

**Approximation of capital markets legislation to EU standards:
Commitments under the DCFTA
and priorities in Georgia's capital market strategy**

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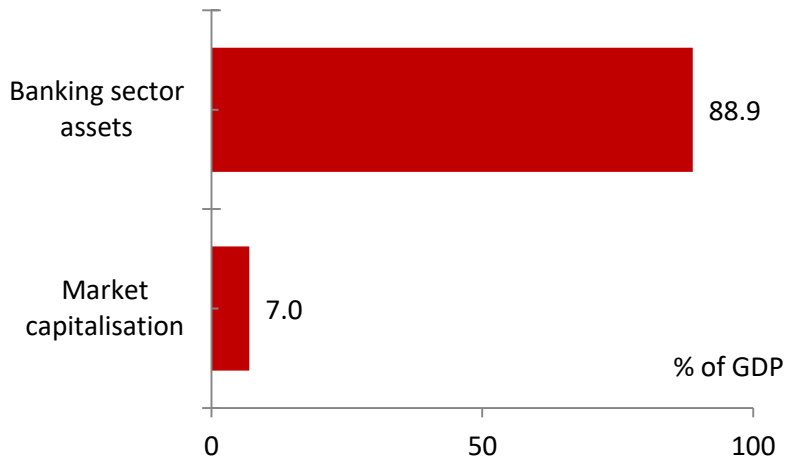
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Outline

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- II. Georgia's 2016 capital market strategy
- III. Considerations in convergence of capital market legislation to EU standards
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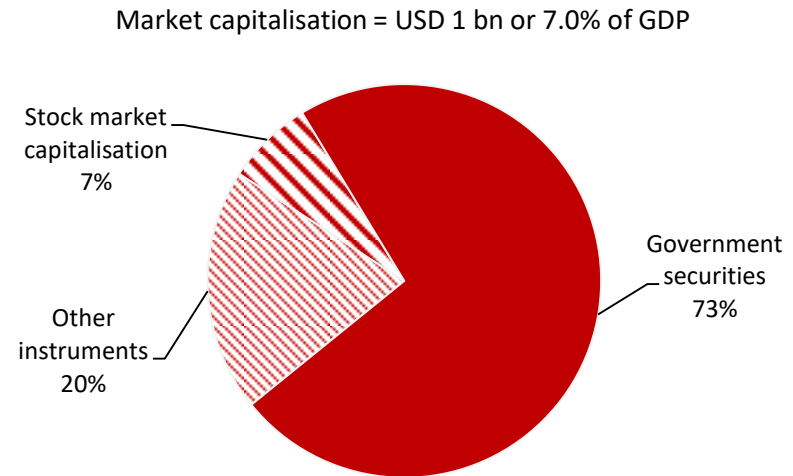
I. Stocktake of capital market developments

Financial market indicators, 2016



Source: Capital market development strategy from the Ministry of Economy and Sustainable Development of Georgia; National Bank of Georgia; eop

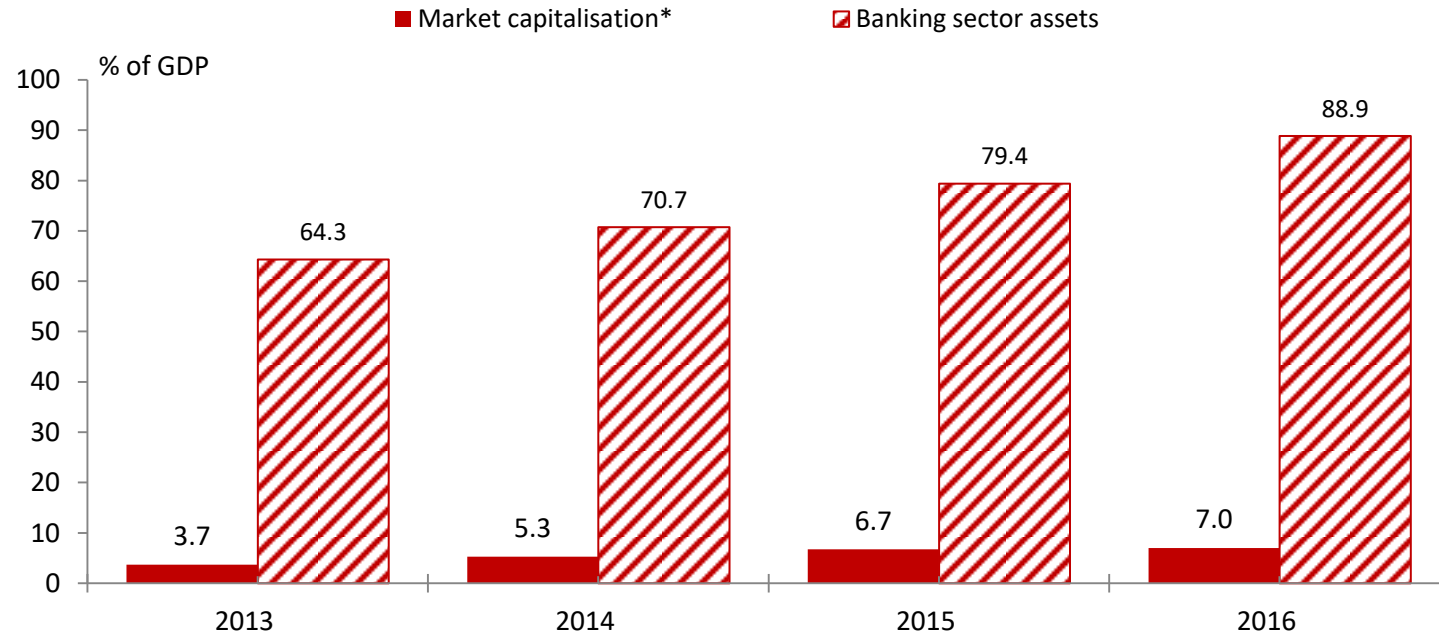
Capital market structure, 2016



Source: Capital market development strategy of the Ministry of Economy and Sustainable Development of Georgia; National Bank of Georgia; eop

- Georgia's financial system is dominated by the banking sector
- Sovereign bond issuance is the mainstay of capital market activity, with good local liquidity and maturities extending to 10 years
- Private bond and equity market capitalisation is limited

Development of banking sector and capital markets

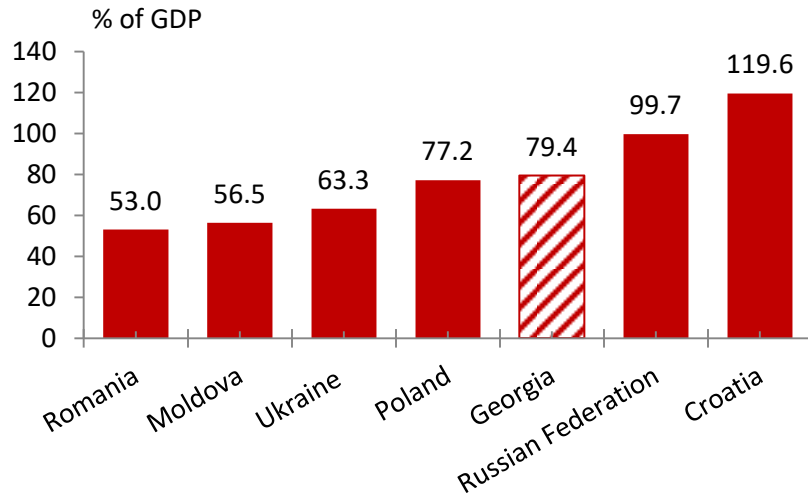


Source: National Bank of Georgia; * Due to data limitations, market capitalisation before 2016 is calculated by assuming the same structure of the capital market as in 2016; eop

- Good progress in deepening banking sector; 89% bank assets to GDP high for an economy at this stage of development
- Relative stagnation in capital market development may hint at some barriers

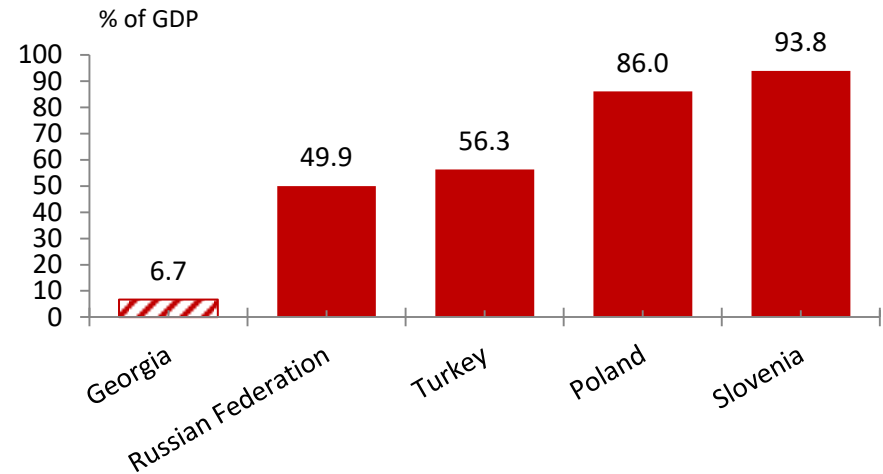
Comparison with other transition economies

Banking sector assets, 2015



Source: National central banks; eop

Market capitalisation, 2015



Source: Bank for International Settlements, World Bank, IMF and capital market development strategy from the Ministry of Economy and Sustainable Development of Georgia and National Bank of Georgia; eop

- Other transition countries underline that there is considerable further potential in capital market development in Georgia

II. Georgia's 2016 capital market strategy

- Proceed from less complex market segments (Government and Corporate Bonds) to the more complex ones (Equities, Derivatives)
- Develop Georgia as a regional financial centre
- Update market infrastructure, educate market participants
- Reforms of the insurance market and pensions system to support development of local institutional investment

Government securities

- Amend Law on Public Debt to increase issued volume
- Attract resident non-bank and foreign investors

Corporate bonds

- Establish a bonds market association
- Facilitate international and local ratings
- Add corporate bonds to NBG's collateral base

Equity market

- Update trading infrastructure
- Decrease fiscal burden for market participants
- Increase efficiency of stock exchange management

Derivatives market

- Adopt Law on Derivatives Market
- Identify of gaps in trading infrastructure

Source: Capital market development strategy of the Ministry of Economy and Sustainable Development of Georgia and the National Bank of Georgia

III. Considerations in convergence of capital market legislation to EU standards

- ‘Approximation’ still to be defined; policy to be applied to similar commitments made under Ukraine and Moldova DCFTAs
- Compliance to be verified by EU Commission
- Banking and capital market legislation is a ‘dynamic’ target: Some provisions listed in DCFTA are already repealed. There will be periodic updates to reflect this
- Requirements of under-developed capital markets likely judged in light of experience and policy in the ‘new’ EU member states in central and southeastern Europe

Implications of Brexit on convergence process

- About one third of UK-based wholesale banking business is related to EU-27 clients, and could be on the move (Schoenmaker, 2017)
- A ‘multi-polar’ capital market may necessitate more complex interaction for ‘third’ countries
- Integrated European Central Bank (ECB) powers in bank supervision currently not matched by the European Securities and Markets Authority (ESMA). ECB does not cover ‘broker-dealers’ or asset managers and Central Counterparty Clearing Houses (CCPs)
- A strengthening of ESMA and its powers proposed by the EU Commission in Sep 2017. It may become the single point of contact for ‘third’ countries

Timeline for convergence

5 years starting Sep 2014	6 years	7 years	New/replaced legislation with unclear timeline
<p>Market infrastructure:</p> <ul style="list-style-type: none"> • Financial collateral arrangements • Finality of settlement 	<ul style="list-style-type: none"> • Investor compensation schemes • Undertakings for the collective investment in transferable securities (UCITS) Directive 	<ul style="list-style-type: none"> • Organisational requirements for investment firms • Record-keeping • Prospectus Directive and Regulation • Transparency requirements • Credit Rating Agencies 	<ul style="list-style-type: none"> • Markets in Financial Instruments Directive (MiFID) II • Market Abuse Regulation

Source: ADB diagnostic study of the capital markets of Georgia

IV. Considerations in implementation of DCFTA commitments

- Trade-off between strong regulatory standard and implementation costs for market participants: Excessive regulatory burden could discourage issuance or market entry. Proportionality?
- Missing markets and instruments: Redundant provisions?
- National supervisory agencies to take the role of EU supervisory agencies but capacity and skills constraints will be serious
- Relations with EU institutions? Process of adapting to a moving target? Timeline for MiFID II?
- Capacity gaps in related legal and regulatory fields, e.g. accounting?

V. Further work by the GET Georgia: Main contribution

- Delivers on technical assistance on EU standards that was envisaged in Georgia's capital market development strategy
- Insight into EU capital market legislation which is rapidly evolving
- Interpretation of DCFTA commitments in light of implementation experience in other EU countries, and in Ukraine and Moldova
- Will interpret conclusions of the Vienna Initiative working group on the implementation of the capital markets union agenda in the transition countries
- Input into communications with EU Commission, where a well-structured and coordinated effort will need to be demonstrated

V. Further work by the GET Georgia: Proposed elements

- Current state of EU capital market legislation: Key policy objectives
- Outlook on legislative plans, including in light of Brexit
- Implementation status and challenges in the EU and the ‘new’ member states; regulatory capacity constraints
- Potential economic costs and benefits for financial market development in Georgia
- Working definition of ‘proportionality’
- Scoring of each policy area in terms of:
 - Administrative resource costs;
 - Compliance costs for the private sector, local and other non-EU market participants;
 - Benefits for capital market development, resilience and integrity
- On this basis a prioritisation of the individual policy areas, and potential elements for adaptation or omission

VI. Conclusions

- Georgia stands to gain from converging its capital markets legislation to EU standards in terms of mutual market access, market integrity and transparency and well-designed supervisory institutions
- Experience elsewhere in the transition region underlines considerable potential in capital market development
- But in an under-developed capital market there are also various risks to an overly ambitious legislative standard
- A 1:1 transposition is not possible, nor desirable or required
'Approximation' is yet to be defined in a legal or operational sense
- There is a need to define objectives in various elements of the EU capital markets acquis, and to prioritize, adapt or delay
- Whatever is legislated needs to be backed by adequate supervisory capacity
- There should be closer coordination with EU Commission and ESMA

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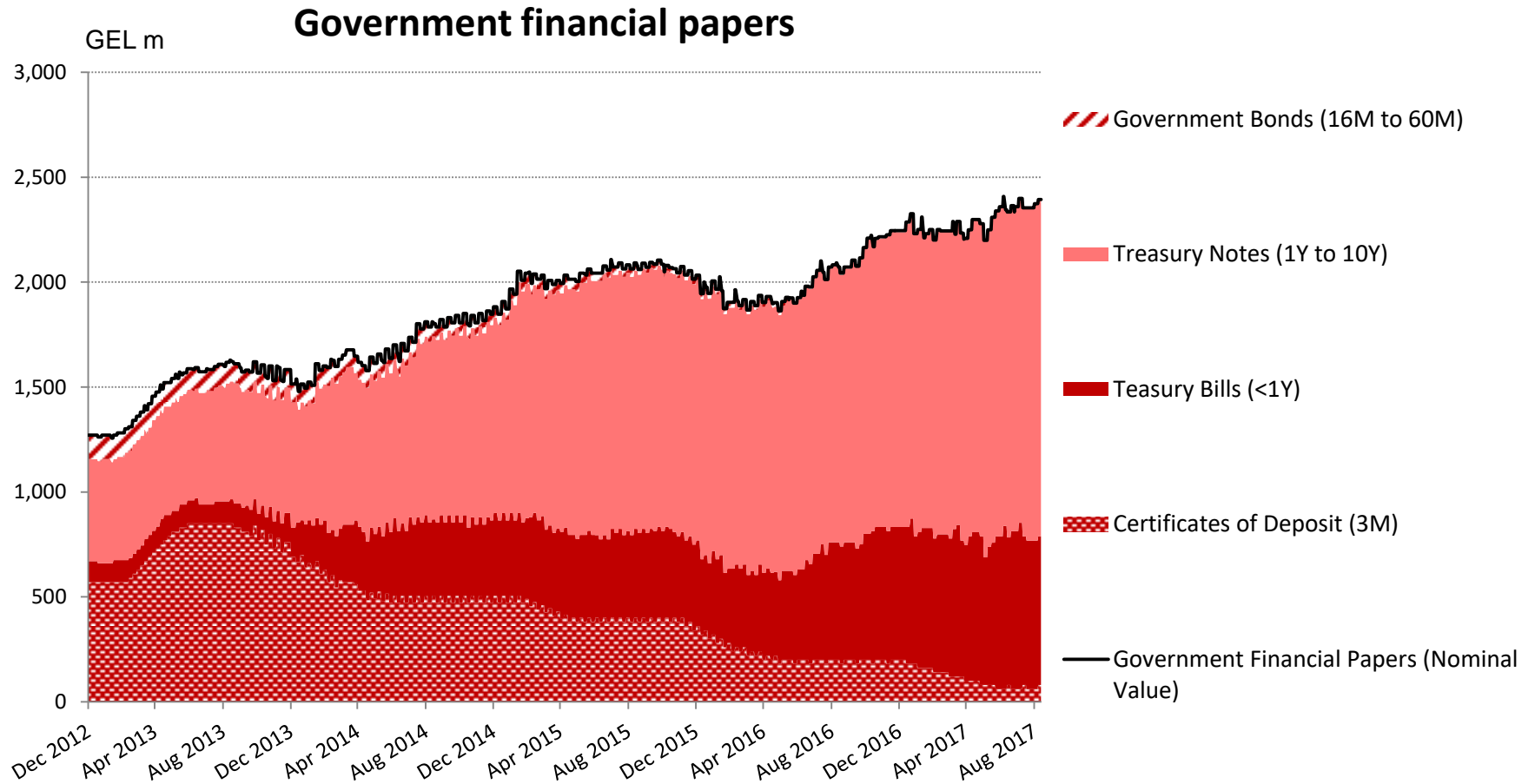
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Annex



Source: National Bank of Georgia