



# Workshop Liquidity Improvement Measures

## Improvement Levers for Market Liquidity

EBRD Project: Kazakhstan Stock Exchange – Capacity Building

a project funded by



Almaty, 27<sup>th</sup> September 2010



# Project Overview



## EBRD: KASE Capacity Building Project

❖ Project is financed by  **European Bank**  
for Reconstruction and Development

❖ **Global objective of the project**

- Contribute to the development of a reliable and transparent capital market in Kazakhstan through upgrading the professionalism and capacity of the Exchange's personnel by providing specific, direct advice and training.

❖ **Specific objectives of the project**

- Design practical and feasible liquidity provision measures for KASE and contribute to increased market transparency by addressing trading data availability and data dissemination issues. Furthermore, provision of training to exchange personnel and preparation of a self-study handbook to increase KASE's institutional capacity.

❖ **Project duration**

- Start: July 2010 – Project Finish: November 2010



## Team Composition & Work Approach

❖ **Team composition**

- Team consists of current and former managers, CEOs and board members of Europe based exchanges
- Team has experience in building-up, restructuring and advising exchanges and/or financial market authorities in Russia, China, Czech Republic, Slovakia, Bosnia, Croatia, Romania, Serbia, Egypt, Germany, Austria, Greece, Hungary, Vietnam, Mongolia, ...

❖ **Work approach – defining liquidity measures**

- Focus is on selected feasible and practical solutions
- Interaction with market participants
  - More than 50 meetings with stakeholders were conducted jointly with KASE.
- Only those measure will be highlighted, which have proved to be successful in improving stock market liquidity in other markets



# Benefits of Capital Markets



## Valuable Effects of Developed Capital Markets

### ❖ Macro-economic effects

- Economic growth
- Better developed financial sector
- Better developed productive and service sector
- Increased productivity and capital growth
- Lower unemployment rates
- Poverty reduction

### ❖ Micro-economic effects

- Easier and cheaper access to risk capital, resulting in more flexible financing for enterprises
- Improved governance structures
- Higher research & development power
- Increased mergers & acquisition power
- Increased "entrepreneurial spirit"
- Wealth creation for private investors

**A reliable, efficient, liquid and safe capital market is essential to provide Kazakhstan's companies with an additional access to finance**



## Effect of Market Liquidity on Economic Growth

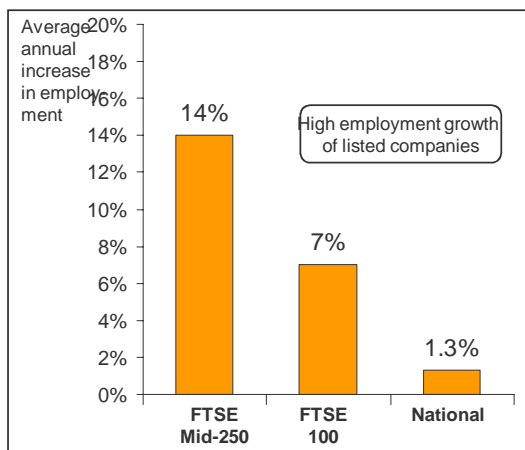
- ❖ **Liquid capital markets foster economic growth**
  - Liquid equity markets make investment less risky and more attractive
  - Allow savers to acquire an asset/equity and to sell it quickly and cheaply
  - By making investment less risky and more profitable, stock market liquidity can also lead to more investment
  
- ❖ **Countries with both liquid stock markets & developed banks grew much faster**
  - Stock markets and banks promote economic growth independently of each other
  - equity financing complements bank lending and bond issues

Source: *Stock Markets: A Spur to Economic Growth*, Ross Levine World Bank

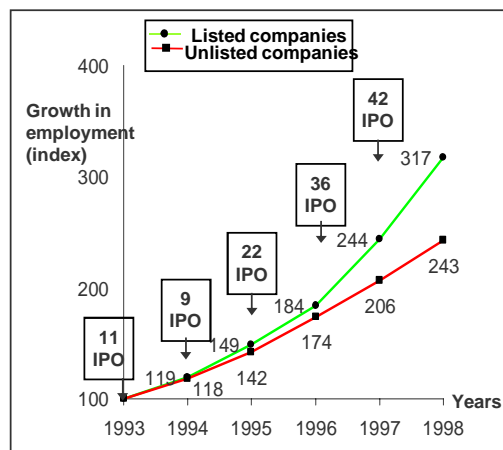


## Availability of Risk Capital Drives Employment

### ❖ UK Example <sup>1</sup>



### ❖ Europe's 500 Employment Growth <sup>2</sup>



Sources: (1) BVCA, PWC; (2) Datastream, BCG Top Performer Study, BCG Analysis



# Current Status



## Current Status: Vicious Circle

### ❖ Marginalized capital market – a vicious circle

- Low market capitalization as well as trade velocity
- Domestic investors seek global liquidity
- Limited access of international investors
- Going public of domestic companies on international exchanges
- Capital markets infrastructure still in development





## Competitive Dynamics

### ❖ Increased international competition

- KASE is facing increasing competition
  - Kazakhstani companies list on foreign exchanges
  - Customs union with RF will further increase competition of exchanges as well as financial institutions for listings and investors
- Other market places are evolving rapidly
  - E.g. currently CHI-X Europe (MTF) trades 3 Kazakhstani IDRs
- International regulatory environment
  - Will further increase international competition by eroding advantages of domestic exchanges and clearing structures
- Alliances are key to drive cost down and to attain critical mass
- Regional approach will strengthen KASE and Kazakhstan's financial sector, but to achieve this, a strong local market is needed



## Potential Reasons for Underdevelopment

### Specifics of companies

- Attractive large non-listed companies are state-owned
- Mainly small/medium sized
- Not listed / no intention to list
- Rely on bank financing
- Prefer to list abroad

### Venture capital market / private equity

- Underdeveloped

### Pension/Insurance system

- Lack of private pension schemes

### Private Stock Ownership

- Low level of private stock ownership
- Lack of awareness/education
- Lack of strategic allocation during IPO
- Invest outside of Kazakhstan

### Ownership structure of listed companies

- Few majority owners
- Small free float

### Lack of attractive stocks

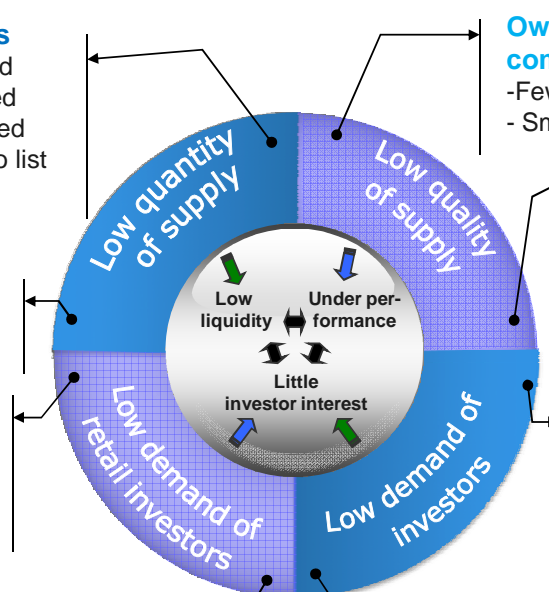
- Few top performers
- Corporate Governance
- Partly weak fundamentals
- Low shareholder value orientation of companies
- Lack of growth segment

### Domestic Institutional Investors

- Pension Funds dominate
- Insufficient activity of other local institutional investors

### International Institutional Investors

- Lack of demand based on low weighting of Kazakhstan's equity market in international portfolios
- Attractive Kazakhstani stocks listed and traded abroad





# Liquidity Measures and Recommendations



# Listing and IPOs at KASE Adjustment of Privatization Strategy

[Supply Side]

## Privatisations contribute to Liquidity

### ❖ Share-issue Privatisations contribute to Exchange Liquidity based on:

- Improved diversification opportunities of investors
- Increased participation of „uninformed“ retail investors
- Improved market liquidity
- Reduced low liquidity - high risk premiums
- Reduced bid-ask spreads
- Eliminated information barriers to investments and thereby boosting liquidity in domestic market
- Improved corporate governance and transparency standards
- Increased liquidity of private companies as positive spill-over effect

**Share-issue Privatization can jumpstart stock market development and trigger gains in economic growth!**

Sources: 1) Pagano,1989, 2) Dewenter & Malatesta,1997, 3) Kyle,1985, 4) Hargis & Ramanlal,1998, Chiesa & Nicodano,2003: 5) Lombardo & Pagano,2000: 6) Bortolotti, de Jong et al.,2004

## Privatization and IPOs

### ❖ IPO pipeline

- Potential IPO candidates:  
Kazakhstan's top 10 companies in terms of sales in 2009\*

Company	Already Listed	Planned IPO**	Open
National Company KazMunayGaz JSC		✓	
Tengizchevroil LTD			✓
ENRC	✓		
Corporaton Kazakhmys Plc			✓
Mangistaumunaigaz JSC	✓		
National Company Kazakhstan Temir Zholy		✓	
PetroKazakhstan JSC			✓
BTA Bank JSC			✓
CNPC-International Aktobe Petroleum JSC			✓
Kazkommertsbank JSC	✓		

\* According to information of ranking "Expert-100-Kazakhstan", made by rating agency "Expert RA", 2009

\*\* According to information obtained from various mass media





## IPO Infrastructure Needed to Succeed

### ❖ Infrastructure preconditions for successful IPO and efficient post IPO trading

- T+3 in place
- CCP or minimum KACD guarantee fund in place
- Specialist /market Maker system in place
- Abolished 5 day rule (or replaced with efficient market surveillance) - high impact on aftermarket price stabilization process and specialist /market maker activity
- Change or adaptation of trading confirmation system
- Capacity of Registry?
- Efficient market surveillance in place
- Upgraded/new trading system in place- capacity testing, failover procedure, business continuity procedure, DR procedure, member network testing and backup.



## KASE as the Listing Place for IPOs

### ❖ Selection of Company decides on IPO Success

- Must be one of "best" state assets to attract worldwide investor attention
- Company selection determines IPO success
- Pricing – has important impact on further market development
  - Increases credibility of capital market and activates retail investor base

### ❖ IPO on KASE increases local market attractiveness

- Company should be listed only on Kazakhstan Stock Exchange
  - Capability of infrastructure has to be ensured
- Double listing should be avoided
- Will attract international investor to local market
- Increases liquidity and investment activity on KASE
- 'Motivates' international participants to become KASE remote members



## Impact on Secondary Market Trading

### ❖ IPO allocation influences secondary market trading

- Proper allocation structure is crucial for post IPO market trading
- Mobilizes retail and domestic institutional investors
- Educational effect for new IPO (state and private)
- Spill-over effect creates IPO market



## Case Study: Croatia - IPO Values

### ❖ Strategic allocation to increase domestic demand



INA Oil&Gas	Listing: end of 2006	T-HT Telecom	Listing: end of 2007
•Privatization of	17%	•Privatization of	32,5%
•Total issued value	400 mEUR	•Total issued value	940 mEUR
•Total demand	2,7 bEUR	•Total demand	5 bEUR
•Total domestic demand	700 mEUR	•Total domestic demand	2,3 bEUR
•Total retail demand	200 mEUR	•Total retail demand	1,7b EUR



## IPO Market Follow Up

<i>Issuer</i>	<i>Size of IPO</i>	<i>Demand</i>	<i>Retail</i>	<i>% retail allocation</i>
Magma*	40m EUR	240mEUR	9.500	40%
Ingra*	47mEUR	135mEUR		0
Veterina	25mEUR	107mEUR	7.600	30%
Atlantic Grupa*	100m EUR	400m EUR	20.000	25%

- ✓ Private IPO s: cap increase, exit,
- ✓ 7 IPO s in 2 years



## Example of a Successful Retail IPO





# Introduce New Products

[Supply Side]



## Financial Derivatives Market at KASE

### ❖ Status quo

- KASE is planning to introduce a financial derivatives market
- Planned products: FX Futures, Index Futures

### ❖ Pre-requisites for successful launch of derivatives

- Regulation in place
- Adequate trading system
- CCP operative
- Short-selling and stock lending possible
- Sufficient base liquidity on underlying stock market
- Trained traders and investors

### ❖ Recommendation

- Ensure that pre-requisites are in place
- Start with index futures, followed by single stock futures and options

### ❖ Impact

- Derivatives markets increase trading volumes on underlying market
  - Example: In 1H2010 the single stock futures' proportion in cash market turnover was approximately 20% at one of European stock exchanges



## Exchange Traded Funds

### ❖ **ETFs are major drivers of turnover volumes**

- Infrastructure must be in place before ETFs can be introduced
- ETFs used to be issued by exchanges, but now are created by highly specialized institutions
- Kazakhstani stocks are constituents of ETFs, but these are listed abroad

### ❖ **Role of exchange: Design index in a “fund-friendly” way:**

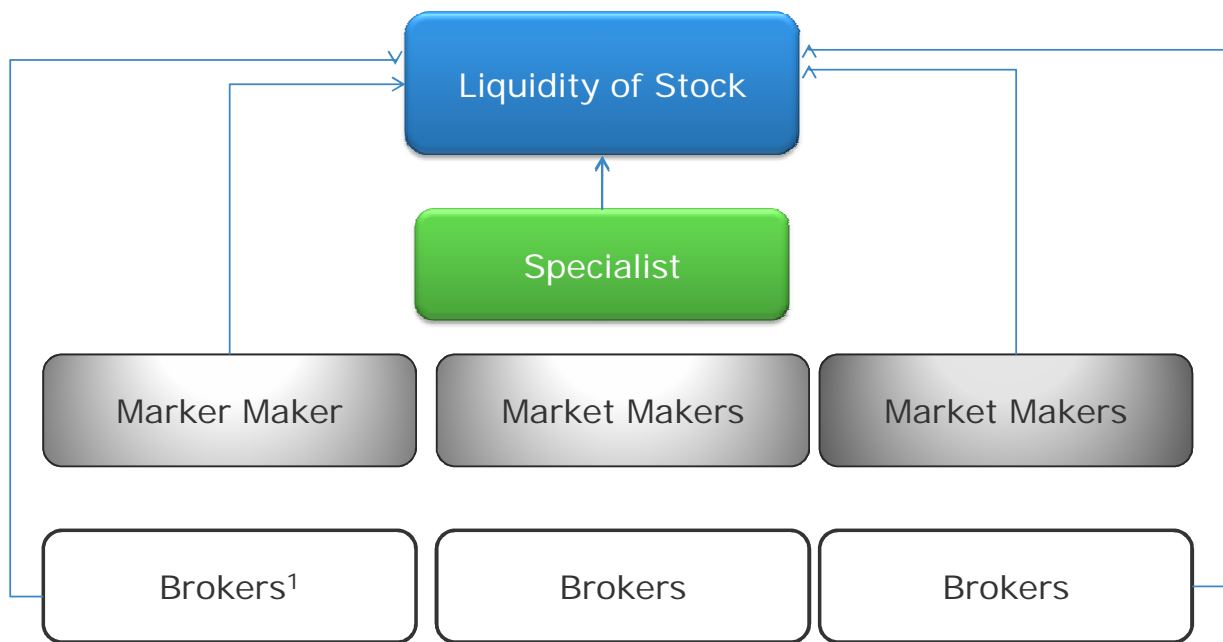
- Weighting: UCITS-compliance, either because of “natural” reason or by special weighting rules
- Re-balancing rules and replacement rules that minimize portfolio turnover
- The index is rules-based. A “back-up” or “ad-hoc” decision-making entity is used only for emergencies not anticipated by the rules
- The number of stocks included in the index is not too large
- The free float has a minimum capitalization



## Introduce Combined Specialist & Market Maker System

[Demand Side]

## Specialist/Market Maker System



<sup>1</sup> Agent and principal trades

## Specialists as "Super" Market Makers

### ❖ Description

- Specialists are "super market makers" with better (more stringent) minimum size and maximum quote obligations than regular market makers
- In exchange for more stringent obligations, specialists enjoy certain *benefits*:
  - No transaction fees
  - Bonus: Specialists may receive a certain percentage of the fees (agent and principal) in the stock volume they create
  - Optional: Issuer may also pay a lump sum to the specialist
- Each year, a tender procedure determines who will become specialist for a certain stock
  - Tender is effected in terms of minimum size and maximum quantity



## Specialists and Market Makers

### ❖ Impact

- Stocks with market makers and a specialist are more liquid than shares with regular market makers only
  - Result: Narrower spreads and higher minimum size
- Spread and size are determined by competitive forces (tender) rather than by the exchange itself
- Specialists participate in transaction fees generated by them
- Exchange fee income from specialist trades is lower than from regular market makers, but will be more than offset by higher turnover



## Attract International Remote Members

[Demand Side]

## International Remote Members

### ❖ Background

- Currently, no investment bank/broker domiciled outside of Kazakhstan is remote member of KASE 's equity market
- It is not possible to become RFCA member without opening a subsidiary in Almaty
- Securities Law, AFN Resolution 360 and KASE Regulation allow foreign financial institutions to become KASE members without opening a subsidiary in Kazakhstan
- According to AFN Resolution 360 a foreign legal entity can become KASE member if it complies with one of the following conditions:
  - Member of an exchange, which is member of World Federation of Exchanges
  - Has a qualifying license of the home country 's authorized body for carrying out brokerage/dealer activities. Admission is subject to MoU between the home country regulator and AFN
- KASE decides on granting membership according to its regulation

### ❖ International remote members are liquidity providers in many markets

## International Remote Members

### ❖ Increasing importance of international remote members

Stock Exchange	Domestic Members		Int. Remote Members	
	2005	2010	2005	2010
Budapest Stock Exchange	26	22	4	4
EURONEXT – Brussels	31	17	83	140
EURONEXT - LISBON	17	16	22	74
Irish Stock Exchange	11	9	5	14
Nasdaq OMX - Riga (Latvia)	10	12	5	18
Nasdaq OMX - Tallin (Estonia)	8	5	9	26
Nasdaq OMX - Vilnius (Lithuania)	19	12	0	22
Oslo Stock Exchange	21	26	14	34
Vienna Stock Exchange	44	41	22	53
Warsaw Stock Exchange	23	28	7	19
<b>Total of selected exchanges</b>	<b>210</b>	<b>187</b>	<b>171</b>	<b>404</b>

Source: FESE, internal analysis





## International Remote Members

### ❖ Recommendations

- KASE starts actively promoting remote membership
- RFCA allows KASE foreign remote members to become also RFCA members without being located in Almaty
  - Would mean a paradigm shift in RFCA´s policy
  - Is a regional financial centre a place where a majority of companies is located or where investors and issuers find a high level of market liquidity?
  - It can be assumed that an increasing number of foreign remote members may later on decide to open a subsidiary in Almaty if sufficient market liquidity is present
- KASE prepares remote membership application kit
  - List of required documents and minimum requirements
  - Market information and technical connectivity requirements
  - KASE-Membership application form
  - KACD CCP - Clearing contract (or agreement with GCM in case of NCM)

### ❖ Impact on Trading Volume

- Additional trading volume is depending on number of remote members
  - E.g. In Austria foreign remote members contribute 50% to the trading volume



## Offer Direct Market Access

[Demand Side]



## Direct Market Access (DMA)

### ❖ Growing importance of Direct Market Access

- Direct Market Access (DMA) is a facility which allows brokers to offer clients direct and full access to the exchange trading system through the broker's infrastructure, notably, without manual intervention by the broker.
- Advantages of DMA:
  - Direct control of clients over their orders
  - Faster execution of client orders
  - Reduced risk of errors associated with manual order entry through broker
  - Greater transparency
  - Increased liquidity
  - Lower impact costs for large orders (by the use of smart algorithms which slice the orders to minimize the impact)
- Currently, KASE and its trading members do not offer DMA



## Regulatory Aspects of DMA

### ❖ Regulatory requirements for Direct Market Access

- IOSCO issued "*Principles for Direct Electronic Access*" (08/2010)
- Pre-conditions for DMA
  - Principle 1: Minimum customer standards
  - Principle 2: Legally binding agreement between FMI and client
  - Principle 3: Intermediary's responsibility for trades
- Information flow
  - Principle 4: Customer identification (responsibility of FMI)
  - Principle 5: Pre- and post-trade transparency (provided by market to FMI)
- Adequate systems and controls
  - Principle 6: Markets should ensure that appropriate systems/controls are in place
  - Principle 7: Intermediaries should use controls, including pre-trade control, which can limit or prevent DMA clients from placing an order exceeding existing position/credit limits.
  - Principle 8: Adequacy of systems – FMIs (including clearing firms) should have adequate operational/technical capabilities to manage appropriately the DMA risks.

### ❖ Specific regulation is needed for KASE DMA



## DMA and Market Turnover

### ❖ Potential impact of DMA on market liquidity

- Int. research & analysis firm Celent estimates that DMA accounts for about 15-18% of stock trading in the US and predicts that flows will increase to 20% in 2010.
- DMA flows for equities in Europe is expected to grow from 8% of traded value to 15% in 2011.
- DMA was introduced in India in 2008 and it is expected that by 2010 around 11% of trading volume will come from DMA
- Increasing number of transition countries allow DMA to increase market liquidity and service level
  - E.g. Croatia, Singapore, Korea, Taiwan, Vietnam, Malaysia, India, Brazil...
- Research by Credit Suisse confirms that markets allowing DMA have higher turnover and lower spreads.<sup>1</sup>

<sup>1</sup> Source: Brook Teeter, director, equities, Advanced Execution Services, Credit Suisse (Hong Kong) <http://www.thetradenews.com/expert-opinions/1519>



## Ensure Technical Readiness for High Frequency Trading

[Demand Side]



## Technical Readiness for High Frequency Trading

### ❖ Description

- High frequency trading (HTF) accounts for increasing amounts of stock turnover in many mature economies
- HTF requires a sophisticated IT infrastructure on part of exchanges

### ❖ Measures

- Ensure technical readiness for HFT over a medium-term horizon

### ❖ Impact

- Increase in market quality due to HTF may be expected<sup>1</sup>
  - Provision of liquidity
  - Decrease in bid-ask spread
  - Decrease in volatility
- HTF was responsible for more than 70% of US equity turnover (2009)
- HTF recently moved to emerging markets (Brazil, Columbia, etc.)

<sup>1</sup> Brogaard: High frequency trading and its impact on market quality; Kellogg School of Management, Northwestern University, 2010 and the literature cited therein



## Rethink Trade Confirmation Rule

[Market Infrastructure & Operations]



## Trade Confirmation

### ❖ Description

- Pension funds transaction: Obligation of custodian to verify all transactions concluded by pension funds slows down investment activity – there is no finality of the trades
- KACD trade confirmation due to T+0 principles –transaction uncertainty

### ❖ Measure

- Abolish trade confirmation system- Law on Pensions, Section 3, Chapter 7, Article 26.
- Proper asset allocation should be solely obligation of pension fund management company. Subject to AFN supervision and detailed reporting



## Trade Confirmation

### ❖ Impact

- With removal of this administrative barrier, you will achieve the following positive effects:
  - Increase investors activities
  - Eliminate transaction uncertainty
  - Step by step introduction of day traders and high frequency trading ( also connected to DMA and technical infrastructure)
  - Improving of market maker activity
  - Increase of investor confidence

### ❖ Final outcome

- Increase in market attractiveness and liquidity



# Implement Additional Marketing Measures

[Demand]



## Road Shows & Investor Conferences

### ❖ Guiding principles

- CEOs, CFOs and IROs of KASE listed companies present the company to institutional investors
- Target groups: renowned international institutional investors
- Key destinations: London, Frankfurt, New York, Paris, Moscow and Tokyo
- Organised in cooperation with investment banks/brokers & companies
- Company will have to cover their travel costs
- KASE organises meeting space
- Investment bank/broker invites investors and promotes event/companies
- RFCA support is highly appreciated as it will leverage the efforts of KASE

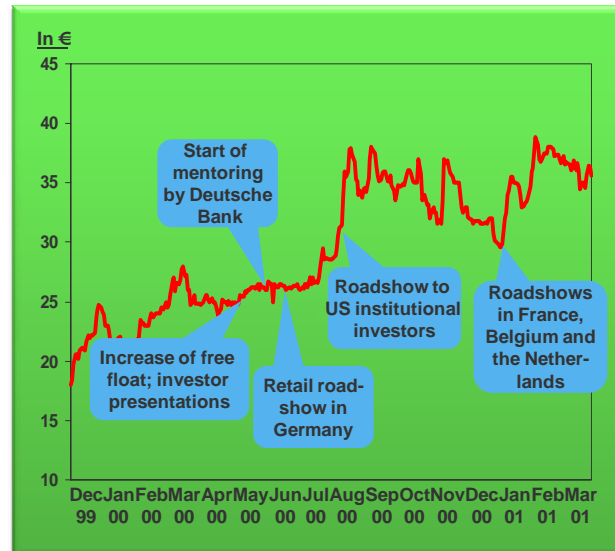
### ❖ Impact of road shows & investor conferences

- Roadshows increase awareness of institutional investors
- Increased analyst coverage
- Resulted in higher trading volumes in shares of participating companies

## Roadshows Increase Trading Volumes

### ❖ Impact: Increased trading volumes

- **Case Study: Strong impact of roadshows on share performance**
  - Mid-cap Company: Palfinger



## RFCA-KASE Research Report Scheme

### ❖ Current situation

- Low level of liquidity in mid & small caps with a number of negative effects
  - Overall market reputation
  - Cost of capital for issuers
  - Profitability of the exchange
- Research coverage of mid & small caps is rare

### ❖ Measure: Company research coverage scheme

- Scheme to enhance research coverage of KASE listed stocks
- Raise profiles of listed companies
- Speed-up learning curve of listed companies regarding value of transparency
- Provide investors with more information to facilitate investment decisions
- Research reports will be published on KASE's website free of charge
- Partly or full coverage of research reports costs by RFCA

### ❖ Available company research increases trading volume

## Case Study: Bursa Malaysia Scheme I

### ❖ CMDF-Bursa Research Scheme (CBRS)

- Platform for Bursa Malaysia to highlight strong performing small- to mid-capitalised companies that are often ignored by investors
  - Participating companies pay 50% of the cost (RM60,000 ~EUR12,000) for a two-year participation in CBRS and coverage by two research houses while the Capital Market Development Fund (CMDF) subsidizes the balance.
- Mechanics
  - Each participating listed company will be covered by at least 2 research firms
  - Research reports are disseminated by Bursa Malaysia free of charge
  - All listed companies and research firms are invited to participate
  - Scheme was offered between 2005 to 2010 – extension planned

### ❖ Result: Increased trading volumes

- S&P Study found that CBRS had a significant impact on trading volumes
- **41% occurrences of increased trading volumes on average in the month following the release of research report on a given company**
  - 214 companies are analysed
  - Around 50,000 downloads per month

Source: Bursa Malaysia and <http://biz.thestar.com.my/news/story.asp?file=2010/9/7/business/6806376&sec=business>

## Case Study: Bursa Malaysia Scheme II

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Company Announcements ▾ **Preamble**

Structured Warrants ▾

List of Companies ▾

Entitlements by Ex-Date

SPEEDS

IPO Summary ▾

Main & ACE Market

**Research Reports (CBRS)**

IR Manual

Relatively low levels of liquidity in "smaller" capitalised stocks have been an issue for many stock exchanges, as they have implications from a variety of perspectives - investor protection, cost of capital for issuers, overall market reputation, and exchange profitability.

As part of measures to enhance liquidity, Bursa Malaysia has launched the 2nd phase of the CMDF-Bursa Research Scheme ("CBRS II"). The scheme is intended to generate interests in stocks, particularly smaller capitalised ones.

The 2-year pilot phase of the scheme, which was launched in June 2005, was completed in June 2007 with participation of more than 300 listed issuers.

CBRS II has commenced in October 2007 and as of June 2008, a total of 212 listed issuers participated.

**Click here for free Research Reports**

Source: Bursa Malaysia; [http://www.kse.com.my/website/bm/listed\\_companies/research\\_reports\\_cb.rs.html](http://www.kse.com.my/website/bm/listed_companies/research_reports_cb.rs.html)





## Retail Investor Participation

### ❖ Only investors with know-how invest in the stock market

- Investor education is also major pillar of investor protection
- RFCA is already active in the field
- Retail investors often prefer convenient access to the stock market (online brokers)

### ❖ Measures

- Self-study handbook
- Lobby for introduction of investment basics in high school curricula
- Cooperate with universities and other institutions of higher learning
- Train financial advisors
- Promote online brokers

### ❖ Impact

- Private investor know-how and maturity/liquidity of the stock market are everywhere positively related
  - Example: Philippine Stock Exchange experienced a 7% increase in private investor accounts following a market education campaign in 2009
- Active participation of retail investors in upcoming IPOs



## International Benchmark Indices

### ❖ Trillions of funds are tied to international benchmark indices

#### ❖ Example: MSCI Index

- Both country weight in an index and category of index (mature vs. emerging market vs. frontier index) are important
- Kazakhstan is in frontier index (= low end category)
- Kazakhstan has weight of 4,4% in frontier index
- Comparison Nigeria 10%, United Arab Emirates 12%



## High Index Representation Drives Volume

### ❖ Measures

- All measures that increase size, free-float, liquidity and foreign participation increase the country weights
  - IPOs of large SOEs with balanced allocation to foreigners
  - SPOs increasing the free-float
  - In general, all liquidity-improving measures are reinforced via this venue
- All measures that enhance the operational framework increase the likelihood of graduation into higher categories
  - CCP, settlement cycle, etc.

### ❖ Impact

- Potentially huge: More than \$3 trillion is benchmarked to the MSCI International Equity Indices



# Implement T+3 Implement Central Registry

[Market Infrastructure & Operations]

# Introduction of T+3 settlement cycle

## ❖ T+0 settlement

- Understandable for transition countries due to insufficient financial market infrastructure, poor market liquidity and implied counterparty risks
- Pre-funding of transaction required. Settlement date for cross-border is shifted to T-3 or requires special agreement with custodian and this increases overall transaction costs
- T+0 in repo, bond and money market
- Has negative impact on trading activity
- Shifts settlement risk to stock exchange member
- Slows down investment process
- Not in line with FX spot settlement T+2- imposes additional currency risk

# Introduction of T+3 settlement cycle

## ❖ International norm & best practice

	Bond	Equity		Bond	Equity
Austria	T+3	T+3	Italy	T+2 for BOT and T-bill T+3	T+3
Belgium	T+3	T+3	Latvia	T+3	T+3
Cyprus	T+3	T+3	Lithuania	T+3	T+3
Czech Republic	T+3 to T+5	T+3	Luxemburg	T+3	T+3
Denmark	T+2 and T+3	T+3	Malta	T+0	T+0
Estonia	T+3	T+3	Netherlands	T+3	T+3
Finland	T+3	T+3	Poland	T+2 for t-bills and T+3	T+3
France	T+3	T+3	Portugal	T+3	T+3
Germany	T+2	T+2 to T+5	Slovak Republic	T+1 for T-bills and T+3	T+3
Greece	T+3	T+3	Slovenia	T+2	T+3
Hungary	T+2	T+5	Spain	T+3	T+3
Ireland	T+3	T+3	Sweden	T+2 for t-bills and T+3	T+3
			UK	T+1(Gilts)	T+3



## Introduction of T+3 settlement cycle

### ❖ T+3 settlement “condicio sine qua non” for further development of capital market

- T+3 is international norm and best market practice
- Reduce FX risk for cross border investors
- Allows cancellation of deals and mistrades
- Allows netting principles (reduces post-trade costs)
- Allows efficient market surveillance (real time and post trade)
  
- **Major prerequisite for CCP introduction or any form of guarantee fund**
- **Implementation ASAP**



## Central Registry

### ❖ Status quo

- 11 registries are operative

### ❖ Recommendation

- Centralize registry functions in KACD as Central Registry

### ❖ Impact

- Enables efficient retail participation in upcoming IPO's
- Increases corporate action efficiency, dividend payment, stock splitting, capital increase and right issuing
- Enable further development of institutionalized securities lending facility



# Upgrade Market Surveillance

[Market Infrastructure & Operations]



# Efficient Market Surveillance

## ❖ Functions and goals

- Effective market surveillance has the primary function of ensuring effective and independent marketplace integrity, investor protection and building of investor's confidence in the capital market in general

## ❖ Recommendations

- In order to prevent market manipulation, the stock exchange must be an effective first "defense" line
- Current market surveillance practice must be improved through an efficient market surveillance IT system
- IT system must ensure effective real-time and post-trade market surveillance
- Fine adjustment of market surveillance regulation to current market condition with purpose to increase investment activity. Review of 5 days rule (Law No.461 art. 56/3/1)
- Appropriate KASE market surveillance regulation and procedures can fully replace this article, which now creates uncertainty among market players



## Efficient Market Surveillance

### ❖ Impact

- Overall increasing of investor's confidence and credibility of Kazakhstan capital market
- Improving of capital market attractiveness
- Efficient market surveillance is additional infrastructure set up for further development of day trading, high frequency trading, market making, short selling, development of structured products and derivatives market

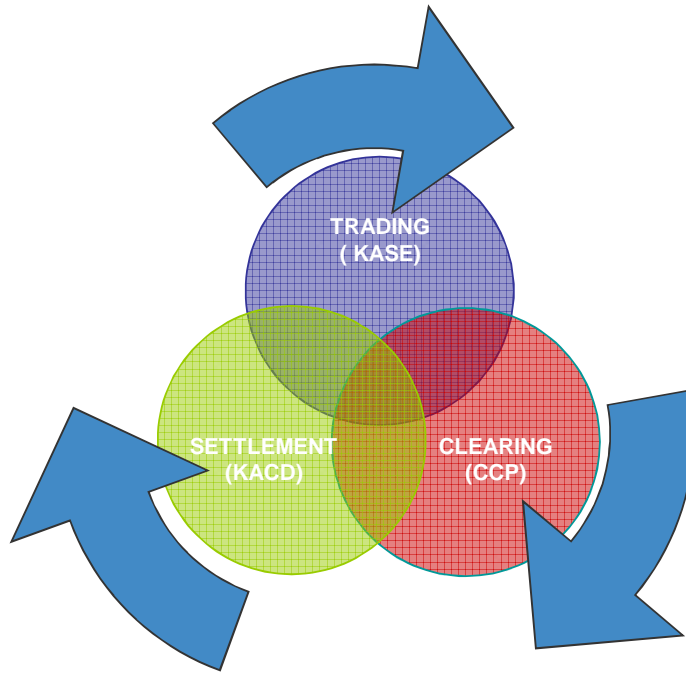


## Implement Central Counterparty CCP

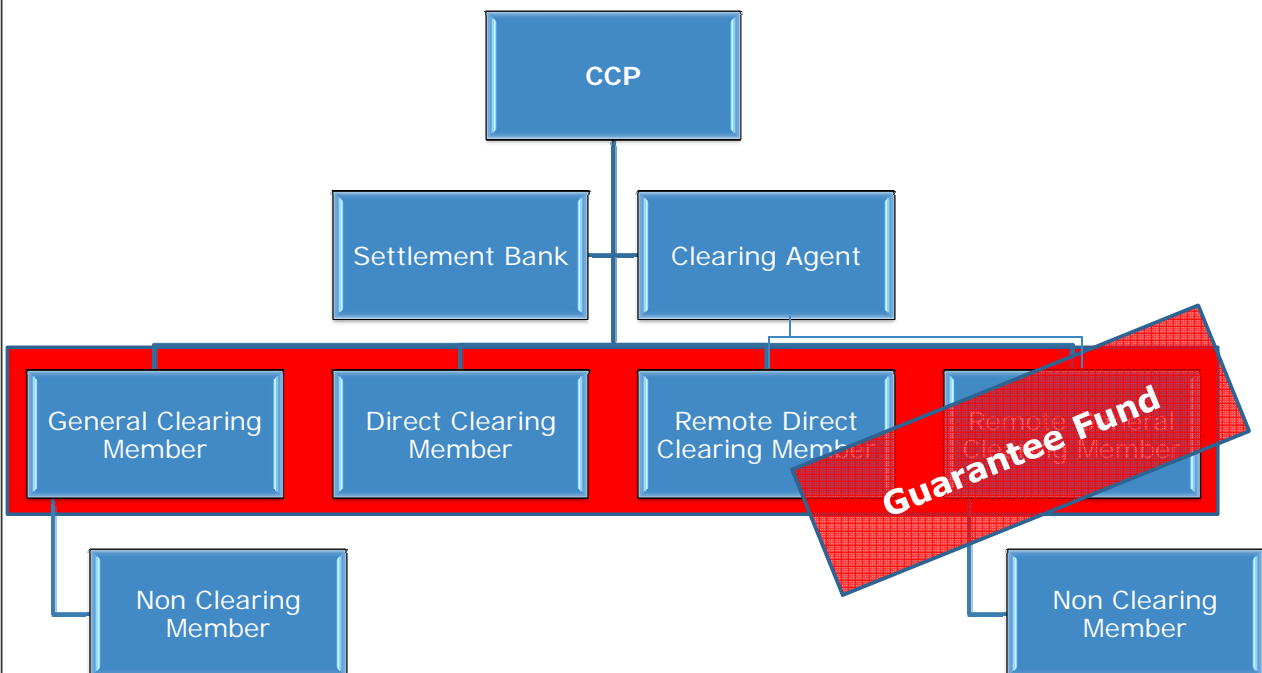
[Market Infrastructure & Operations]



# Standard Market Model



# Stakeholder Structure Clearing





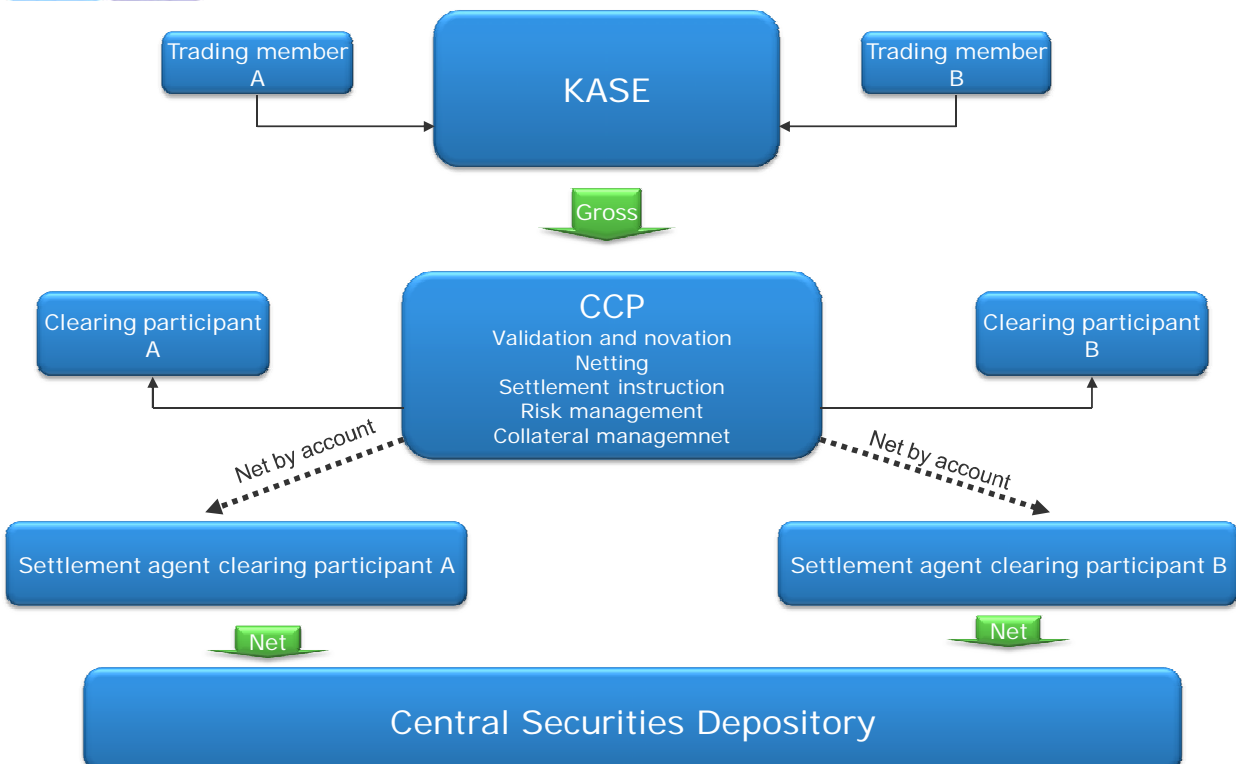
# Membership Clearing

## ❖ Recommended types of clearing membership

- **General Clearing Member (GCM)**
  - Authorized to settle transactions for their own account and for customers as well as the transactions of other members (NCM) under the condition that a clearing agreement with such member has been concluded.
- **Direct Clearing Member (DCM)**
  - Authorized to settle transactions for their own account and for customers.
- **Clearing Agents (CA)**
  - Act as a technical assistant for the settlement of securities trades for DCMs for the account of the DCM. The Clearing Member undertakes to guarantee the fulfillment of customers' trades, but only if said Clearing Member has been put into a position to meet its obligations by the customer.
- **Non Clearing Member (NCM)**
  - have access to the trading system, but are not admitted as clearing members. Trades are settled through a General Clearing Member GCM.



# CCP Clearing and Settlement Process







## Lines of Defense – KACD CCP

### ❖ General provisions

- Sound rules & regulations
- Distinct membership circle
- Strong capital Requirements
- Intra-day margin Calculation
- Regular member ratings
- Pledged collateral

### ❖ Risk management

- LoD1: Daily margin requirement
- LoD2: Minimum collateral
- LoD3: Risk premium (Rating)
- LoD4: Haircuts on collateral
- LoD5: Guarantee fund
- LoD6: KACD CCP own funds
- LoD7: Ownership structure



## Upgrade KASE Trading System

[Market Infrastructure & Operations]



# Trading System

## ❖ Measure

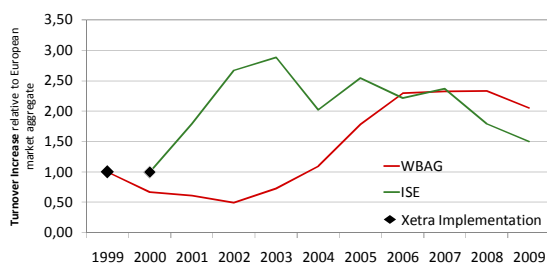
- Upgrade KASE trading system
- Ensure technical support for introduction of new markets and instruments, new trading methods
- Ensure high capacity due to upcoming IPO's
- Ensure stability and business continuity
- Standardized IT connectivity & capacity for: remote members, Direct Market Access, high frequency trading, algorithmic trading, efficient market surveillance
- Fast and efficient time-to-market implementation



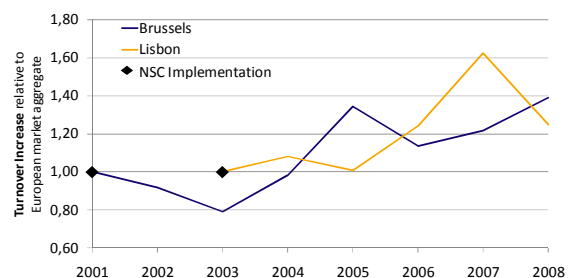
# Effects of Trading System Change

## ❖ Introduction of an international trading system may facilitate a more attractive and liquid market

Turnover of WBAG and the Irish Stock Exchange after the Xetra implementation (relative to performance of European markets)



Turnover of Brussels and Lisbon markets after the NSC implementation (relative to performance of European markets)





# Strategic Capital Market Development



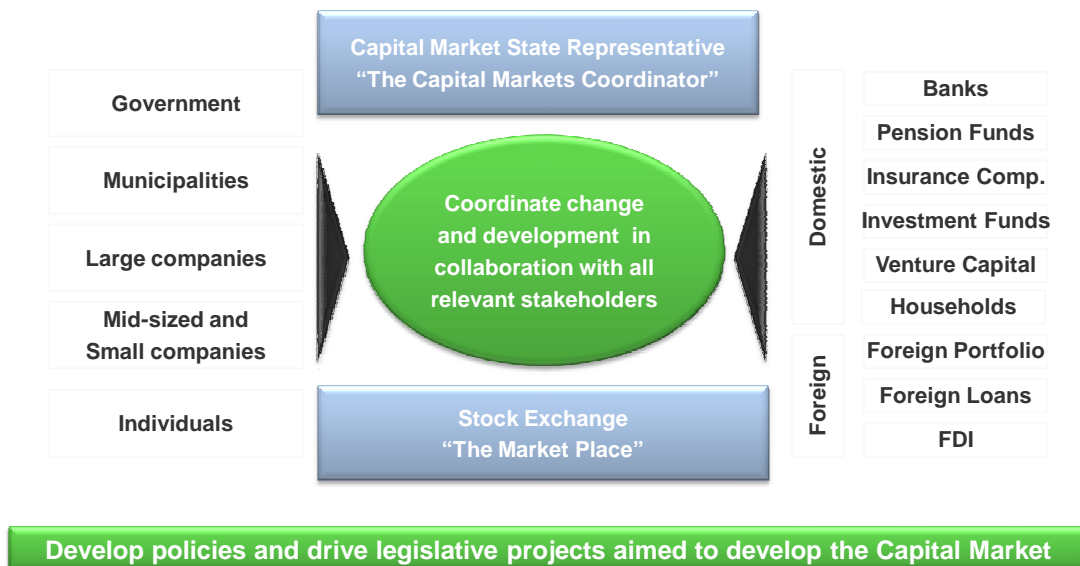
## Managing Strategic Capital Market Development

### ❖ Key elements that will tip the difference between success and failure:

- Clear strategy for development
- Political commitment from top political leadership
- Transparency and fairness of development process
- One central unit coordinating all capital market development efforts (RFCA)
- Favourable legal environment
- Selecting the appropriate development methods/measures and implementation partners
- Adjusting regulatory framework to cope with international trends
- Fast decision making processes

## Capital Market Representative as Coordinator

### ❖ Coordinated and systematic management of capital market development efforts and initiatives



## The State Capital Market Representative

### ❖ Measure

- Create the position of a State Capital Market Representative
- Responsibility: representation of capital market needs at a high level
  - Planning, channelling, counselling, driving all necessary changes

### ❖ Objectives and benefits

- Integrate and consolidate actions to support entire capital market infrastructure
- Eliminate inconsistencies and barriers limiting growth
- Speed-up change processes, especially regulatory

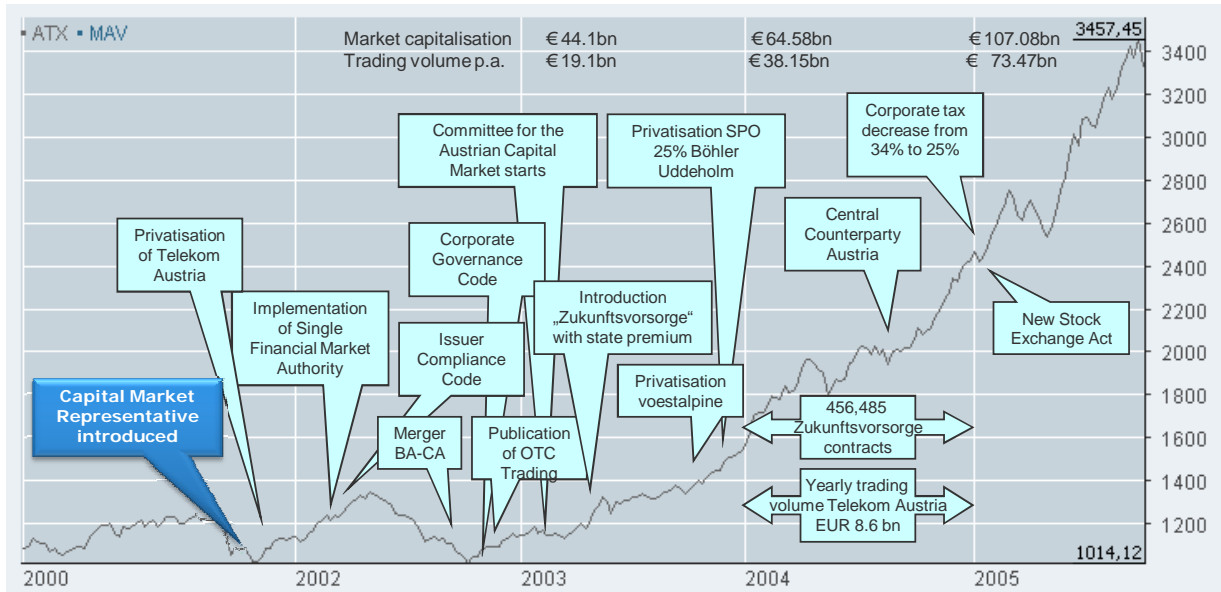
### ❖ Role

- Grow the breadth and depth of the capital market and support RFCA and market initiatives
- Develop policies and projects of regulations concerning capital market in collaboration with RFCA
- Exert influence over regulations that affect capital market
- Lead critical projects on government level



# Case Study: Securities Market Austria

## ❖ Best performance and high liquidity through well planned capital market initiatives



2006: Market capitalisation € 146.2 bn (57% of GDP); trading volume €125.85 bn



## Summary



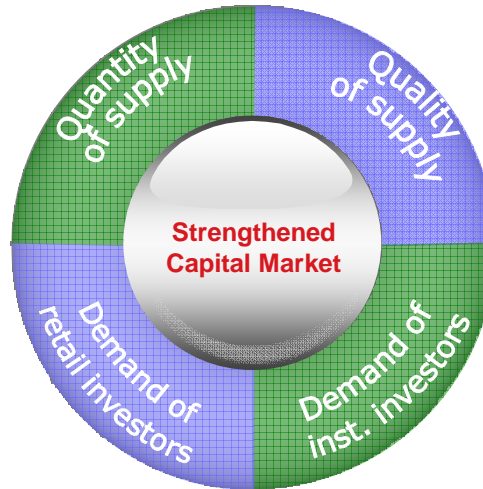
## Potential Levers to Strengthen Kazakhstan's Equity Market

### Increase quantity of supply

- IPOs of SoEs on KASE
- Initiate PR-campaign and educational program
- Identify & approach companies for new listings
- Support IPO process
- Foster high growth sectors
- Develop Venture Capital industry

### Increase demand of retail investors

- Investor education (handled by RFCA Academy)
- Start PR-campaign
- Target selected distribution channels
- Introduce specialist/market maker system
- Consider higher retail allocation at SoE IPOs



### Leverage market infrastructure

- Implement CCP (t+3, guarantee fund)
- Upgrade trading system
- Implement market surveillance system
- State Capital Market Representative

### Improve quality of supply

- Promote value management initiatives for the industry
- Encourage companies to increase free float
- Educate company managers
- Train corporate advisers
- Promote Corporate Governance
- Organize road-shows

### Increase demand of institutional investors

- Introduce specialist/market maker system to enhance liquidity
- Enhance general IR-activities by organizing road-shows and analyst conferences
- Focus on defined target groups (local and int.)
- Improve data services
- Support Analyst Report coverage



## Selected Liquidity Improvement Levers for Kazakhstan by Type

Measure	Liquidity Impact	Difficulty of Implementation	Responsible Institutions
<b>INFRASTRUCTURE AND OPERATIONS</b>			
Upgrade Trading System	Low	High	KASE
Central Counter Party	High	High	KASE/KACD
Surveillance System at KASE	Low	Low	KASE
Implement T+3	Medium	Medium	KACD/KASE
Implement Guarantee Fund	Medium	Medium	KACD
Short selling/stock lending	Medium	Medium	AFN
Rethink 5-day rule	Low	Medium	AFN
Rethink Trade Confirmation	Low	Medium	AFN
<b>DEMAND SIDE</b>			
International Remote Members	High	Low	KASE
Specialist/Market Maker System	High	Medium	KASE
Direct Market Access	Medium	Low	AFN/KASE/Members
HFT & capability of trading system	Medium	Medium	Members/KASE
Investor Education	Medium	Medium	RFCA/KASE
RFCA-KASE Research Scheme	Medium	Low	RFCA/KASE/Issuers
Specialist/Market Maker System	High	Medium	KASE
<b>SUPPLY SIDE</b>			
Conduct SoE IPOs on KASE	High	Medium	Government
New Products/Derivatives	High	High	AFN/KASE/Members
Roadshows/ IR Companies	Medium	Low	KASE/Issuers

## Measures Ranked by Liquidity Effect

Measure	Liquidity Impact on Equities	Difficulty of Implementation	Pre-requisite Linked to	Responsible Institutions
International Remote Members	High	Low	T+3, guarantee fund, trading system	KASE
Conduct SoE IPOs on KASE	High	Medium	KASE readiness	Government
Specialist/Market Maker System	High	Medium	T+3, guarantee fund,	KASE/Members
Central Counter Party	High	High	T+3, guarantee fund	KACD/KASE
New Products/Derivatives	High	High	Upgrade trading system	AFN/KASE/Members
Direct Market Access	Medium	Low	Upgrade trading system T+3, guarantee fund	AFN /KASE/Members
RFCA-KASE Research Scheme	Medium	Low		RFCA/KASE/Issuers
Roadshows/ IR Companies	Medium	Low		KASE/Issuers
Implement t+3	Medium	Medium	Guarantee fund	KACD/KASE
Implement Guarantee Fund	Medium	Medium	T+3	KACD
Short selling/stock lending	Medium	Medium	Regulatory approval New Products/Derivatives	AFN
Investor Education (Increase Financial Literacy)	Medium	Medium		RFCA
HFT + HFT capability of trading system	Medium	Medium	Upgrade trading system, Remote members	KASE/Members
Surveillance System at KASE	Low	Low		KASE
Rethink Trade Confirmation	Low	Medium	Regulatory approval,	AFN
Rethink 5-day rule	Low	Medium	Regulatory approval, DMA, Remote members	AFN
Upgrade Trading System	Low	High	Prerequisite for most measures	KASE