop MFS, an organization established by market players, as the only national depository. They believe that active government involvement can take the form of financing, management and oversight, but that the state cannot take complete control of a central depository that is supposed to be managed only on a market basis. Nor

can the depository be a state-owned structure, since providing services to stock market players is not a government function. Political support for the work of the central depository will be enough. Indeed, professional market players say that setting up a sole central depository is a necessary but not sufficient condition for effective stock market development.

But the Government Program for Developing a National Depository System calls for this depository to be based on the NDU, with a large share—nearly 50%—of public financing. The NDU matches the provisions of the State Program in terms of goals, tasks and directions for developing a central depository system and the market as a whole. This would require the lateral integration of MFS and NDU structures. The central depository will then own the entire infrastructure of the domestic stock market, since the concepts of a national depository system and a national stock market are identical in the Government Program.

NDU representatives believe that public funding to develop a national depository system will offer a real opportunity to significantly improve the technical side of Ukraine's stock market infrastructure, which is an important condition for Euro-Atlantic integration.

International experts: There is a third option

According to Tim Reucroft, Director of Research at Thomas Murray, a British company, Ukraine needs to determine what direction and principles it wants for its national depository system as soon as possible. Globalization and economic integration are leading to the rapid disappearance of small depository systems in individual countries. These generally integrate into international systems and switch to their platform. Since Ukraine aspires to global integration, it is headed for a similar situation. A possible solution to this problem could be to identify a major international depository system to partner the Ukrainian system right now and to use its platform on a lease basis. ■

For more information on the opinions of participants in the controversy over the national depository, you can see online publications at:

New! **Handbook for analyzing party platforms**

ICPS has summarized its experience analyzing, monitoring and evaluating party platforms in a new publication called "Public Participation in a Dialog on Party Platforms." The handbook is based on the results of a project of the same name, which was carried out by ICPS from December 2003 to March 2005 and financed by the Ukraine Citizen Action Network (UCAN). The handbook includes methodological materials and proposals for making party platforms more effective at gaining voter support. In addition, the handbook contains basic materials from two methods handbooks developed by ICPS: "Methods for analyzing, monitoring and evaluating party platforms" and "Methods for preparing and holding public debates on party policy issues." Included in the publication are the results of this project from six Ukrainian cities: Donetsk, Kolomyia, Mykolayiv, Poltava, Striy, and Vinnytsia.

The handbook was designed for leaders of political parties, civic organizations, think-tanks, and active citizens interested in engaging in a public dialog on the problems of developing party platforms, raising the effectiveness of party activities and understanding the impact of political parties on social and political processes in Ukraine.

To view the materials that served as a basis for this publication, visit us online at: <http://www.icps.com.ua/eng/project.html?pid=15>. To get a printed copy, contact Andriy Zelnytskiy by telephone at (380-44) 246-9501 and via e-mail at azelnitskiy@icps.kiev.ua.

- <http://www.ndu.gov.ua/ua/publication/content/296> (in Ukrainian);
- <http://www.pfts.com/ukr/press/press.php?id=140> (in Ukrainian).

Materials of the "Government Program for Developing a National Depository System" seminar can be viewed on the ICPS web-site at: <http://www.icps.kiev.ua/project.html?pid=75> (in Ukrainian). For more information, contact Ihor Shevliakov by telephone at (380-44) 236-4477 or via e-mail at ishevliakov@icps.kiev.ua.

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