

Russian Capital Market 2007

Facts and events

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Introduction

This paper deals with the situation in the Russian capital market in the year 2007. Our purpose was to give a general idea of the Russian capital market and its key elements – instruments, participants, infrastructure, regulation and supervision systems, as well as list the main market events of the year. The present report was prepared by the National Association of Securities Market Participants with active participation of the Moscow School of Management SKOLKOVO.

Please note:

first, in this review we strived to avoid extensive comments and judgments, except for those necessary to understand the data contained in the present report, its dynamics, as well as the essential features of the Russian capital market;

second, we used the data as of the end of 2007 whenever possible; however in some cases when such data were unavailable we used available data with the timestamp as close to this date as possible;

third, it was not our purpose to show a lengthy trend of the Russian market development prior to 2007. Generally, when using historical data, we limit ourselves with the information dating to no earlier than 2005;

fourth, the numerical data in the review are presented both in national and in foreign currency. This is due to peculiarities of trading and presenting results;

fifth, sometimes we quote data from different sources to show the existing dissimilarity in estimates or calculations.

We acknowledge and are thankful for the materials and assistance granted to us by RTS Group, Moscow Interbank Currency Exchange Group, Group of companies “REGION”, the League of Management Companies and PARTAD (both are selfregulating organizations), and as well Standard&Poor’s, EPFR Global, ReDeal Group and CBONDS agencies.

1. Instruments

1.1. Shares

The CJSC SKRIN database, as of the end of 2007, contains entries on 128,356 share issues effected by 86,598 issuers (for comparison, as of the end of 2006, this database contained entries on 124,911 share issues effected by 85,170 issuers). Russian legislation requires registering all share issues by all joint stock companies (including closed joint stock companies). The overwhelming majority of all these shares are absolutely illiquid, and they are not quoted in secondary markets.

A tiny part of these share issues is traded on stock exchanges. See summary data on shares offered at Russian stock exchanges in Table 1.¹

Table 1. Formal Share Market.

	MICEX			RTS		
	2005	2006	2007	2005	2006	2007
Number of Issuers	163	190	208	261	281	302
Number of Share Issues	256	325	309	383	398	413
including these in the quotation lists (common/preferred shares)	34/16	46/14	71/16	46/13	63/13	87/16

Sources: MICEX, RTS

It should be noted that the overwhelming majority of the share issues traded on formal markets (70-75% of their total number) refer to non-listed securities. The number of the share issues offered on formal markets has a small growth tendency: about 3.8% annual growth. The growth rate of the number of instruments included in the quotation lists of different levels, is much higher, 30 to 35%.

A specific feature of Russian capital markets is the opportunity to conduct organized trade in securities of the same issuer simultaneously on several stock exchanges. Therefore a considerable part of the issuers is present at both of the principal Russian stock exchanges. Shares of some Russian issuers, in the form of depository receipts, are traded at foreign exchanges as well. According to Standard&Poor's data², the number of Russian issuers with shares listed at RTS, Moscow Interbank Stock Exchange, NYSE, NASDAQ as well as entered in the LSE-listed S&P EMD Russia index, was 309 as of December 2006, and 328 as of December 2007.

The data on the Russian issuers' share market capitalization are shown in the Table 2.

Please note that at present there is no commonly accepted methodology for calculating Russian issuers share market capitalization. Because of that, this report uses data from several sources.

¹ Hereinafter, the quoted data refer to the end of the period.

² Emerging Stock Markets Review, S&P, 2007 issues series.

Table 2. Russian issuers share market capitalization

Units		2005	2006	Q1-07	Q2-07	Q3-07	Q4-07
MICEX ³	billion roubles	N/A/7,440	25,482/23,338	N/A/23,630	N/A/24,860	N/A/25,720	32,740/29,975
MICEX	billion \$	N/A/259	966/885	N/A/908	N/A/964	N/A/1,041	1,329/1,217
RTS							
classical market	billion \$	329	966	1,028	1,060	1,116	1,329
S&P data ⁴	billion \$	549	1,057	1,125	1,169	1,253	1,503

Sources: MICEX, RTS, S&P.

Capital Market Development Center (CMDC) estimates the total Russian share market capitalization, as of the end of 2007, as 1,341.5 billion dollars, or 32.9 trillion roubles. The FFMS of Russia, in a draft report published on the official Service's Web-site to be discussed with the market participants⁵, estimates the share market capitalization at 32.3 trillion roubles. In general, at the experts' consensus, as of the end of 2007, the market capitalization for the Russian issuers' shares circulating in the internal market, can be estimated at 1.3 billion dollars. If the Russian issuers' shares circulating in the foreign market are included, the estimated market capitalization is 1.5 billion dollars. The capitalization of the Russian share market increased about 3.8 times in the last two years; 2006 was the year of the most rapid growth (at a rate of roughly 175%). Capitalization growth in 2007 was about 40%.

The ratio of capitalization to GDP has increased 2.8 times and amounted to about 95% in 2006. In 2007 it reached almost 100%.

A high concentration of capitalization is a specific characteristic of the Russian share market; it's true both for the issuers and for the industries they belong to.

Table 3. Top-ten most highly capitalized companies according to MICEX data.

No.	Issuer	Capitalization (billion dollars)	Share in total capitalization (%)
1	OJSC "Gazprom"	331.7	27.27
2	OJSC "Savings Bank of Russia"	92.9	7.64
3	OJSC "NK "Rosneft"	89.8	7.39
4	OJSC "Lukoil"	71.8	5.90
5	OJSC RAO "UES of Russia"	55.2	4.54
6	OJSC "MMC Norilsk Nickel"	50.2	4.13
7	OJSC "Surgutneftegaz"	47.9	3.93
8	OJSC "VTB Bank"	33.9	2.79
9	OJSC "Mobile TeleSystems"	30.2	2.49
10	OJSC "Gazprom нефт"	29.1	2.40
TOTAL			68.46
Total capitalization		1,216.6	100.00

Source: MICEX.

³ MICEX appraises both the total capitalization of the share market (the numerator) and the capitalization of the issuers whose shares are circulating in the stock exchange (the denominator). This stock exchange also offers the capitalization estimates in national and foreign currency.

⁴ The estimate included Russian issuers with shares listed at RTS, Moscow Interbank Stock Exchange, NYSE, NASDAQ as well as those featured in the LSE-listed S&P EMD Russia index.

⁵ The report "On the measures for enhancement of capital market regulation and development for the years 2008 to 2012 and for the longer term."

According to the summarized data based upon the issuers' capitalization on all the stock exchanges, CMDC estimates the share of ten most capitalized Russian issuers as 63.2% of the total capitalization.

In the last few years, there was little change in the list of the most capitalized issuers: in 2006, Rosneft entered the list after an IPO, and upon the results of 2007, VTB Bank, also after an IPO. In 2006 and 2007, the concentration of the issuers' capitalization was decreasing (see Table 4).

Table 4. The ten most capitalized issuers' share in the total capitalization of the share market.

	2006	2007			
		Q1	Q2	Q3	Q4
Top 10 companies' share (%)	78.5	74.3	69.6	71.27	68.46
Including the share of OAO "Gazprom" amounting to	30.70	27.50	25.50	25.21	27.27

Calculated using MICEX data.

Table 5 shows data on the Russian market capitalization concentration by industry for the last 2 years. In this table, petrochemical industry and manufacturing of mineral fertilizers are categorized as chemical industry, and the pharmaceutical industry as Other industries.

Table 5. Russian share market capitalization by industry (%).

No.	Industry	2006		2007			
		Q1	Q4	Q1	Q2	Q3	Q4
1	Oil and gas	69.1	62.4	55.9	50.2	50.2	50.4
2	Financial activities	5.3	9.2	9.1	15.7	13.3	11.8
3	Power utilities	10.0	11.9	15.9	13.4	12.8	12.5
4	Metals	6.3	8.1	9.8	10.5	11.9	11.0
5	Communications	4.6	4.1	4.5	4.3	5.6	5.8
6	Food	1.5	1.5	1.6	1.6	1.3	1.3
7	Construction	0.0	0.0	0.0	1.2	1.4	1.3
8	Mechanical engineering	1.0	0.8	0.9	1.1	1.1	1.1
9	Transportation	1.1	0.8	0.9	0.7	0.8	1.2
10	Trade	0.4	0.6	0.7	0.6	0.6	0.6
11	Mining	0.6	0.3	0.4	0.4	0.5	0.7
12	Chemical industry	0.0	0.2	0.2	0.1	0.2	1.5
13	Other industries	0.2	0.2	0.2	0.2	0.3	1.0

Source: MICEX.

As one may see from the Table 5, the trend of the Q1 and Q2 of 2007 for the decrease of oil and gas industry share did not develop further in the second half of the year. More than a half of the Russian share market capitalization is still concentrated in the oil and gas companies. A positive tendency in the industry structure that manifested itself in mid-2007 was the increase of the financial companies' share which has more than tripled compared the same period of 2006.

This tendency was related to the large offers of shares by two financial organizations, Sberbank and VTB Bank in the first half of 2007. However, in the second half of 2007 the share of financial companies in the total capitalization dropped slightly.

Table 6 contains data on Russian companies' shares trading.

Table 6. Russian issuers' shares trading volume.

	Units	2005	2006	Q1-07	Q2-07	Q3-07	Q4-07	2007
MICEX⁶	billion roubles	3,279.7	11,062.8	3,888.9	3,570.7	3,643.6	4,204.0	15,307.1
<i>Share of repurchase transactions to the total volume of stocks transactions on MICEX</i>	%	18.3	25.6	32.6	47.6	58.1	56.5	50.5
RTS Classical market⁷	billion \$	7.7	16.1	3.2	3.1	4.1	4.3	14.6
<i>Share of repurchase transactions to the total volume of stocks transactions on RTS classical market</i>	%	0.0	0.0	0.0	0.0	0.0	0.0	0.0
RTS exchange market⁸	billion roubles	81.5	24.1	4.5	3.0	4.0	3.5	15.0
<i>Share of repurchase transactions to the total volume of stocks transactions on RTS exchange market</i>	%	0.6	12.0	11.9	44.8	40.4	44.1	36.2
SPB Stock Exchange⁹	billion roubles	772.8	903.5	7.8	5.2	3.5	6.1	22.6
<i>Share of repurchase transactions to the total volume of stocks transactions on SPB Stock Exchange</i>	%	17.5	25.1	65.4	65.0	72.8	55.8	64.8
Exchange rate of US dollar for the last day of the period ¹⁰ (informational)		28.78	26.33	26.01	25.82	24.95	24.55	24.55
TOTAL (estimate)	billion roubles	4,354.1	12,415.6	3,984.3	3,658.2	3,752.1	4,318.3	15,713.0
TOTAL (estimate)	billion \$	151.3	471.5	153.2	141.7	150.4	175.9	621.2
S&P data¹¹	billion \$	159.3	514.4					754.5
Turnover ratio¹² (annual)	%	45.98	48.81					46.74
Turnover ratio¹² (quarterly)	%			14.90	13.37	13.48	13.24	

Sources: Bank of Russia, MICEX, RTS, S&P.

Russian shares trading volumes have experienced sustained strong growth in the past years. Thus, the volume of trade in the leading trading floors has, on the average, tripled in 2006 compared to 2005; in 2007 the yearly increase was lower, around 30%. The estimated total transactions volume (repo deals not included) of Russian companies' stocks in the domestic market for 2007 is 15.7 trillion roubles (or 621.2 billion dollars).

⁶ Including auction mode, negotiated deals mode and IPO deals. Repo deals are not accounted for.

⁷ Including market deals and OTC deals. Repo deals are not accounted for.

⁸ Including market deals and OTC deals. Repo deals are not accounted for.

⁹ Including market deals and OTC deals. Repo deals are not accounted for.

¹⁰ At the Central Bank of Russia's rate.

¹¹ The estimate included Russian issuers with shares listed at RTS, Moscow Interbank Stock Exchange, NYSE, NASDAQ as well as entered in the LSE-listed S&P EMDB Russia index.

¹² Here, calculated as the ratio of the transactions volume for a period (a quarter or a year) to the capitalization as of the end of this period.

At the same time the turnover rate for stock exchange trade of shares in 2007 showed a slight downtrend.

It is worth noting that, starting from 2005, the share of repo deals with stocks grew significantly. In 2005 it constituted 17% of the total volume of stock exchange trade of shares, in 2006, 25%, and by the end of 2007 it was 50%; in some moments during the year it got even higher than that. Thus, in the 3rd quarter of 2007, the share of these deals reached 58% of the total stocks transactions volume at MICEX, and 73% at SPB Stock Exchange.

The trade in shares is concentrated on a rather limited set of instruments. Table 7 shows lists of issuers whose shares were traded most actively at MICEX in 2007¹³.

Table 7. List of issuers whose shares were traded most actively at MICEX.

No.	Issuer	Share in total turnover (%)
1	OJSC "Gazprom"	28.4
2	RAO "UES of Russia"	21.3
3	OJSC "Savings Bank of Russia"	11.1
4	OJSC "MMC Norilsk Nickel"	10.1
5	OJSC "Lukoil"	8.1
6	OJSC "Rostelecom"	5.0
7	OJSC "Surgutneftegaz"	4.9
8	OJSC "NK "Rosneft"	3.4
9	OJSC "VTB Bank"	1.3
10	OJSC "Tatneft"	1.2
TOTAL		94.8

Source: MICEX.

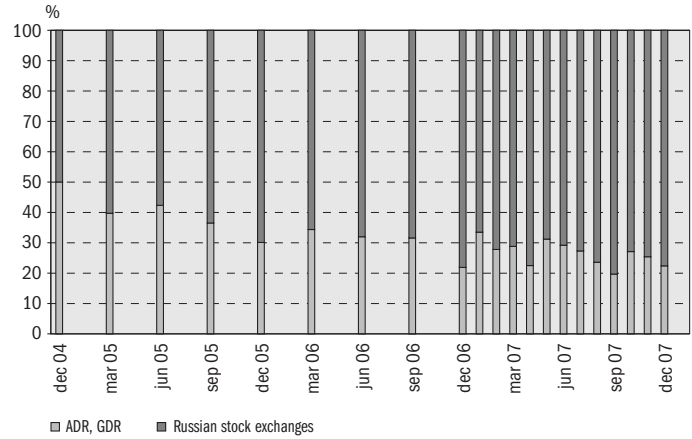
By CMDC's estimates, the share of the top 30 most liquid stocks in the total stock exchange turnover is 98.9%. Therefore, most stock exchange deals involve only about 7% of the available instruments. In the last few years, there was little change in the top liquidity list: in 2006, Rosneft and later VTB Bank joined the list after IPOs.

An important issue for the Russian capital market is the distribution of trading between domestic and foreign exchanges.

Foreign trade in depository receipts far exceeded domestic trade in these instruments in the late 1990s. However from the end of 2004 (see Fig. 1) domestic exchanges have restored the parity with foreign exchanges and in 2005 – 2006 have established the average ratio of 70% to 30%. In 2007 this ratio was mostly preserved, with a small trend for increasing the share of domestic trading floors.

¹³ Including repo deals.

Figure 1. Trading volumes of shares and depository receipts of Russian companies whose depository receipts are traded on foreign trading floors.



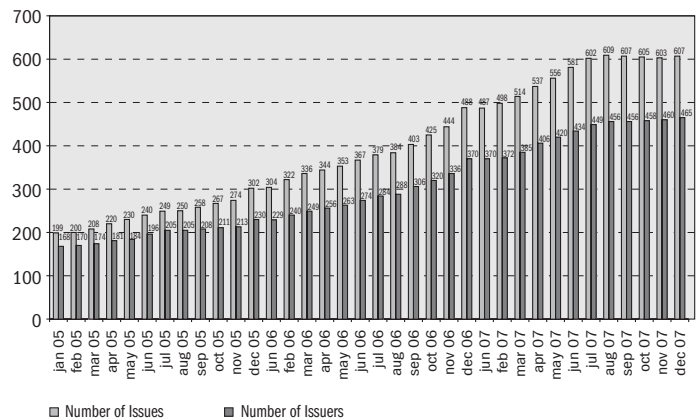
Source: MICEX.

1.2. Corporate bonds

Unlike many other national bond markets, the Russian domestic corporate bonds market from the very beginning developed predominantly as an exchange market. Development of the corporate bonds market for the last few years shows a stable increase in the quantity of issuers and issues, as well as growth in trading volumes.

According to the CBONDS agency, as of the end of 2007, there were 607 corporate bonds issues of 465 issuers in circulation, which exceeds the 2006 figures by 24.4% and 25.7% respectively (see Fig. 2). This growth rate is low compared to the previous years (52.7 and 36.3% for 2005, 61.6 and 60.9% for 2006). It is also worth noting that in 2007 most new share issues and most growth of the issuers' numbers occurred earlier in the year. In the second half of the year, there were practically no new issues.

Figure 2. Numbers of corporate issuers and issues in domestic debt instruments market.

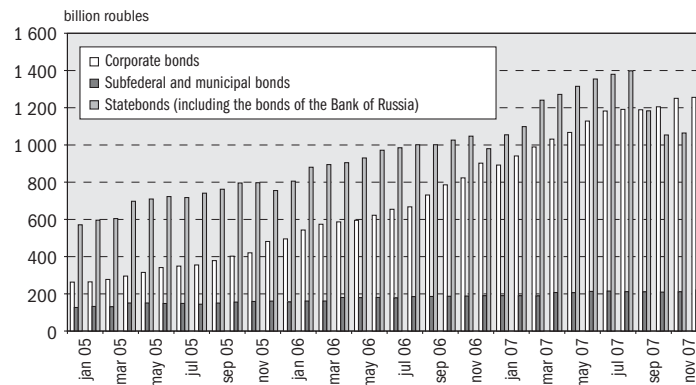


Source: CBONDS.

According to CBONDS agency¹⁴, the total amount of the Russian enterprises' corporate bonds in circulation, at par value, amounted to 1,255.71 billion roubles, which is a 39.2% increase compared to the end of 2006 (see Fig. 3). This growth rate is also much lower than in the previous years (88.3% for 2005, 87.4% for 2006). As with the numbers of the new issuers and issues, most growth of the corporate bonds turnover volume occurred in the first half of the year.

There was little change in the ratio of the total Russian corporate bonds volume to the GDP over the last years: it changed from 2.23% in 2005 to 3.81% in 2007.

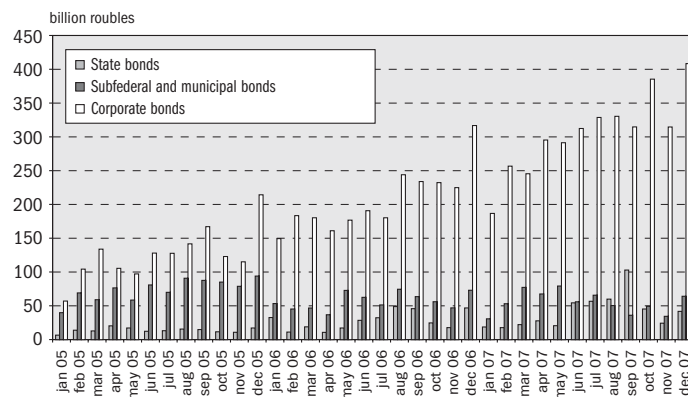
Figure 3. The volume of the domestic debt market (at minimal value).



Source: CBONDS.

It is worth noting that in September 2007 the volume of corporate bonds exceeded the volume of the State bonds, including these of the Bank of Russia. It is worth noting that the share of the financial industry in the total corporate bonds turnover volume experiences constant growth¹⁵: at the end of 2005, it was 20.7%, at the end of 2006, 26.3%, and it reached 32.4% by the end of 2007. It means that the finance companies, and first of all credit institutions, increasingly use the debt market as a source of additional debt financing.

Figure 4. Total trading volume on the domestic debts instruments market (by months).



Source: CBONDS.

¹⁴ By GK "Region"'s estimates, 1,258 billion roubles, by CMDC's estimates – 1,231 billion roubles.

¹⁵ As estimated by CBONDS.

About 470 billion roubles' worth of corporate bonds were placed in initial offerings in 2007. This is 10 billion roubles less than in 2006. The volume of bonds registered but not placed was also 470 billion roubles¹⁶. These offerings were spread unevenly throughout the year: in particular, there were no initial offerings in August or September of this year.

The trading volume at the secondary corporate bonds market¹⁷ (exchange and off-exchange in total) is permanently growing (see Fig. 4). The share of so-called non-market issues (issues that are not in circulation) for the last 2 years is more or less unchanged and stays between 0.25-0.4%.

See total volume of secondary market transactions with corporate bonds for 2005-2007 in Table 8.

Table 8. Volume of transactions with corporate bonds.

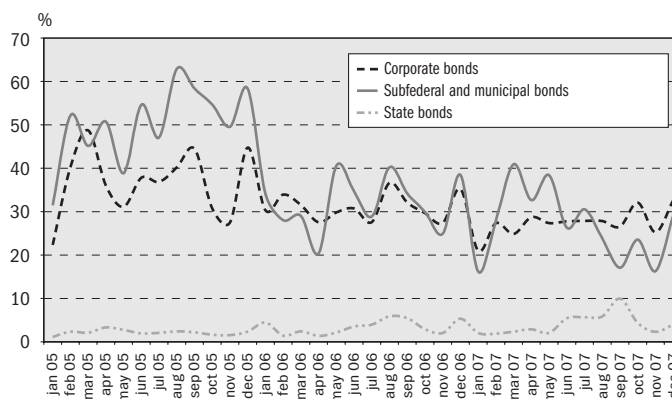
	Units	2005	2006	Q1-07	Q2-07	Q3-07	Q4-07	2007
Total turnover	billion roubles	1,514.3	2,437.5	688.7	899.0	973.8	1,108.0	3,669.5 ¹⁸
The share of transactions at organized marketplaces in the total turnover	%	60.3	72.2	74.2	75.8	74.0	71.6	73.9

Source: CBONDS.

As one may see from the Table 8, the volume of transactions with corporate bonds grows permanently: The total turnover for 2006 was 61% higher than for 2005. In 2007, the transaction volume increased by 51%. Characteristically, the share of exchange transactions in the total turnover is permanently growing. In 2007, it reached 74%. The second half of 2007 was characterized by large month-to-month variability of the corporate bonds transaction volume: two troughs in September and November emphasize two months of peak activity in October and December.

The corporate bonds market is rather liquid (see Fig. 5).

Figure 5. Turnover index for the various segments of the domestic debt instruments market.



Source: CBONDS.

¹⁶ As estimated by GK "Region".

¹⁷ From now on, repo deals are not included in secondary market volume estimates for all types of bonds, unless stated otherwise.

¹⁸ 3,617.5 billion roubles, as estimated by GK "Region".

Even though the turnover index¹⁹ for corporate bonds was highly volatile in 2005-2007, its median in 2007 was quite high, at 27.6%. In the second half of the year there were two large swings of the turnover index: a positive one to 32.1% in October, and a negative one to 25.3% in November.

Corporate bonds are traded at MICEX and RTS. Table 9 contains summary data on corporate bonds offered at Russian stock exchanges, and Table 10, data on MICEX bonds transactions volume²⁰.

Table 9. Formal corporate bonds market.

	MICEX			RTS		
	2005	2006	2007	2005	2006	2007
The number of bond issuers	202	316	445	4	77	79
The number of bond issues	250	414	577	4	118	120
including these in the quotation lists (issuers/issues)	46/62	69/98	149/207	1/1	0/0	0/0

Sources: MICEX, RTS.

Therefore, as follows from Figure 2 and Table 9, currently only about 95% of all the bond issues are available at the formal market. At the same time, despite the permanent growth of corporate bond exchange transaction volumes in the absolute figures, their growth rate decreases. Thus, while in 2006 the numbers doubled in comparison to 2005, the year 2007 showed only 50% growth.

Table 10. Data on MICEX bonds transactions volume.²¹

	Units	2005	2006	Q1-07	Q2-07	Q3-07	Q4-07	2007
Corporate bonds	billion roubles	900.4	1,801.3	513.4	689.7	705.5	791.9	2,700.5
<i>Share of repurchase transactions to the total volume of corporate bond transactions</i>	%	27.95	50.85	64.30	69.74	74.58	72.52	71.19
Bonds of RF constituent entities	billion roubles	556.7	520.1	127.3	156.5	110.9	102.1	496.8
<i>Share of repurchase transactions to the total volume of RF constituent entities bond transactions</i>	%	28.00	60.05	73.71	77.70	84.53	82.25	79.95
Municipal bonds	billion roubles	24.0	23.9	6.6	6.6	6.3	8.7	28.3
<i>Share of repurchase transactions to the total volume of municipal bond transactions</i>	%	31.52	42.05	58.54	67.79	73.92	63.26	66.54

Source: MICEX.

A new tendency of the last few years is the rapid growth of the share of repo deals in the total secondary turnover of the corporate bonds. For example, in 2007 this index grew 2.5 times compared to 2005 and exceeded 70%. Thus, the formal corporate bonds market is more and more used as secured credit market.

The slowdown in Russian corporate bonds market growth in 2007 and the significant growth of repo deals are largely caused by the global financial system troubles and the liquidity crisis.

¹⁹ In this case calculated as the ratio of the monthly transactions volume to the total volume of corporate bonds in circulation, at nominal value, for this month.

²⁰ The data on bond trading on RTS is not shown in this table due to relatively small volumes.

²¹ The calculations include auction mode and negotiated deals mode. Repo deals and initial offerings are not included.

A notable characteristic of the corporate bonds market, unlike the share market, is low concentration of trading volumes. Table 11 contains data for 10 bond issues that had the highest transaction volumes on stock exchanges in 2007²².

Table 11. Corporate bond issues that were traded most actively at MICEX.

No.	Security	Issuer	Share in total turnover (%)
1	RZhd-06obl	OJSC "Railways of Russia"	3.19
2	GAZPROM A8	OJSC "Gazprom"	2.52
3	FGC UES - 02	OJSC "FGC UES"	2.50
4	GAZPROM A9	OJSC "Gazprom"	2.11
5	FGC UES - 05	OJSC "FGC UES"	1.87
6	Lukoil3obl	OJSC "Lukoil"	1.77
7	OGK5 ob1	OJSC OGK5	1.73
8	Lukoil4obl	OJSC "Lukoil"	1.59
9	Hydro OGK - 1	OJSC "UK Hydro OGK"	1.48
10	RusAlF-3v	LLC "Russian Aluminum Finances"	1.37
		TOTAL	20.13

Calculated using MICEX data.

Therefore, the secondary bonds market is much less focused on particular instruments. Moreover, the concentration of corporate bond deals tends to decrease: according to the results of the first quarter of 2007, the share of the top 10 most traded bonds in the total turnover was 26.1%.

In the first half of 2007 an opportunity to issue a new debt financial instrument, the so-called exchange bonds, appeared. To issue the exchange bonds, the issuer does not have to register the issue formally and report the issue results: these functions are delegated to the stock exchange, which shortens significantly the interval between the decision to issue bonds and the start of secondary trading. For the exchange bonds to be offered on a stock exchange, the issuer must comply with a number of requirements, including the following:

- this issuer's stocks must be included in this stock exchange's quotation lists;
- the issuer must have existed for at least 3 years and must have properly approved annual financial statements for at least 2 complete fiscal years;
- the bonds' maturity date cannot exceed one year after the offering date.

Exchange bonds were intended to become a convenient instrument for liquidity management; they allow covering cash gaps and can replace promissory notes programs. 9 issues of exchange bonds from two issuers, for the total volume of 13 billion roubles, were allowed to be offered on MICEX in the second half of 2007. However, none of them were placed before the end of the year. Thus, in the situation of a liquidity crisis, the issuers did not show any interest in the new debt financial instrument, preferring other means of maintaining their liquidity – mainly repo deals.

Mortgage bonds, a new segment of the debt market, have not received significant development either. In 2006 and 2007 three issues of mortgage bonds occurred, for a total volume of 7.9 billion roubles. Most trading in mortgage bonds happens at MICEX: the total transaction volume in 2007 was 36.9 billion roubles, including repo deals, and 8.85 billion roubles without repo deals.²³

The average annual return on investment for corporate debt market in 2007 was 8.17%.²⁴

²² Including repo deals.

²³ Data from CBONDS and MICEX.

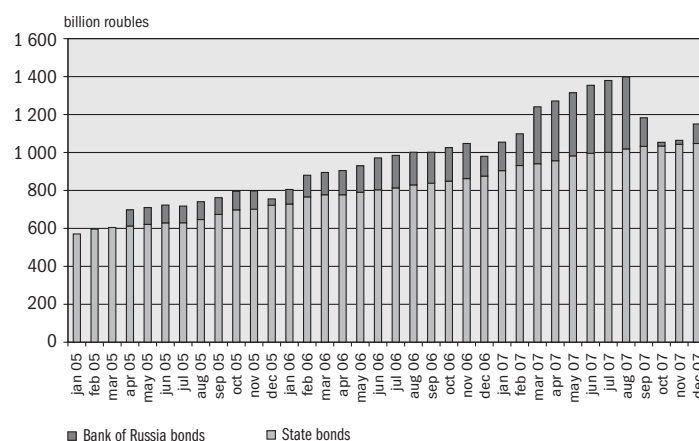
²⁴ As estimated by GK "Region".

1.3. State, subfederal and municipal bonds, bonds of the Bank of Russia

The first State bonds of the Russian Federation were issued in 1991. Rapid development of the domestic exchange market transactions with these bonds (GKO, i.e. State Credit Bonds, and OFZ, i.e. Federal Loan Bonds) took place in 1993-1998. However, it was interrupted by the default of August 17, 1998, and since then this market never recovered the pre-crisis volumes or its pre-crisis role in the financial system. Bonds of the Bank of Russia, issued since 2005, formally are not State securities, even though they have the same reliability level. They are short-term securities and are used by commercial banks for liquidity management; the other investors are not allowed to acquire them.

The trading volume of the state bonds market has been increasing over the last years (see Fig. 6). The ratio of state bonds volume (including the Bank of Russia bonds) to the GDP in 2005-2007 stays around 3.5%-3.6%.

Figure 6. Volume of the domestic debt market (at nominal value).



Source: CBONDS.

According to the CBONDS agency, as of the end of 2007, the volume of the state bonds circulating in the domestic market at par value amounted to 1,047.4 billion roubles, an increase by 19.6% compared to the previous year. (In 2006, the increase was slightly higher, at 21.35%.) At the same time, the volume of the secondary market and the liquidity of state bonds are small if compared with those of the corporate bonds market (see Fig. 4 and Fig. 5).

The state securities market is organized at MICEX. Table 12 contains data on state bonds market turnover.

Table 12. Volume of transactions with state bonds.

	Units	2005	2006	Q1-07	Q2-07	Q3-07	Q4-07	2007
Turnover	billion roubles	166.16	335.01	58.45	102.45	219.45	111.28	491.45

Source: CBONDS.

From the Tables 8 and 12 we can see that despite of commensurability of the par value placement volumes, the turnover of the State securities is almost ten times less than that of the corporate bonds, and the turnover rate is also much lower. A notable leap (see Fig.5) of the state bonds turnover rate to a several years' maximum occurred in September 2007, in the context of a decrease of the corporate bonds turnover rate. Evidently, this was caused by the exacerbated liquidity problems at the time.

Volumes of issues of these bonds by the Bank of Russia were growing very fast in 2005 and 2006, except for the traditional December decrease; for example, in the year 2006 the volume grew by 35.2%. However, the tide turned in 2007 (see Fig. 6). According to CBONDS, the total amount of circulating bonds issued by the Bank of Russia as of the beginning of 2007 was 104.2 billion roubles, and as of the end of the year, 102.9 billion roubles. However, in October and November it dropped to 20 billion roubles in what was probably a reaction to the refinancing crisis.

Subfederal and municipal bonds have smaller volumes of issue than state and corporate bonds, and they do not show any significant growth tendencies (see Fig. 3). According to the CBONDS²⁵ data, as of the end of 2007, the volume of the subfederal and municipal bonds circulating in the domestic market at par value amounted to 220.6 billion roubles a 16.2% increase over the previous year. (In 2006, the increase was slightly higher, at 17.8%.) The ratio of subfederal and municipal bonds volume circulating in the domestic market to the GDP in the last years is around 0.7%.

Total volume of transactions with subfederal and municipal bonds for years 2005-2007 is shown in Table 13.

Table 13. Subfederal and municipal bonds transactions volume.

	Units	2005	2006	Q1-07	Q2-07	Q3-07	Q4-07	2007
Total turnover	billion roubles	890.1	682.8	161.1	202.7	151.93	147.86	663.54 ²⁶
The share of exchange transactions in the total turnover	%	70.0	79.9	84.2	92.0	79.24	77.31	83.18

Sources: MICEX, RTS.

As follows from Table 13, the total subfederal and municipal bonds transaction volume is diminishing from one year to another.

Exchange trade for subfederal and municipal bonds is effected at MICEX and RTS. Table 14 contains data on subfederal and municipal bonds offered at Russian stock exchanges.

Table 14. Formal market of subfederal and municipal bonds

	MICEX			RTS		
	2005	2006	2007	2005	2006	2007
The number of bond issuers	41	50	59	2	14	16
The number of bond issues	90	105	116	16	35	30
<i>including these in the quotation lists (issuers/issues)</i>	<i>22/53</i>	<i>22/49</i>	<i>27/49</i>	<i>1/1</i>	<i>0/0</i>	<i>0/0</i>

Sources: MICEX, RTS.

²⁵ 220 billion roubles, as estimated by GK "Region".

²⁶ 673.73 billion roubles, as estimated by GK "Region".

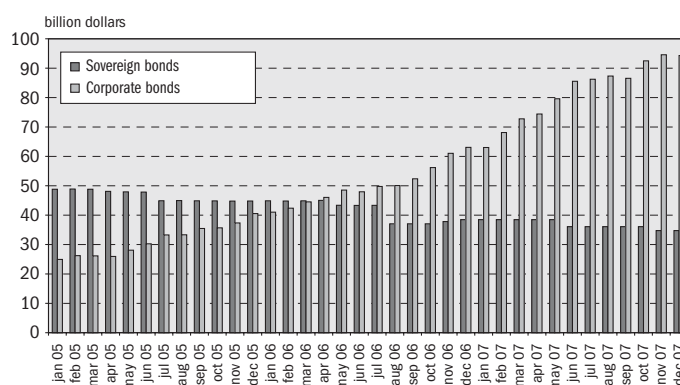
These bonds have a rather high liquidity despite the small volumes of circulation. Comparative analysis of Tables 9, 11 and 12 shows that in 2005-2007 the subfederal and municipal bonds' turnover, while being significantly smaller than the corporate bonds, is much higher than that of the State securities. The level and trends of the of subfederal and municipal bonds' turnover rate (see Fig. 5) are rather similar to those of the corporate bonds.

The share of the subfederal and municipal repo deals in the total exchange turnover has significantly changed in the last years (see Table 10): the increase over 2005 was about 2.5 to 2.8 times, the share of repo deals exceeding 80% for some quarters. Thus, the formal subfederal and municipal bonds market becomes more and more like a secured credit market.

1.4. Eurobonds

Besides rouble bonds, the Russian Federation, its subjects, municipal bodies and Russian companies seek financing for their development on foreign markets by issuing eurobonds. Figure 7 shows data for different segments of the Russian eurobonds market.

Figure 7. Eurobonds market volume.



Source: CBONDS.

According to the CBONDS data, as of the end of 2007, the total volume of the eurobonds market is 130.18 billion dollars, including 34.74 billion dollars of sovereign bonds and 94.29 billion dollars of corporate bonds. Compared to this, the volume of municipal eurobonds is insignificant and remains for a long time at the level of about US\$ 1 billion.

Sovereign and corporate eurobonds have manifested opposite trends in the last years. While the volume of sovereign eurobonds has a stable downtrend of about 10%, the volume of corporate eurobonds shows permanent growth: 73% in 2005, 55% in 2006, 49% in 2007. It should be noted that in March and April of 2006 the volume of corporate eurobonds has for the first time exceeded the volume of sovereign eurobonds.

If we compare the volume of corporate loans using debt market instruments in domestic and foreign markets, we will see that in 2006 and 2007 the share of domestic loans is about 35%, and the foreign loans, 65%.

1.5. Promissory notes

Promissory notes as securities were extremely popular in Russia in the mid-1990s. They had a double function: firstly, they were used as money substitutes for settlements between enterprises and organizations, as well as for tax payments in the conditions of extremely low monetarization of the Russian economy; secondly, they substituted bonds used for debt financing, alternative to bank credit. From late 1990s the promissory notes as an instrument of financing are being replaced gradually by bonds. Bonds are often perceived as more “civilized”, reliable and liquid instrument; however the promissory note market is still one of the significant elements of the domestic debt market.

According to estimates and calculations by GK “Region”, the share of the promissory note market in the entire debt market has lowered from 25% as of the beginning of 2005 to 17% as of the end of 2007. Table 15 shows estimates on the volumes of the issued promissory notes in circulation and transactions with promissory notes at the secondary market.

Table 15. Volume and turnover of the circulating promissory notes market (Billion roubles).

	2005	2006	2007
Volume of circulating promissory notes (billion roubles, data for the period)	350-370	480-500	470-480
Average daily turnover of the secondary promissory note market (billion roubles)	7-8	10-12	N/A

Source: GK “Region”.

As one may see from Table 15, after a period of active growth in 2006 (when the yearly volume of the promissory note market has increased by 35%), the growth slows down somewhat in 2007. At the same time the activity of the secondary promissory note market does not decrease. According to estimates and calculations by GK “Region”, the share of the promissory note market in the entire domestic debt market turnover is around 40%. This is caused, among other reasons, by the large nominal values of promissory notes and large volumes of individual transactions.

Last years demonstrated a decrease in the nonfinancial organizations’ share in the promissory note market; it dropped from 60–70% in the late 1990s to 10% at present.

1.6. Investment units

Unit investment funds (UIF) dominate in the sphere of collective investments in Russia. A UIF is not a legal person, but a property complex entrusted to a management company. Customers’ investments in UIF are registered as a purchase of special securities – investment units, the income on which is not fixed and may be obtained only if the unit’s value is growing; the latter, in turn, depends on the price of the UIF’s underlying assets. Investment funds as institutions are intended first and foremost for accumulating funds of small private investors. Nevertheless, in Russia they are also popular among large investors – both private individuals and non-financial corporate entities.

The secondary market of investment units is still in development and has a tendency to grow. Investment units are traded on MICEX and RTS. Table 16 contains summary data on investment units offered at Russian stock exchanges, and Table 17 presents trading volume data.

Table 16. Formal investment units stock exchange market.

	MICEX			RTS		
	2005	2006	2007	2005	2006	2007
The number of management companies	33	48	88	6	10	15
The number of UIFs	69	114	219	18	22	38
including these in the quotation lists (management companies/UIFs)	3/4	4/4	20/30	1/1	3/3	6/7

Sources: MICEX, RTS.

Table 17. Investment units stock exchange transactions volume.

	Units	2005	2006	2007
MICEX	million \$	43.8	186	790
RTS ²⁷	million \$	1.7	30.9	27.9

Sources: MICEX, RTS, LMC.

Currently around 25%²⁸ of all functioning UIFs are present at stock exchanges. However, not all of them have high liquidity. Thus, trading in one UIF ("AG Capital" managed by CJSC "AG Capital") constitutes 37.7% of the total volume on both main exchanges together, and the share of the top 10 most traded UIFs is 81.4%²⁹.

In June 2007, on MICEX, investment units of 0.5 billion roubles each were initially offered for the first time (see details in section 2.3).

1.7. Futures and options on securities and market indices

Financial instruments like futures and exchange options formally are not securities. Nevertheless, they are closely related to the capital market. Currently the market for instruments that use underlying assets such as securities and stocks indices is concentrated at the FORTS derivatives market of RTS. Besides derivatives based on securities and stocks indices, this market also deals in instruments based on assets like gold, currency, oil and so forth; the volume of transactions in these contracts, however, is relatively insignificant and amounts to less than 1-5%, depending on the type of volume indicator.

In 2006, FORTS market offered 18 types of derivatives (12 futures and 6 options) whose underlying assets include securities and stocks indices. By the end of 2007, their number increased to 53 (36 futures and 17 options).

In mid-2007, MICEX introduced its first index derivative, a futures contract based on the MICEX index. However, its trading volumes are so far very low, amounting to 1.76 bn roubles by the end of the year.

Tables 18 and 19 summarize the data on the FORTS market for index derivatives for the last 3 years.

²⁷ Classical market and stock market.

²⁸ As estimated by LMC.

²⁹ The calculations are based on LMC's data.

As one may see from Table 18, in 2006 the FORTS market had undergone a period of rapid growth: the total volume of trade has increased almost fourfold (!), and the number of transactions grew by 164%. In the 2007 the growth continued: the total volume of forwards instruments trade (in monetary value) has increased by 170%, and the number of concluded deals grew by 130%.

The most actively traded derivative in 2007 was the future on RTS stock index – it constituted 48.8% of the total trade volume for all derivatives based on securities and stock indices (in monetary value); the same instrument was the most liquid one in 2006, when its share was 27.8%.

Table 18. Contracts on securities and stock indices trading at the FORTS forwards market.

	2005	2006	Q1-07	Q2-07	Q3-07	Q4-07	2007
FUTURES CONTRACTS							
Volume of trade, billion roubles	607.8	2,397.1	925.5	1,066.2	1,454.9	2,605.8	6,052.4
<i>including index-based</i>	119.8	752.0	328.0	391.5	867.5	2,000.1	3,587.1
<i>including stock-based</i>	471.0	1,569.6	573.6	642.0	572.3	601.3	2,389.2
<i>including bond-based</i>	9.0	13.7	3.0	6.8	15.2	4.3	29.3
Trading volume, million cont.	46.0	78.9	23.5	25.4	28.2	37.6	114.6
<i>including index-based</i>	2.3	9.0	3.4	4.2	8.8	18.3	34.7
<i>including stock-based</i>	42.6	66.3	18.9	19.8	17.9	18.8	75.5
<i>including bond-based</i>	0.8	1.3	0.3	0.6	1.5	0.4	2.8
Number of transactions, million pcs.	1.8	4.9	1.9	2.2	2.8	4.3	11.3
<i>including index-based</i>	0.1	0.7	0.3	0.5	1.1	2.4	4.3
<i>including stock-based</i>	1.7	4.1	1.6	1.8	1.7	1.9	7.0
<i>including bond-based</i>	0.0	0.0	0.0	0.0	0.0	0.0	0.0
OPTION CONTRACTS							
Volume of trade, billion roubles	79.3	311.4	106.3	178.6	311.7	703.5	1 300.2
<i>including index-based</i>	2.6	84.3	23.3	61.1	170.0	504.3	758.7
<i>including stock-based</i>	76.6	226.9	82.9	117.6	141.7	199.1	541.4
<i>including bond-based</i>	–	–	–	–	–	–	0.0
Trading volume, million cont.	7.3	10.7	3.1	4.7	6.7	10.5	25.0
<i>including index-based</i>	0.0	1.0	0.2	0.6	1.7	4.5	7.1
<i>including stock-based</i>	7.2	9.7	2.9	4.0	4.9	6.0	17.8
<i>including bond-based</i>	–	–	–	–	–	–	0.0
Number of transactions, million pcs.	0.1	0.2	0.0	0.1	0.1	0.1	0.3
<i>including index-based</i>	0.0	0.0	0.0	0.0	0.0	0.1	0.1
<i>including stock-based</i>	0.1	0.1	0.0	0.0	0.0	0.1	0.2
<i>including bond-based</i>	–	–	–	–	–	–	0.0
TOTAL							
Volume of trade, billion roubles	687.1	2,708.5	1,031.8	1,244.9	1,766.7	3,309.2	7,352.6
Trading volume, million contracts	53.3	89.6	26.6	30.1	34.8	48.1	139.6
Number of transactions, million	1.9	5.0	2.0	2.3	2.9	4.5	11.6

Source: RTS.

The proportion of the security- and index-based derivatives market volume to the volume of the stock spot market excluding repo deals (see Table 6) is permanently growing: it was equal to 15.4% in 2005,

21.2% in 2006, 46.3% in 2007. It means that the derivatives market has a tendency for growth, not only in absolute value, but in relative terms as well.

It should be emphasized that in 2007 the futures market not only experienced impressive quantitative growth but moved to an entirely new level. First of all, there was a major change in the volume of open positions (Table 19). In 2005–2006 this indicator constituted 1.8%–2.1% of the total futures trading volume and 8.2%–9.6% of the options volume. In 2007 the average volume of open positions on futures was 4.6 to 5.4% for the first 3 quarters, and in the 4th quarter it dropped to 2.8%. The likely explanation for this is the year-end position closures.

The same indicator for options in the first 3 quarters was 35-55% and dropped to 16% by the end of the year.

Table 19. Open positions on securities and stock indices trading at the FORTS forwards market.

	2005	2006	Q1-07	Q2-07	Q3-07	Q4-07
FUTURES CONTRACTS						
Average volume of open positions, billion roubles	11.5	34.6	47.7	57.2	66.5	74.7
<i>including index-based</i>	0.6	7.9	9.4	12.2	22.2	33.5
<i>including stock-based</i>	9.5	20.9	30.8	34.0	38.6	38.9
<i>including bond-based</i>	0.7	1.6	1.3	2.0	5.7	2.3
Average volume of open positions, million cont.	1.0	1.2	1.4	1.7	2.1	1.9
<i>including index-based</i>	0.0	0.1	0.1	0.2	0.2	0.3
<i>including stock-based</i>	0.9	0.9	1.0	1.1	1.3	1.3
<i>including bond-based</i>	0.1	0.1	0.1	0.2	0.6	0.2
OPTION CONTRACTS						
Average volume of open positions, billion roubles	6.5	30.0	58.6	63.7	121.2	117.3
<i>including index-based</i>	0.2	9.0	10.0	21.0	53.8	71.7
<i>including stock-based</i>	6.3	20.9	48.5	42.7	67.4	45.5
<i>including bond-based</i>	–	–	–	–	–	–
Average volume of open positions, million cont.	0.6	1.0	1.8	1.7	2.8	2.3
<i>including index-based</i>	0.6	0.9	1.7	1.5	0.6	0.7
<i>including stock-based</i>	0.0	0.1	0.1	0.2	2.3	1.6
<i>including bond-based</i>	–	–	–	–	–	–
TOTAL						
Average volume of open positions, billion roubles	18.0	64.6	106.2	120.9	187.7	191.9
Average volume of open positions over the year, million cont.	1.6	2.2	3.2	3.4	4.9	4.2

Source: RTS.

This dramatic change may mean that now not only speculators and arbitrageurs work at the futures market, but large institutional investors interested in risk hedging have entered it as well.

Futures contracts traditionally prevail in the general structure of FORTS derivative instruments. In 2007, futures accounted for 82% of the total trade volume and 97% of all the deals.

1.8. Stock indices

At present both Russian and international organizations, such as exchanges, information agencies, investment banks, brokerage companies etc. calculate dozens of various indices of the Russian capital market. The most recognized of them are: for the share market – the RTS Index, MICEX Index, MSCI Russia Index; for the bond market – the Corporate bonds Index RUX-Cbonds, Municipal bonds Index Cbonds-Muni, MICEX Corporate bonds Index, EMBI+ Russia Index; for the market of collective investments – RUIF Indices calculated by National Rating Agency.

Traditionally, however, the most popular and quoted indices are those calculated by RTS and MICEX.

RTS Index is being calculated since 1995. It is a composite index currently based on 50 stocks of the most capitalized and liquid issuers. The list of these stocks is revised once in three months. Besides the main RTS Index, RTS Stock Exchange calculates RTS-2, an index of second tier companies, since 2003. Industry indexes are calculated since 2005:

- 1 RTS – Oil and gas;
- 2 RTS – Metals and mining;
- 3 RTS – Telecommunications;
- 4 RTS – Industry;
- 5 RTS – Consumer goods and retail trade.

The summarized data on indexes that has been calculated by RTS for more than 1 year are represented in Table 20³⁰.

In 2007, two new RTS industry indices were introduced: RTS - Electric Power Industry and RTS - Finances.

The MICEX Index is calculated since 1997. Originally its basis included 21 most liquid shares traded at the basic trade sessions of MICEX. In the first quarter of 2007 the basis for calculation of this index was extended to 30 shares of the issuers representing main sectors of economy. The index basket is updated not more than once in a quarter based upon expert estimates of the Index committee.

Besides the main MICEX Index, Moscow Interbank Currencies Exchange also calculates industry indices since early 2005:

- 1 MICEX O&G – oil and gas companies stock index;
- 2 MICEX PWR – power industry companies stock index;
- 3 MICEX TLC – telecommunication companies stock index;
- 4 MICEX M&M – metallurgical and mining companies stock index;
- 5 MICEX MNF – mechanical industry companies stock index.

The summarized data on indexes that has been calculated by MICEX for more than 1 year are represented in Table 21.

In 2007, three new capitalization indices entered the line of MICEX industry indices – indices for high, medium and basic capitalization companies.

Among industry indices maintained by the two stock exchanges, a similarity of calculation base (75%-80% of coincidence) can be observed for the oil and gas industry indices (RTSog, MICEX O&G), telecommunications industry (RTStl, MICEX TLC), as well as metallurgy and mining (RTSmm, MICEX M&M).

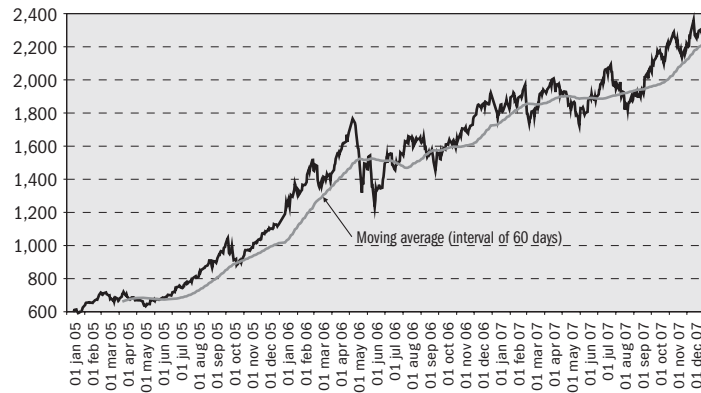
Figures 8, 9 and 10 show the graphs for RTS and MICEX indices.

Tables 22 and 23³¹ show profitability and volatility data calculated for the RTS and MICEX indices for the last 3 years.

³⁰ Tables 20 and 21 calculate indices based on the closing prices.

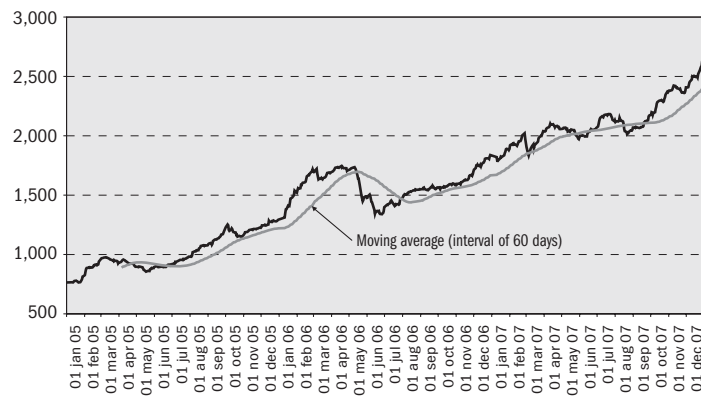
³¹ The profitability was calculated upon the range from the last trading day of the previous year to the last trading day of the appraised year based on the length of 365 days. The volatility was calculated as standard deviation of relative daily index change from the second trading day of the year to the last trading day of the year. The extremum values of changes were calculated as the limits of relative daily index change from the second trading day of the year to the last trading day of the year.

Figure 8. RTS Index.



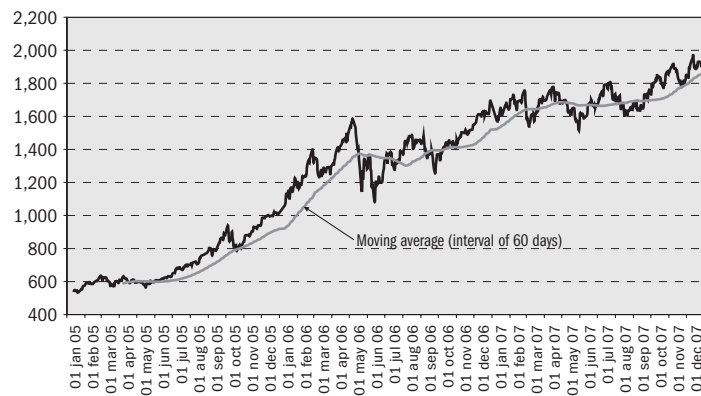
Source: RTS.

Figure 9. RTS-2 Index.



Source: RTS.

Figure 10. MICEX index.



Source: MICEX

Table 20. RTS stock indices.

No.	Name	Short description	Start of calculation	Initial value	Extremum value				
					Since the start of calculation		2007		
					Date	Value	Date	Value	
1	RTS Index	Composite index weighted by capitalization of stocks traded on RTS, taking free into account. Based upon a list of 50 stocks. Quotations are in US dollars.	01.09.95	100.00	min	05.10.98	38.53	30.05.07	1,724.69
					max	12.12.07	2,359.85	12.12.07	2,359.85
2	RTS-2 Index	Composite index weighted by capitalization of second-tier stocks traded on RTS, taking free float into account. Based upon a list of 78 stocks. Quotations are in US dollars.	31.12.03	567.25	min	05.01.04	565.91	11.01.07	1,788.59
					max	28.12.07	2,629.56	28.12.07	2,629.56
3	RTS – Oil and gas (RTSog) index	Industry index weighted by capitalization of stocks, taking free float into account. Based upon a list of 12 stocks, taken from the list of RTS and RTS-2 indices. Quotations are in US dollars.	11.01.05	100.00	min	20.01.05	98.14	30.05.07	219.14
					max	06.05.06	306.99	12.12.07	299.19
4	RTS – Telecommunications (RTStl) index	Industry index weighted by capitalization of stocks, taking free float into account. Based upon a list of 13 stocks, taken from the list of RTS and RTS-2 indices. Quotations are in US dollars.	11.01.05	100.00	min	21.01.05	97.07	05.03.07	236.40
					max	12.12.07	326.68	12.12.07	326.68
5	RTS – Metals and mining (RTSmm) index	Industry index weighted by capitalization of stocks, taking free float into account. Based upon a list of 11 stocks, taken from the list of RTS and RTS-2 indices. Quotations are in US dollars.	11.01.05	100.00	min	11.01.05	100,00	10.01.07	218.23
					max	08.11.07	379.69	08.11.07	379.69
6	RTS – Consumer goods and retail trade (RTScr) index	Industry index weighted by capitalization of stocks, taking free float into account. Based upon a list of 11 stocks, taken from the list of RTS and RTS-2 indices. Quotations are in US dollars.	11.01.05	100.00	min	14.01.05	98.67	18.01.07	274.47
					max	28.12.07	369.50	28.12.07	369.50
7	RTS – Industry (RTSin) index	Industry index weighted by capitalization of stocks, taking free float into account. Based upon a list of 12 stocks, taken from the list of RTS and RTS-2 indices. Quotations are in US dollars.	11.01.05	100.00	min	13.01.05	99.61	11.01.07	239.41
					max	28.12.07	407.05	28.12.07	407.05

Source: RTS.

Table 21. MICEX stock indices.

No.	Name	Short description	Start of calculation	Initial value	Extremum value				
					Since the start of calculation		2007		
					Date	Value	Date	Value	
1	Issuers	Composite index weighted by effective capitalization of stocks traded on MICEX. Based upon a list of 30 stocks. Quotations are in US dollars.	22.09.97	100	min	05.10.98	18.53	30.05.07	1,516.09
					max	12.12.07	1,969.91	12.12.07	1,969.91
2	Oil and gas companies stock index (MICEX O&G)	Composite index weighted by market capitalization of stocks traded on MICEX. Based upon a list of 12 stocks. Quotations are in US dollars.	31.12.04	1000	min	31.12.04	1,000.00	30.05.07	2,152.32
					max	06.05.06	3,171.33	12.12.07	2,847.10
3	Telecommunications companies stock index (MICEXTLC)	Composite index weighted by market capitalization of stocks traded on MICEX. Based upon a list of 10 stocks. Quotations are in US dollars.	31.12.04	1000	min	17.01.05	992.34	10.12.07	2,712.95
					max	10.12.07	2,712.95	10.12.07	2,712.95
4	Metallurgical and mining companies stock index (MICEXM&M)	Composite index weighted by market capitalization of stocks traded on MICEX. Based upon a list of 8 stocks. Quotations are in US dollars.	31.12.04	1000	min	13.01.05	950.12	09.01.07	2,515.56
					max	08.11.07	3,952.3	08.11.07	3,952.3
5	Mechanical industry companies stock index (MICEXMNF)	Composite index weighted by market capitalization of stocks traded on MICEX. Based upon a list of 7 stocks. Quotations are in US dollars.	31.12.04	1000	min	27.05.05	815.9	10.01.07	2,071.45
					max	24.12.07	3,532.26	24.12.07	3,532.26
6	Power industry companies stock index (MICEXPWR)	Composite index weighted by market capitalization of stocks traded on MICEX. Based upon a list of 12 stocks. Quotations are in US dollars.	31.12.04	1000	min	16.05.05	888.98	09.01.07	3,090.43
					max	26.02.07	4,099.06	26.02.07	4,099.06

Source: MICEX.

As follows from these data, RTS and MICEX indices show practically identical behaviour. Significant growth of these indices, which began in 2005, gradually slows down; nevertheless, in the end of 2007 (on December 12th) they reached their historical maxima simultaneously. RTS-2, the composite index based on the second-tier stocks, has demonstrated stable growth in 2006 and 2007; in the end of 2007 (on December 28th) it reached its historical maximum.

Among the industry indices, these related to oil and gas industry have undergone the biggest slowdown. In 2005, they demonstrated extremely high growth rates and, consequently, profitability (87% annual rate by RTSog index, and 92% annual rate by MICEX O&G index); but in 2007 they showed the lowest profitability among all the industry indexes, and MICEX O&G index was the only one among all the industry indices whose profitability even went down 3.6%. The most stable results over the last three years were demonstrated by the indices related to metallurgy and mining (RTSmm, MICEX M&M). None of the industry indices showed significantly higher profitability in 2007 than in 2006.

Table 22. RTS indices' profitability and volatility.

No.	Name		Profitability and volatility (%)			Extremum value (%)				
			2005	2006	2007	Since the start of calculation		2007		
						Date	Value	Date	Value	
1	RTS Index	P	83.57	70.89	19.23	min	28.10.97	-19,03	16.08.07	-3,52
		V	1.27	2.01	1.38	max	31.12.99	+16,83	19.09.07	+3,96
2	RTS-2 Index	P	69.32	42.27	43.17	min	22.05.06	-6,13	05.03.07	-3,20
		V	0.76	0.95	0.67	max	02.02.05	+3,14	09.03.07	+2,06
3	RTS - Oil and gas (RTSog) index	P	86.78	50.80	1.05	min	13.06.06	-9,67	05.03.07	-3,93
		V	1.40	2.19	1.51	max	23.05.06	+7,13	05.12.07	+3,55
4	RTS - Telecommunications (RTStl) index	P	40.78	81.47	28.13	min	13.06.06	-6,14	05.03.07	-4,72
		V	1.10	1.46	1.10	max	02.02.05	+4,96	27.09.07	+3,63
5	RTS - Metals and mining (RTSmm) index	P	53.18	52.42	54.00	min	13.06.06	-7,80	27.02.07	-4,48
		V	1.12	1.79	1.49	max	30.06.06	+7,47	14.06.07	+4,80
6	RTS - Consumer goods and retail trade (RTScr) index	P	92.46	51.27	29.31	min	22.05.06	-5,50	28.02.07	-3,58
		V	0.91	1.03	0.74	max	04.05.05	+4,19	20.06.07	+2,50
7	RTS - Industry (RTSin) index	P	40.50	73.76	66.83	min	22.05.06	-9,11	01.03.07	-2,36
		V	0.77	1.31	0.84	max	07.02.06	+7,02	04.07.07	+6,94

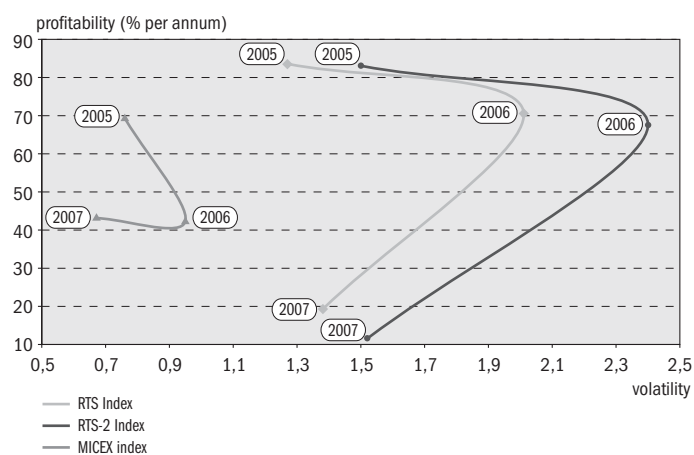
Calculations are based on RTS data.

Table 23. MICEX indices' profitability and volatility.

No.	Name		Profitability and volatility (%)			Extremum value (%)				
			2005	2006	2007	Since the start of calculation		2007		
			Date	Value	Date	Value	Date	Value		
1	Issuers	D	83.08	67.69	11.57	min	28.10.97	-20,81	01.03.07	-4,35
		V	1.50	2.40	1.52	max	07.09.98	+31,65	15.01.07	+3,73
2	Oil and gas companies stock index (MICEX O&G)	D	92.21	47.95	-3.57	min	22.05.06	-10,06	01.03.07	-4,26
		V	1.41	2.39	1.58	max	23.05.06	+10,13	15.01.07	+3,90
3	Telecommunications companies stock index (MICEX TLC)	D	39.10	65.98	15.62	min	13.06.06	-8,02	05.03.07	-3,79
		V	1.14	1.67	1.18	max	27.07.06	+5,95	27.09.07	+4,33
4	Metallurgical and mining companies stock index (MICEX M\$M)	D	74.60	51.69	45.64	min	13.06.06	-10,94	09.08.07	-3,55
		V	1.64	2.56	1.44	max	23.05.06	+9,14	19.09.07	+5,02
5	Mechanical industry companies stock index (MICEX MNF)	D	28.90	69.62	61.43	min	22.05.06	-12,56	01.03.07	-3,90
		V	1.76	2.75	1.04	max	07.02.07	+12,01	09.06.07	+5,22
6	Power industry companies stock index (MICEX PWR)	D	38.79	134.51	7.87	min	04.04.06	-6,94	01.03.07	-4,77
		V	1.45	2.03	1.32	max	09.02.07	+7,56	09.02.07	+7,56

Calculated using MICEX data

Figure 11. Profitability and volatility of composite stock indices.



Calculations are based on RTS and MICEX data.

The indices related to industry and mechanical engineering showed the highest profitability in 2007 (RTSIn – 67% per annum, MICEX MNF – 61% per annum).

The volatility changes of the stock indices lately have manifested approximately the same trends. In general, the year 2007 has demonstrated no significant leaps of indices in either direction. The volatility of all indices was lower than in 2006. Figure 11 shows the behaviour of three main composite indices on “profitability-volatility” coordinate system, for the years 2005 to 2007.

Therefore, as follows from Figure 11, the main composite stock indices in 2005 were in the zone of higher profitability and relatively small volatility; in 2006 they moved into the zone of lower profitability and higher volatility. In 2007 they returned to the level of volatility characteristic for 2005, but at a much lower profitability level. In general, RTS-2 index shows the least volatility in 2005-2007, and oil and gas industry indices, the highest.

2. Institutional structure

2.1. Issuers

In Russia there are no precise statistics relating to security issuers. Any joint stock company is an issuer because it issues and places shares at the moment of its incorporation (and is required to register them). A limited liability company, and, in some cases, a non-profit organization can also be a bonds issuer. We present some data on the issuers whose securities (both shares and bonds) are traded on formal markets – be it securities included in quotation lists or those traded as non-listed. Summarized data on the numbers of issuers are shown in Table 24.

Table 24. Issuers on formal stock exchange market.

	MICEX			RTS		
	2005	2006	2007	2005	2006	2007
The number of issuers (stocks and bonds)	385	539	670	262	332	354
of them, included in the quotation lists	93	127	229	46	64	88

Sources: MICEX, RTS.

Existing data indicate that the stocks of 71 issuers also circulate as depository receipts in foreign stock exchanges.

A specific feature of the Russian stock market is the extensive presence of the state in the general property structure, and over the last two years this share has manifested a tendency to grow. Six out of ten most capitalized companies (see Table 3) comprising about 50% of the overall capitalization of the Russian capital market are directly or indirectly controlled by the state. It was estimated that the share of the state in the total capitalization of the Russian capital market as of the beginning of 2006 was 29,6%, and as of the beginning of 2007 it increased to 35,1%³². The estimates for later periods are not available at the moment; we can be confident, however (considering, in particular, the public offerings of such issuers as Sberbank and VTB Bank, conducted in the first half of the year), that the share of the state in the Russian security market capitalization has increased lately.

In general, the number of issuers in the formal market is growing; and the number of issuers in the quotation lists, i.e. public issuers, is growing even faster. For example, as follows from Table 24, the total number of issuers whose securities are traded at MICEX has increased by 24.3% in 2007; and the number of issuers whose securities are included in the quotation lists, by 80.3%.

Public offerings

Placement of most shares traded today at the Russian stock exchanges happened during privatization and did not bring any financial resources to the issuing companies. The first public offering of Russian stocks abroad happened in 1996 (VimpelCom placed its ADR at NYSE). The first IPO at Russian stock exchanges has taken place in 2002 (RosBusinessConsulting company at MICEX and RTS).

³² Monitoring investors' activity in Russia. – Alfa Bank, February 2007.

In the last few years the volumes of the public offerings of the Russian companies have drastically increased. Table 25 contains summary data on the volumes of public offerings over the last three years.

Table 25. Russian issuers' public offerings.

	2005	2006	2007
Volume of offerings (US\$ billion)	4.55	17.98	23.6
of them, in domestic market	6%	36%	44%
Number of companies	13	24	25

Source: www.offering.ru.

It must be noted that there is no generally accepted methodology in Russia to categorize the offerings (private, primary, secondary); neither there is a methodology for estimating the volume of raised capital. Because of that, the data on quantity and volume of stocks placed differ according to different sources. Thus, the CMDC estimates the offerings volume in 2007 at 32.7 billion dollars, and the FFMS of Russia at 30 billion dollars (or 740 billion roubles)³³.

Nevertheless, according to general estimates, the market for public offerings of Russian companies' stocks is growing rapidly over the last several years, and is gaining leading positions worldwide, both by the total volume of the offerings and by the amount of finances raised by each particular company. The total volume of offers in 2006 has 4 (!) times exceeded the result of 2005, and the volume for 2007 is 1.4 times the result of 2006.

It should be noted, however, that this growth was largely caused, not by a large number of new companies having entered the market, but by massive placement of stocks of several companies, mostly with the state's participation and support. The largest public offerings in 2007 were: Sberbank (\$US 8,8 billion) and VTB Bank (US\$7,9 billion) in the banking sector; in the real estate sector the companies that went public were "PIK Group" (US\$1,9 billion) and "AFI Development" (US\$1,9 billion), in the pharmaceutical industry, "Pharmstandart" (US\$0,9billion). Together, these companies accounted for more than half of the placement volume for this year.

It is important to note that, starting from 2006, the volume of the financing raised in the domestic market is growing. The domestic market's share in offerings has grown from 36% in 2006 to 44% in 2007³⁴. It is also related to the fact that all of the stock of Sberbank and part of the shares of VTB Bank were offered in the domestic market.

Characteristically, the industry structure of the companies who went public in 2007 (see Table 26) is noticeably different from the industry structure of the share market capitalization (see Table 5).

First of all we should note the low share of the oil and power companies and the significant volume of offerings by the issuers from the financial industry. We would like to emphasize the especially high interest of the real estate and development companies to attracting capital by public offerings.

In the first half of 2007 specialized trading floors were opened at both principal exchanges for attracting investments into new innovative companies, and into the companies with small and average capitalization.

In conclusion, we should note that in 2007 the regulatory legal base was developed that allowed to perform placement and circulation of the foreign-issued securities on Russian trading floors, as depository receipts. However no placement occurred by the end of the year.

³³ The report "On the measures for enhancement of capital market regulation and development for the years 2008 to 2012 and for longer term."

³⁴ IPO in Russia: liquidity on financial markets stops growing (ReDeal Group, 2007)

Table 26. Russian issuers' public offerings by industry.

No.	Industry	Share in total placements (%)
1	Finances	50
2	Construction, real estate	17
3	Metallurgy	7
4	Fuel and energy industry	6
5	Pharmaceutical industry	4
6	Chemical industry	4
7	Trade	4
8	Transportation	4

Source: www.offering.ru.

2.2. Investors

Investors are any persons or institutions investing funds in securities for the purpose of gaining profit. There is no official systematized data available on the structure and quantitative statistics of the Russian capital market investor base. Nevertheless, lately professional security market participants, selfregulating organizations and research groups began working on listing and studying Russian investors.

a) Population

Here, the population includes “market” investors – subjects (physical persons) who have decided to work independently in the capital market and periodically use brokers' or trust managers' services, or the persons that purchase investment fund units. The individual holders of shares received in the course of the voucher privatization, as well as the shareholders of check investment funds, or holders of units in unit investment funds which have emerged in the result of transformation of the check investment funds, do not belong to this category.

There is no complete and credible statistics on the quantity of the individuals engaged in security market deals in Russia. It is possible to create the following, far from complete picture by compiling data from various nonsystematic sources.

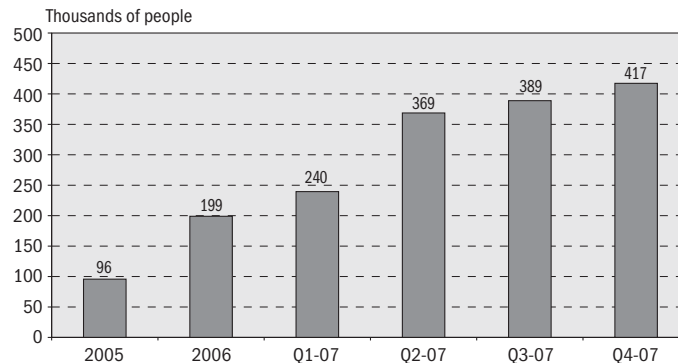
Since 2005, MICEX regularly publishes data on the numbers of individuals participating in the trades (hereinafter referred to as “MICEX clients”).

In the middle of 2007 MICEX has changed the methodology for counting its clients, accepting the new methods that take individual identifying features into account. Figure 12 depicts data on the quantity of individuals working at MICEX calculated using new methods.

The number of individuals on MICEX has increased by 108% in 2006. MICEX had 198.9 thousand unique customer accounts that belonged to individuals, as of the beginning of 2007 and 417.4 thousand by the end of the year. Therefore, in 2007 this number's incremented by 109%. However, these numbers require additional commenting.

The placement of VTB Bank stocks happened in the first half of 2007. This was a major event by the number of the individuals involved (estimated at 131 thousand people) who could become clients of VTB, a MICEX trade participant. The total number of unique clients of this trade participant at the latest available date (June 2007) was 132,580 people. The dramatic increase of the unique MICEX clients number in the 2nd quarter of 2007 compared to the 1st quarter is also remarkable. Their number incremented by 129 thousand. In the previous quarter this increment equalled 40.6 thousand, and in the next quarter, 20.2 thousand. This allows to assume that the participants of the VTB Bank stocks initial offering were included into the number of physical persons, clients of MICEX.

Figure 12. Participation of population in securities market investments (MICEX customers).



Source: MICEX.

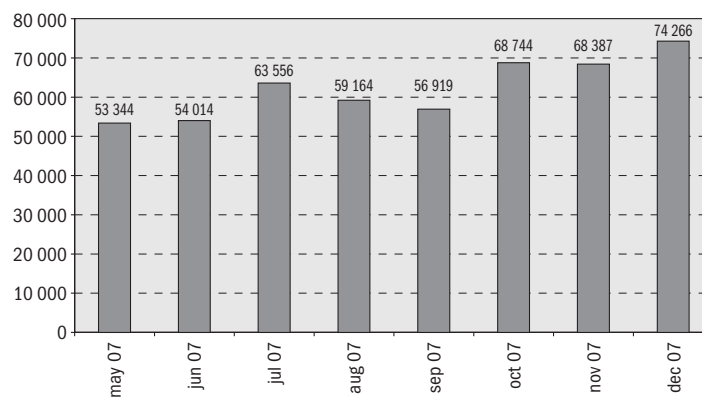
An important statistic of private investor base is the number of so called active investors who make at least one deal per month at the stock exchange. Figure 13 presents the available data on the active investors at MICEX.

As follows from Figure 13, the number of active clients is about 13-14% of all the unique clients. It is remarkable that the number of active MICEX clients is very close to the difference between the total number of client accounts and the number of unique client accounts. This difference corresponds to the part of client base that, for example, uses more than one broker company's services.

Between May 2007 and the end of the year the number of active clients grew by 40%. At the same time, there was a lull in August and September that can be explained both by vacation time and by a negative security market situation.

RTS does not disclose its customer statistics on regular basis. According to RTS data, among FORTS forward market clients, as of April 1, 2007, 11.9 thousand customer accounts belonged to private investors. We have every reason to believe that individual investors operating in the forwards market do not belong to a separate investor niche, but most of them work at the spot market as well, using forwards market instruments for arbitrage transactions and hedging.

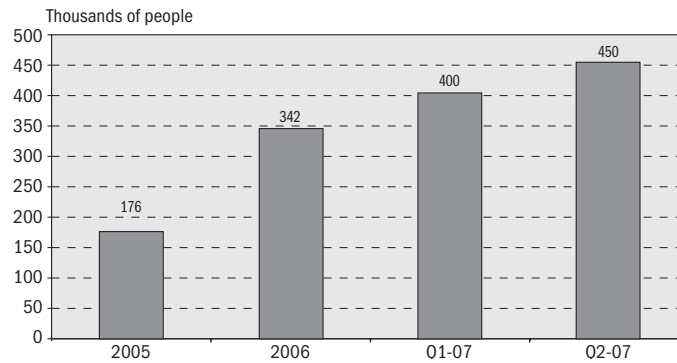
Figure 13. The number of active MICEX clients.



Source: MICEX.

The League of Management Companies has been estimating the number of accounts that belong to UIF “market” shareholders (see figure 14) with nonzero accounts, from 2002 to the first half of 2007.

Figure 14. Participation of the population in securities market investments (UIF customers).



Source: LMC.

According to these estimates, the number of the UIF unit holders in 2006 increased by 94%. At the beginning of 2007, according to LMC data, there were 342 thousand UIF shareholders, and by the end of the 2nd quarter their number increased to 450 thousand. Thus, the increase in the number of shareholders was 31,6 % for the first half of 2007, which is lower than for the same period in 2006. This decrease may be explained by unstable behavior of the capital market, and also by the fact that the UIF customers have practically no opportunity to gain profit from the falling market or from a long-term lateral trend with increased volatility. The opportunities of direct investments in the capital market instruments in such conditions are much wider – scalping, short sales, forwards and so on. Another possible reason for the slowdown in the shareholders’ number growth in the first half of 2007 is the large public offerings conducted in this period by the leading Russian banks – Sberbank and VTB Bank.

They were accompanied by intensive advertising campaigns and have undoubtedly distracted some interest of private investors. Unit investment funds are unable to purchase securities at the stage of their public offering due to existing legal restrictions.

Unfortunately, there is no data for “market” shareholders’ numbers available for the second half of 2007.

A separate new group of private investors consists of the private individuals who participated in the so called “people’s IPO” of Rosneft in July 2006, as well as that of Sberbank and VTB Bank in the first half of 2007. According to the data of issuing companies and mass media, the total number of such individuals was approximately 115 thousand at the Rosneft shares placement, 30 thousand at the Sberbank shares placement and 131 thousand persons at the VTB Bank shares placement.

A certain number of private investors not only use brokers, but also acquire investment units, and probably from several investment funds, and may also have participated in the recent public offerings, so the direct addition of the above data would yield an incorrect result. It is not currently possible to define a methodologically sound discount ratio. Nevertheless, based upon the estimates of experts, we can estimate the number of private “market” investors at approximately 700 thousand as of the end of 2007.

b) Investment funds

There were in total 948 registered UIF in Russia as of the end of 2007, which is 53.2% more than in the beginning of the year. Taking into consideration that in 2006 the number of UIFs had increased by 60.7%, it is necessary to note that in 2007 the growth rate of the number of UIFs has somewhat decreased.

The structure of UIFs has changed in the last 3 years. As of 2005, open-ended UIFs constituted around 53% of all UIFs. By the end of 2007, it was 48%. The share of close-ended UIFs increased from 32 to 42%. This happened mainly because of the real estate funds (whose share grew from 19% to 28% of all the UIFs). The share of interval UIFs has been constantly decreasing: during 2007 the niche of interval funds was decreased to 10% (compared to 2005 when it was 15%).

Table 27 contains summary data on the UIF numbers dynamics over the last three years.

Table 27. The number of unit investment funds³⁵.

UIF type	2005	2006	Q1-07	Q2-07	Q3-07	Q4-07
Open-ended	201	299	317	340	392	455
Interval	59	86	91	93	91	95
Close-ended	121	234	261	301	342	398
of this, real estate	73	152	169	201	229	269
TOTAL	381	619	669	734	825	948

Source: LMC.

Table 28 contains summary data on the UIF net assets cost dynamics over the last three years.

Table 28. UIF net assets value (Billion roubles)³⁶.

UIF type	2005	2006	Q1-07	Q2-07	Q3-07	Q4-07
Open-ended	30.8	91.1	131.0	127.6	133.9	134.8
Interval	38.7	59.6	46.1	46.8	44.5	43.8
Close-ended	163.4	268.1	367.6	465.3	479.1	564.9
of this, real estate	24.9	69.0	81.3	104.5	122.9	157.8
TOTAL	233.0	418.8	544.7	639.7	657.5	743.5
UIF net assets value / GDP (%)	1.08	1.56				2.25

Source: Federal State Statistic Service, LMC.

In general the ratio of UIFs' assets to GDP is still low, even though there is a certain growth trend. The value of the UIFs' net assets as of the end of 2007 was 743.5 billion roubles, which is 77.5% more than in the beginning of the year. In 2006, there was a similar increase of 79.7%. We should note that in 2007 the UIFs' net assets value grew irregularly: the highest increase of 30% happened in the 1st quarter, and the lowest, only 2.8%, in the third quarter. The trends for change of net asset value for different types of UIF were also very different. The net asset value for open-ended UIFs increased by 196% in 2006 and by 48% in 2007. For the close-ended UIFs these indicators are 110 and 64% respectively. The interval UIFs have grown by 54% in 2006 and decreased by 27% in 2007.

³⁵⁻³⁶ Only the funds that completed launch are included in the statistics.

This allows to infer that, while formation of new UIFs slows down, the assets of existing funds are experiencing more stable growth. One of the possible explanations for this is an evident shortage of financial instruments for creating new funds. In 2006, the open-ended UIFs were leading in the increase of their net asset value; in 2007, however, the closed-ended UIFs demonstrated the highest growth rate, 128%. It is likely explained by the general market instability and simultaneous permanent growth of residence and business real estate prices.

Table 29 and 30 contain summary relative data on the net assets value for different types of UIFs as of the end of 2007.

Table 29. Relative data on UIFs number (%)³⁷.

Category	Open-ended	Interval	Close-ended	Total
Stocks	41.76	46.32	7.29	27.743
Bonds	16.04	8.42	0.00	8.544
Mixed investments	29.23	41.05	4.27	19.937
Index stocks	8.35	1.05	0.00	4.114
Index bonds	0.22	0.00	0.00	0.105
Funds	3.30	3.16	0.00	1.899
Money market	1.10	0.00	0.00	0.527
Real estate	These types of funds are not provided for by legislation		67.59	28.376
Venture investments	These types of funds are not provided for by legislation		14.57	6.118
Direct investments	These types of funds are not provided for by legislation		3.52	1.477
Mortgage	These types of funds are not provided for by legislation		2.76	1.160
TOTAL	100.00	100.00	100.00	100.00

Source: LMC.

Table 30. Relative data on the UIFs' net asset value (%).

Category	Open-ended	Interval	Close-ended	Total
Stocks	57,41	64,69	40,13	44,706
Bonds	10.62	0.77	0.00	1,970
Mixed investments	25.98	32.05	12.84	16,351
Index stocks	4.99	0.38	0.00	0,928
Index bonds	0.02	0.00	0.00	0.004
Funds	0.76	2.12	0.00	0,263
Money market	0.22	0.00	0.00	0,040
Real estate	These types of funds are not provided for by legislation		27,93	21,222
Venture investments	These types of funds are not provided for by legislation		5,42	4,121
Direct investments	These types of funds are not provided for by legislation		12,48	9,485
Mortgage	These types of funds are not provided for by legislation		1,20	0,911
TOTAL	100.00	100.00	100.00	100.00

Source: LMC.

³⁷ Only the funds whose formation is completed are included in the statistics.

As one may see from Tables 29 and 30, the most popular open-ended funds are stocks funds (41.8% of all the open-ended UIFs, 57.4 of the open-ended UIFs' net asset value); then the mixed funds (29.2 and 26.0 respectively) and the bonds funds (16.0 and 10.6 respectively). Interval UIFs manifest similar tendencies with the mixed funds' share being slightly higher.

Real estate funds are the most popular among closed-ended UIFs (67.6% of the total number), but the highest volume of assets is concentrated in stocks funds (40.1% of the total net assets cost of CEUIFs).

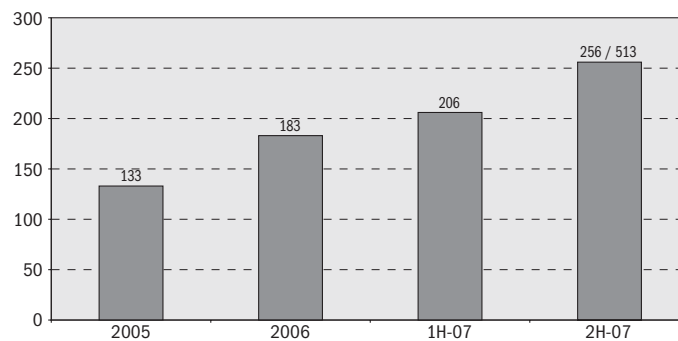
If we compare the data from Tables 29 and 30 to the last year, we can see that no significant change occurred in the various UIF categories. As to the relative data on the net asset value for different categories of UIFs, in the open-ended UIF category the share of stocks funds has increased at the expense of the bonds funds' and mixed funds' shares decreasing. In the close-ended UIF category the share of direct investment funds has almost halved. At the same time it is necessary to emphasize that UIF classification by types of assets is mainly nominal because the regulations allow, for example, to have up to 40% of bonds in a shares fund, etc. There is no summarized statistics on distribution of assets in UIFs by various classes of financial instruments. Therefore, unfortunately, it is impossible to make any inferences about UIF asset redistribution among different asset classes.

We should note that at present there is no call for a number of UIF types provided for by the legislation. It is mainly explained by the fact that several allowed types of funds, e.g. close-ended money market UIFs, have questionable consumer benefits and would hardly be demanded by the investors.

Because a UIF is a property pool and not a legal person, any transaction involving a UIF also involves a management company. Figure 15 depicts summary data on the quantity of management companies controlling UIFs over the last three years.

The number of the management companies controlling UIFs has increased by 36.6% in 2006, and by further 39.9% in 2007. Such growth statistics prove that there is a considerable interest towards the collective investments industry. They are noticeable against the changes in the other aspects of security market activities. It should be mentioned that according to official data disclosed by the FFMS 513 management companies' licenses are issued as of today. Thus, about the half of all the organizations that hold management companies' licenses are involved in managing UIFs. The others are engaged only in pension funds management and in other projects, or do not carry out any activity whatsoever.

Figure 15. The number of management companies controlling UIFs.



Source: LMC.

Assets concentration is traditionally high in the market for UIF management, but it has a certain downtrend. In the end of 2006, the share of the first ten companies was 74,9% of the total UIF assets, and by the end of 2007 this index has decreased to 58,8%³⁸.

³⁸ Calculations are based on data courtesy of National Rating Agency and LMC.

c) Bank-managed mutual funds

Bank-managed mutual funds (BMMF) are an investment product that credit organizations can offer according to the rules established by the Bank of Russia. BMMF is a property complex that consists of property placed into trust management by various persons. An investor of a BMMF receives a participation certificate, which is not a security. The requirements for BMMF's asset composition and structure are less restrictive than the UIF requirements. As of the end of 2007, 34 credit organizations were involved in BMMF management. The summary data on the number of BMMF and their net asset value over the last three years is shown in Table 31.

Table 31. Bank-managed mutual funds.

	2005	2006	Q1-07	Q2-07	Q3-07	Q4-07
The number of funds	101	149	151	153	158	162
including funds in roubles	59	91	92	94	99	103
including funds in currency	42	58	59	59	59	59
Net asset value (billion roubles)	7.83	17.05	19.49	19.39	22.12	21.09

Source: *investfunds.ru*.

As one may see from Table 31, the BMMFs are much fewer than UIFs and have much lower total net asset value. In 2006, the BMMF were growing rapidly (their number increased by 47%, and their total net value by 118%). In 2007, however, the growth was insignificant. Summarized data on the number of BMMF investors are not available.

d) Non-state pension funds

According to the FFMS³⁹, 293 organizations had licenses for non-governmental pension funds as of the end of 2007, and 126 of them were allowed to participate in mandatory pension insurance program.

The data on NPF assets connected with non-state pensions and obligatory pension insurance are shown in Table 32.

Table 32. NPF investment resources (billion roubles, as of the end of the period).

	2006	Q1-07	Q2-07	Q3-07	Q4-07 ⁴⁰
Pension reserves	405.18	417.61	431.33	443.44	472.3
Pension savings	9.96	19.85	19.92	25.55	26.7

Source: *www.investfunds.ru, FFMS*.

In February 2007 the new rules of the pension reserves placement were adopted, essentially changing the NPF investment opportunities. Thus, the promissory notes and real estate were excluded from the list of allowed assets; NPF are required to ensure compliance with these new requirements for the composition and structure of assets within three years. However, in September 2007 the real estate objects were again included in the list of allowed assets.

³⁹ *www.fcsn.ru*.

⁴⁰ Preliminary data.

As one may see from Table 32, the NPF pension reserves have slightly increased in the first half of 2007 – only by 13.1% (the non-pension savings have grown a lot more, by 34.5%). Nevertheless, the NPF investment resources⁴¹ are currently insignificant: as of the end of 2007, they only amounted to 1.5% of the GDP.

The concentration of pension reserves and savings in NPF is quite high. And it has a pronounced uptrend for the pension reserves: in the end of 2006 the first ten NPFs contained 60,4% of all the pension reserves, and by the end of the 3rd quarter of 2007 this statistic has increased to 86.2%. The similar statistic for pension savings at the same period was around 77-79%⁴².

e) Pension savings investment

The insured persons, i.e. employees for whom their employers make contributions to the Pension fund of Russia (PFR) and who therefore have pension savings (along with the right to a state-provided minimum pension) may transfer their pension savings to a NPF or put them in trust for a management company – either private or state-owned. The first tender among private management companies for the right of participation in the investment of pension savings was held in 2004 and attracted attention of both professional market community and interested public. As a result, 55 companies were admitted to the management of pension savings assets. At the same time in the next years the private companies has practically lost interest in this project. Functions of the state management company are currently fulfilled by the OJSC “State corporation “Bank of Foreign Trade Activities and Development” (“Vneshekonombank”).

The data on the pension savings amounts transferred into NPF are shown in Table 33. Table 34 shows data on the net asset value of the pension savings entrusted to the state and private management companies.

Table 33. Net value of the assets in which pension savings are invested (Billion roubles).

	2006	Q1-07	Q2-07	Q3-07	Q4-07
Total amount	276,445	270,075	274,533	340,033	375,082
including:					
State management company	267,072	260,668	265,126	328,97	362,87
Private management companies	9,373	9,407	9,407	11,063	12,208

Sources: VEB, Pension fund of Russia, www.investfunds.ru.

As one may see from Table 33, most (around 96.7%) of the pension savings transferred to a trust management are in trust management of the state management company.

Currently the amount of pension savings is insignificant. It is estimated as being equal to around 1.1% of GDP, including the assets managed by the management companies, and around 1.2% of the GDP if the assets managed by NPF are included (see Table 32).

Being a state management company, “Vneshekonombank” has a right to invest pension savings only in state securities. The private management companies have a wider range of investment opportunities. The summary data on the investment structure of the private management companies is shown in Table 34.

As shown in Table 34, on the average 26-30% of the resources received by private managing companies are invested in shares, and subfederal and corporate bonds are second. It should be noted that in 2007 the share of subfederal bonds was steadily decreasing (from 23% to 11%), and the share of corporate bonds was, on the contrary, growing (from 22% to 39%). The share of federal bonds

⁴¹ Decree of the Government of the Russian Federation from 01.02.07 No. 63 “On approval of the Rules of placement of PF pension reserves and control over their placement”

⁴² Calculations are based on data courtesy of www.investfunds.ru.

remains insignificant and has a pronounced downtrend. It should be noted that many admissible asset classes are still absent in investment portfolios.

Table 34. Structure of assets in which private management companies invest pension savings (%).

No.		2006	Q1-07	Q2-07	Q3-07	Q4-07
1	Money in accounts with credit organizations	0.77	5.46	0.24	2.01	1.93
2	Rouble deposits in credit organizations	6.60	7.23	7.21	7.20	7.34
3	State securities of the Russian Federation	10.37	10.17	9.04	5.91	4.64
4	State securities of the Russian Federation for placement of institutional investors' finances	0.00	0.00	0.00	0.00	0.00
5	Bonds of foreign bonded loans of the Russian Federation	0.00	0.00	0.00	0.00	0.00
6	Subfederal state securities	22.99	17.60	15.28	13.78	11.17
7	Municipal bonds	2.02	1.68	1.60	1.14	1.54
8	Bonds of the Russian economic companies	21.90	22.59	32.90	33.55	38.79
9	Shares of the Russian issuers incorporated as OJSC	29.43	26.65	29.98	28.16	30.15
10	Bonds with a mortgage backing, issued according to the legislation of the Russian Federation on mortgage securities	0.00	0.00	0.00	0.00	0.00
11	Mortgage participation certificates issued according to the legislation of the Russian Federation on mortgage securities	0.00	0.00	0.00	0.00	0.00
12	Units (shares) of the index investment funds placing financial resources in state securities of foreign countries, bonds and shares of other foreign issuers	0.00	0.00	0.00	0.00	0.00
13	Debts receivable, including:	5.90	8.61	3.74	8.25	4.44
14	Pension savings on special discretionary accounts	4.95	7.61	2.74	7.19	3.47
15	Debt receivable under an interest (coupon) income from bonds	0.94	0.97	0.99	1.04	0.96
16	Other debt receivable	0.00	0.00	0.01	0.02	0.00

Calculated according to data presented by the Pension fund of Russia.

f) Commercial banks

Many Russian banks act as professional participants of capital market and as investors as well.

Summary data on the volumes of various types of securities in the assets of credit organizations for the last two and a half years are shown in Table 35⁴³.

Table 35. Securities in the assets of financial entities (Billion roubles).

	2005	2006	2007			
			Q1	Q2	Q3	Q4
Securities (total)	1,539.4	1,961.4	2,404.4	2,725.9	2,434.7	2,554.7
including						
Debt instruments	1,036.6	1,341.2	1,627.3	1,824.0	1,549.9	1,674.0
of them						
Debt instruments of the Russian Federation	492.0	537.2	585.6	615.6	559.8	580.3
Shares	292.8	391.0	531.8	645.1	645.3	629.6
of them, controlling interest portfolio	64.9	79.8	104.3	116.6	119.0	141.9
Discounted promissory notes	210.1	229.2	245.3	256.7	239.5	251.1

Source: Bank of Russia.

⁴³ Taking into consideration securities purchased both in the foreign and in the domestic markets.

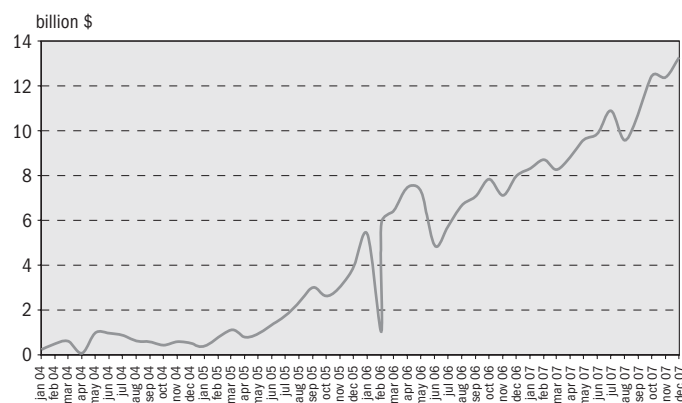
On the average, the share of securities in the assets of the Russian credit organizations (banks) averaged 14%-16% over the last years. It is characteristic that by the end of the 4th quarter, 2007, it dropped to the lowest level over the last three years, 12.6%. It is likely explained by the general securities market instability and the bank system's liquidity problems. In the absolute figures, as of the end of 2007, the amount of securities within the assets of the Russian banks was equal to 2,554.7 billion roubles, having increased by 30.3% since the beginning of the year. (In 2006 the increase amounted to 27.4). At the same time, there is a significant change in the securities amounts during the year. More precisely, in the 1st quarter the amounts of securities have increased by 22.6%; in the 3rd quarter, however, the amount of securities that the banks have withdrawn from their assets was 291.2 billion roubles. (This is a decrease by 10.7%.)

The average share of debt securities in the aggregate portfolio of financial organizations amounts to 67%-68%, with a slight decrease in the 3rd quarter of 2007. The share of state securities among all the debt securities has a downtrend (from 47.5% in the end of 2005 to 34.7% in the end of 2007) and are being gradually replaced with corporate bonds. On the other hand, the share of stocks (disregarding stocks of affiliated and dependent companies) shows a certain growth (from 14.8% of the aggregate investment portfolio in the end of 2005 to 19.0% as of the end of 2007), with a slight increase in the 3rd quarter of 2007. The share of promissory notes constantly decreases (from 13.6% in the end of 2005 to 9.8% as of the end of 2007).

g) Foreign investment funds in the Russian capital market

The Russian capital market have not yet become attractive enough for major global investment and pension funds catering for foreign retail investors. The funds specializing in investments in the Russian economy usually have low capitalization and are mainly hedge funds or funds working with qualified investors. The share of foreign funds' resources into Russia and the CIS countries in 2007 is about 16% of the total financing attracted by the BRIC countries and 3% of the total financing placed into the emerging markets⁴⁴. Figure 16 shows the dependence of net volume of Russian stocks purchase and sale transactions on a representative group of 1000 foreign stock funds over the last years.

Figure 16. Net balance of stocks purchase and sale transactions by the global foreign stock funds investing in Russian companies.



Source: EPFR Global.

Therefore, the net balance of stocks purchase and sale transactions is positive and has an uptrend.

⁴⁴ IPO/SPO market in Russia: one more record-setting year". – Alfa Bank, December 2007.

2.3. Professional capital market participants

Summarized, systematized and detailed data on professional participants of the Russian capital market are not published. According to FFMS data⁴⁵, the total number of professional market participants dealing in securities on the basis of appropriate licenses amounted to 1,711 organizations as of the end of 2006. By our estimations, around 40% of them are at the same time functioning as credit companies. According to the same data there were 1,634 organizations as of the end of 2005. Therefore, the increase for 2006 was 4,7%.

a) Brokers, dealers, trust managers

Russian legislation regulates brokerage activity, dealer activity and equity management activity. The definitions of these kinds of activities correspond as a whole to the understanding accepted in the developed markets, taking into consideration the following reservations:

- The brokerage activity as such does not imply the holding of clients' securities, therefore brokers wishing to carry out depositary activity should receive a separate license;
- The dealing activity includes only sale and purchase of securities accompanied by public announcement of the bid and/or sale prices; therefore the companies and persons who regularly make transactions in securities and even offer them publicly are exempt from regulation as long as they do but not announce prices;
- Security trust management formally differs from trust management of UIFs and non-state pension funds; two different types of licenses exist for these similar kinds of activity.

The data on the numbers of valid licenses for professional brokers are presented in Table 36.

Table 36. Licenses for professional brokers.

Activity type	2005	2006	2007 ⁴⁶
Brokerage	1,379	1,433	1,445
Dealer activity	1,398	1,394	1,422
Securities management	1,022	1,100	1,169

Source: *The FFMS of Russia*.

Therefore, as follows from Table 36, over the last three years the contingent of professional market brokers is stable, with a small uptrend. Please note that this is the number of issued licenses, not the number of organizations that work as brokers in the capital market. Most professional capital market participants have three or four licenses. The number of professional participants holding all three licenses listed in Table 36, according to the data provided by the FFMS of Russia, is 1,691.

b) Trade and settlement infrastructure

The professional capital market participants that constitute the trade and settlement infrastructure of the Russian capital market conduct the following activities:

- organizing trade in the capital market (including stock exchanges);
- clearing activity;
- depositary activity as settlement depositaries.

Besides, the non-banking credit entities engaged in settlement operations are also a part of this infrastructure.

⁴⁵ FFMS annual report for 2006.

⁴⁶ Preliminary data.

According to the data provided by the FFMS, as of the end of 2007 there were 9 organizations with trade organizers' or stock exchange licenses and 10 organizations with clearing house licenses. In 2007 CJSC "Sankt-Petersburg Stock Exchange" obtained a clearing house license. However, due to market competition and objective integration processes, there emerged two factual leading infrastructural centers, MICEX Group and RTS Group that in fact constitute the formal market for dealing in securities and derivatives in Russia.

The MICEX Group is an integrated trade and settlement infrastructure including, among other organizations:

- CJSC "Moscow Interbank Currency Exchange";
- CJSC "MICEX Stock exchange";
- Noncommercial partnership "National Depository Center";
- Nonbanking credit company "MICEX Clearing house" (CJSC);

CJSC Joint Stock Commercial Bank "National Clearing Centre"; The capital market of MICEX (where the organizer of trade is MICEX Stock Exchange) functions on the "order-driven market" principle where the transaction is made automatically if there are corresponding anonymous bids. Transactions are carried out on a "delivery against payment" basis with 100% preliminary assets deposit. The transactions fulfillment is carried out on the date of their conclusion (T+0).

In the negotiated transactions mode the traders have an opportunity to quote securities by making public bids (invitations to offer for all traders) or to make a transaction on bilateral (not anonymous) principle using corresponding addressed bids (offer for a deal from one trader to another). At that, the traders define the appropriate date of fulfillment of their obligations ranging from the current business day (T+0) to 30 calendar days after conclusion of the transaction (T+30). This mode of trade allows the traders to make transactions either with complete control of backing or without the control of backing.

Clearing on MICEX Capital Market transactions is carried out by CJSC MICEX. The settlements of the net obligations of traders on their transactions are carried out based on the CJSC MICEX settlement documents at the MICEX Clearing house (settlement organization for cash) and at the National Depository Center (settlement depository for securities).

There are plans to transfer clearing functions on all markets within MICEX Group to the National Clearing Centre. The summary of MICEX Group trading in the non-state securities in 2005-2007 are shown in Table 37⁴⁷.

Table 37. MICEX trading results.

	Units	2005	2006	Q1-07	Q2-07	Q3-07	Q4-07	2007
Trading volume	billion \$	225.6	754.9	297.4	387.6	785.0	538.9	1,708.9

Source: MICEX.

A Sector of innovative and growing companies (IGC) was formed within the MICEX Group in 2007. The following criteria for issuers selection were defined for this sector:

- An essential part of proceeds is generated by activities in the industries related to application of the innovative and high technologies;
- The capitalization is between 0.1 billion roubles and 5 billion roubles. For the informational transparency of the companies present in the IGC Sector the institution of listing agents was introduced. The functions of a listing agent include, under an agreement with the issuer, such tasks as preparing the documents for admission of securities to circulation, ensuring the information disclosure process and so forth.

⁴⁷ Including transactions with shares, corporate, subfederal, municipal bonds, investments units, including repurchase transactions.

The first issuer in Sector IGC was “FINAM – Information technologies”, a close-ended venture UIF. This fund specializes in the assets acquisition for different segments of IT business, including context advertisement, social networks, payment systems, and games.

In the course of its stock exchange offering in June 2007 the fund raised 500 million roubles. For the entire year, the volume of transactions with this fund’s units at MICEX amounted to 564.8 million roubles, which equals 2.7% of the total IUF transaction volume. By the results of 2007, “FINAM – Information technologies” ranked 8th among the most liquid UIFs at MICEX⁴⁸.

Also in July 2007 an additional share issue of OJSC “Armada” was offered simultaneously in IGC sector of MICEX and at RTS START. The total volume of placement was 29.7 million dollars. This company is a member of RBK group of companies; it specializes in software development and IT services. In 2007, the total volume of transactions with additional shares offered at MICEX was 20.2 million roubles.

A derivatives market offering a cash settlement future on a stock index began working at MICEX at the end of the second quarter of 2007.

The RTS Group is an integrated trade and settlement infrastructure including, among other organizations:

- Noncommercial partnership “Stock exchange “Russian Trade System”;
- OJSC “Stock exchange “Russian Trade System”;
- Noncommercial partnership “Saint-Petersburg Stock exchange”;
- CJSC “RTS Clearing Centre”;
- Non-banking financial entity “RTS Clearing house” (LLC);
- CJSC “Depository and Clearing Company”.

The RTS Group supports several trading modes:

- classical market;
- exchange market;
- futures and options market FORTS.

The trade is organized by OJSC “Stock Exchange RTS”. NP “Saint-Petersburg Stock exchange” trades the stocks of Gazprom.

Within the classical market of RTS two models of trade are used:

- The classical market with nonanonymous trade: the transactions are based on non-anonymous quotations («quote-driven market”), there is no preliminary assets deposit; the quotations are made in US dollars and it is possible to choose the settlement date (from T+0 to T+30), the method of settlement («delivery against payment” or free delivery), the currency of settlement (roubles or foreign currency). Neither clearing centre nor settlement depository are used here. Money settlements in “delivery against payment” mode are performed through NFE “RTS Clearing house” or J.P Morgan Chase Bank, and in free delivery mode, through any bank.

- The classical market with anonymous trade: this means anonymous auctioning of bids («order-driven market”), partial preliminary deposit of assets; the method of settlement is “delivery against payment” on T+4 basis; the quotations and settlements are made in US dollars. The clearing centre used is NP “Stock Exchange RTS”, the settlement depository is CJSC “Depository and Clearing Company”, the settlement financial organizations – NFE “RTS Clearing house” or J.P Morgan Chase Bank.

RTS Exchange market works on the following principles: anonymous bids auction («order-driven market”), 100% preliminary assets deposit; the settlement method – “delivery against payment” on T+0 basis, the quotations and settlements are made in roubles. The clearing centre is NP “Stock Exchange RTS”, the settlement depository is CJSC “DKK”, the settlement financial organization – NFE “RTS Clearing house”.

In September 2007, central counterparty technology was launched at the stock market. This technology implies that NP “Stock Exchange RTS” functions as counterparty for all the deals.

⁴⁸ As estimated by LMC.

The forwards market FORTS is based on anonymous bids auctioning (“order-driven market”). The settlements and delivery are performed after the term of the contract circulation expires. The quotations and settlements are made in roubles. The clearing centre is NP “Stock Exchange RTS”, the settlement depository is CJSC “Depository and Clearing Company”, and the settlement financial organization is NFE “RTS Clearing house”. Since September 2007, intermediate clearing started at the FORTS market.

Besides, there is a system of indicative quotations within RTS: RTS Board, that works on the following principles: displaying indicative quotations on securities not admitted to trade at RTS stock exchange; no preliminary security and money deposits required; the quotations are made in US dollars; it is possible to choose the settlement date (from T+0 to T+30), the method of settlement (“delivery against payment” or free delivery), the currency of settlement (roubles or foreign currency). Neither clearing centre nor settlement depository are used here. Money settlements in “delivery against payment” mode are performed through NFE “RTS Clearing house” or J.P Morgan Chase Bank, and in free delivery mode, through any bank. The summary results of RTS Group trade at different markets in 2005-2007 are shown in Table 38⁴⁹.

Table 38. RTS trade results.

	Units	2005	2006	Q1-07	Q2-07	Q3-07	Q4-07	2007
Classical market								
Trade volume	billion \$	7.65	16.13	3.20	3.07	4.05	4.27	14.59
RTS exchange market								
Trade volume	billion roubles	81.96	27.3	5.06	5.44	6.74	6.25	23.49
SE SPB exchange market								
Trade volume	billion roubles	936.82	1205.91	29.50	14.98	12.93	13.75	71.16
FORTS forwards market								
Trade volume	billion roubles		2,708.5	1,031.8	1,244.9	1,838.0	3,398.6	7,513.3
RTS Boards								
Trade volume	billion \$	324.0	544.8	171.7	150.6	141.0	229.4	697.7 ⁵⁰

Source: RTS.

A special segment, RTS START, was created within RTS Group. Capitalization of the companies included in this segment cannot exceed 3 billion roubles. If any bonds are offered for circulation at this trading floor, the total value of the issue at par should not exceed 0.5 billion roubles.

To increase the information transparency of the companies present in the RTS START, the institution of authorized financial advisors and market makers was introduced. Their functions include, under contract with the issuer, such tasks as ensuring the issuer information disclosure process and liquidity management.

The first issuer presented by RTS START was BF “Kommunar”, and within the year four more issuers appeared at this trading floor: Armada, Kosogorsky metallurgical complex, SiGMA, and Neftekamsky Avtozavod. The transaction volumes with these issuers’ stocks were insignificant. Armada and Neftekamsky Avtozavod proved to be the most liquid issuers, by the results of this year (with transaction volume of 4.0 million dollars and 2.7 million dollars respectively). SiGMA proved to be the least liquid issuer (5 transactions with the total volume of 20,000 dollars).

In November 2007, the main and additional issues of Armada’s stocks circulating at RTS were transferred to the “B” quotation list with their subsequent removal from RTS START segment. Thus, within a year and based on one issuer’s case, the whole process of introducing a small innovative company into the formal market was implemented and tested.

⁴⁹ Including transactions with stocks, corporate, subfederal, municipal bonds, investments units, including repurchase transactions. For FORTS forward market, futures and options deals for all types of underlying assets were included.

⁵⁰ According to the press release on the RTS results of 2007 the total trade volume of RTS Board amounted to 752 million dollars.

c) Registration system

There are two alternative methods to register rights on securities in the Russian capital market: on depo accounts with a depository and on personal accounts in the register keeping system. Both methods have equal legal weight. Depositories and registrars, together with issuers who keep shareholder registers themselves, constitute the capital market registration system. Depository and registrar activities are subject to licensing. The data on the numbers of valid licenses for depositories and registrars are shown in Table 39.

Table 39. Licenses for depositories and registrars.

Activity type	2005	2006	2007
Depository	743	831	787
Registry	82	73	65

Source: *The FFMS of Russia*.

Therefore, as follows from Table 39, over the last three years the number of depository licenses was subject to increases and decreases; the number of registrars, however, has a pronounced downtrend.

Depositories

The depositories render services of registering and certifying rights on securities, of registering and certifying transfers of securities, as well as of custody of securities (if issued in physical certificated form). A depository carries out its activity on the basis of agreement with the owner of securities or the person having other rights on securities (depository agreement).

In Russia, as it is an accustomed practice all over the world, the depositories have separated into settlement ones and custodial ones. The settlement depositories are those that make settlements with securities following the results of clearing and conduct all the operations with capital market participants' deposit accounts needed to execute transactions made through trade organizers. All other depositories are custodial depositories.

According to PARTAD data, the total market value of securities deposited with 30 leading Russian depositories as of June 30, 2007 amounted to 21,492 billion roubles, which is 10% higher than in the beginning of the year. However we should account for possible "double count" as the same security may be listed in the account of a settlement depository and of its customer, a custodial depository.

The depository services market is extremely monopolized – the top ten depositories in 2005-2007 accounted for 89% of the total market value of securities accepted for service.

Registrars

A registrar is a professional participant of securities market who carries out activities related to keeping a register of the owners of registered securities (data collection, recording, processing, storage and ensuring availability of data that constitute the system of keeping the register for the owners of securities). The registrar works upon an agreement with the security issuer. The individuals who open accounts in the register do not conclude an agreement with the registrar. An issuer with 50 or fewer shareholders can keep the register by himself or have an agreement with a registrar. If the number of the shareholders exceeds 50, the issuer is required to delegate the register keeping to a registrar, even though the issuer is still responsible for the register-keeping.

The market of registrar services is much less monopolized than that of the depository services. Top ten biggest registrars in 2005-2007 covered about 54% of the total number of issuers served and around 52% of the issuers whose number of shareholders exceeds 500.

3. Legislative base and regulation

The legislative base regulating capital markets in the Russian Federation is by now mostly complete. It comprises several dedicated laws (“On capital markets”, “On protection of rights and legitimate interests of investors in the capital markets”, “On mortgage securities”) which define general rules for the capital market, and numerous bylaws (predominantly decrees of the Government of the Russian Federation and internal orders of the FFMS) establishing special rules and norms.

The functioning of particular institutions is regulated by special laws: “On investment funds”, “On non-state pension funds”, “On investment of assets for financing the funded part of labour pension”, “On savings and mortgage system for providing military personnel’s housing” which are also accompanied by extensive bylaws.

It should be noted that in December 2007 the federal law “On updates to the Federal Law “On investment funds” and several legislative acts of the Russian Federation” introduced important changes into the regulation the investment funds’ activities in the Russian Federation, including these directed at regulating the investment funds’ activities for qualified investors; at the same time, the concept of a “qualified investor” was introduced into the security market legislation. These updates are in agreement with the international trends in financial markets regulation.

General provisions of the Civil Code of the Russian Federation and norms regulating joint-stock companies established by the law “On joint-stock companies” are also very important for the Russian capital market.

Taxation of capital market activities

The Russian Federation is a traditional taxation country, i.e. it does not position itself as a tax shelter.

Table 40 lists the main taxes that apply to profits (the income of enterprises which carry out activities subject to taxation in the Russian Federation, relevant to securities trade or to individuals’ income).

Table 40. Taxation of security activities

Income	Tax rate, for a resident, %	Tax rate, for a non-resident, %
Individuals		
Dividends on stocks of Russian companies	9	15
Interest on bonds with a mortgage backing issued before January 1, 2007	9	30
Other income from securities and operations with them	13	30
Legal entities		
Dividends from affiliate companies, provided that certain conditions are met (the share of more than 50% in capital, ownership for at least one year etc.; if the dividend-paying company is a foreign one it should not be located in an offshore zone)	0	Not applicable
Dividends from Russian and foreign organizations	9	15
Interest on state and municipal bonds, interest on mortgage-backed bonds issued after January 1, 2007, interest on the income of the founders of trust management for mortgage backing received upon purchasing the mortgage participation certificates issued by the mortgage backing management after January 1st, 2007	15	15
Interest on state and municipal bonds with term at least 3 years long, issued before January 1, 2007, as well as interest on mortgage-backed bonds issued before January 1, 2007, and interest on the income of the founders of trust management for mortgage backing received upon purchasing the mortgage participation certificates issued by the mortgage backing management before January 1st, 2007	9	9
Other income from securities and operations with them	24	24

Russian Federation has double taxation treaties with 67 countries of the world. According to these treaties, a company registered in one country and receiving income from sources located in two countries (Russia and the other signatory country) pays taxes only in one of these countries: either in Russia, using a discounted rate, or in the other country that signed the agreement, also on a discounted rate.

The RF Ministry of Finance has published a list of the offshore zones⁵¹, the registration in which does not entitle the companies to transfer non-taxable dividends to Russia as provided for in the subsection 3 of section 284 of the Tax Code of the Russian Federation. The list includes 41 offshore zones, such as the Cyprus Republic etc.

Regulation and control of foreign currency activities

2007 was momentous for the currency regulations in the RF. The changes of foreign currency activities regulations affected several industries.

The most important change in the foreign currency activities regulations for the security market was the removal, effective January 1, 2007, of the concept of “special account” and all the restrictions on its usage from the law regulating the currency operations⁵².

Since the sections 7 and 8 of this law are abolished, the mechanisms that allowed the Russian Government and the Bank of Russia to regulate the procedures for capital currency operations have disappeared. Thus, the regulation that required all the money settlements between residents and non-residents resulting from internal security trade to be effected in Russian currency unless stated otherwise by the Bank of Russia, has been abolished. It is also worth noting that the restrictions on security trade between residents and non-residents have been also removed; prior to that, this type of operations required funds reservation.

In October 2007, the legislation regulating residents’ accounts in banks outside of the boundaries of the Russian Federation was amended. As of November 16, 2007, residents are required to notify the taxation bodies at the location of their registration, not only of the accounts’ (deposits) opening and closing, but of their banking details change as well. Besides, it was established earlier that residents, except for individuals, report to local taxation bodies the fund movements in their accounts (deposits) in banks outside of the Russian Federation, according to procedures established by the Russian Government in coordination with the Bank of Russia. Now the diplomatic missions, consulates and other official representation offices of the Russian Federation located abroad are also exempt, as well as Russia’s permanent missions with international or inter-governmental organizations.

Therefore, the currency regulations’ amendments of 2007 have significantly facilitated the companies’ participation in the foreign currency activities of the capital market, reduced the number of required documents and streamlined the regulation mechanism of these operations.

The Russian system of capital market regulation was formed in parallel with the formation of market and has played a positive role in its development, in many aspects. This system generally follows the norms of international capital market regulations and meets the world development trends of regulation in this area; it has, however, some national specifics. The most important specific feature is a complex distribution of regulatory and supervising authorities in the area of financial markets between several departments. At present a significant part of the corresponding functions in the area of capital market as such has actually passed to a single state body, the Federal Financial Markets Service; however, certain powers still remain with the Central Bank and, to a lesser degree, with the Ministry of Finance.

⁵¹ The Ministry of Finances’s order of November 13, 2007, No.108H “On approval of the list of the states and territories providing tax shelter and/or allowing non-disclosure of information for financial operations (offshore zones)”.

⁵² The Federal Law of December 10, 2003 No. 173-ФЗ “On foreign currency regulation and control”.

3.1. The Federal Financial Markets Service of the Russian Federation

The principal State regulating authority on the Russian capital market is at present the Federal Financial Markets Service (FFMS). Its status is similar to that of a ministry, as it reports directly to the Government of the Russian Federation and performs both regulating and supervising functions.

The activities of the FFMS are defined by the Law "On capital markets" and by the FFMS Regulation approved by the Decree of the Government of the Russian Federation of June 30, 2004, No. 317. According to this Regulation, the FFMS is a federal executive authority performing functions of adopting normative legal acts, controlling and supervising the financial markets, except for insurance, banking and auditing activities.

The FFMS regulates the activities of all the principal subjects of the capital market: issuers, professional participants, collective investment institutions and, in some cases, investors. The FFMS has functional independence; it does not coordinate its actions with other bodies. Nevertheless, being an executive body it reports to the Government of the Russian Federation that has a right to suspend or cancel any act of the FFMS.

Concerning issuers, the FFMS has authority to approve the standards of securities issue, securities registration procedures and reports on results of issue, as well as the circulars of securities (except for state and municipal securities). The FFMS also checks the issuers, and issues instructions to them in case of any violations; it can suspend issue of securities if required and file a lawsuit for the securities issue to be declared invalid. The FFMS also determines the procedure of the admission to IPO and circulation of the Russian issuers' securities outside of the territory of the Russian Federation.

Concerning professional capital market participants, the FFMS approves requirements to the rules of conducting professional activities with securities, approves norms of sufficiency of internal funds, carries out licensing of professional activities in the capital market, registers some internal documents of professional participants. It also carries out checks of professional participants and issues instructions to them if required; it can prohibit or restrict particular deals at the security market, and has right to suspend or cancel licenses of violators.

Concerning collective investment institutions, the FFMS issues licenses for PF, equity investment funds, activity of management companies and specialized depositaries. It also registers the rules of investment fund management and mortgage backing management, rules for NPF and documents of specialized depositaries. The FFMS also approves requirements to the structure of assets of joint-stock and unit investment funds, defines standards of disclosing information and forms of reporting for NPF; conducts checks of these organizations and issues instructions to them.

The FFMS also regulates admission of securities to public placement, their circulation, quotation and listing, takes measures to stop unfair advertising in the capital market, publishes methodology materials and recommendations on the matters in its competency. It has right to file lawsuits and take claims to the court and arbitration court. An important function of the FFMS is its right to review cases of administrative violations within its area of competence, and to take measures established by administrative legislation.

It should be noted that that the FFMS competence has a number of essential exemptions concerning financial organizations: for them, the FFMS can neither establish measures of prudential nature nor regulate issue of their securities. The authority of the FFMS does not extend to the matters of issue and circulation of the state and municipal securities.

3.2. The Central Bank of the Russian Federation

The Central Bank is not an executive body and carries out its activity on the basis of the special law "On the Central bank of the Russian Federation (Bank of Russia)". Its authority on the regulation of

commercial banks is defined by the law “On banks and banking”. Being an organization responsible for monetary circulation and the stability of the banking system in Russia, the Bank of Russia has a number of powers affecting to some extent the capital market and its participants.

For example, the Bank of Russia works together with the Government of the Russian Federation in developing and carrying out a consistent state monetary and credit policy that affects many factors of the capital market. Effecting its monetary and credit policy, it acts as an issuer of its own bonds and carries out open market transactions with state securities and its own bonds, being a large player in this market.

As a banking system regulator, the Bank of Russia defines specifics for the procedures of securities issue for financial organizations, and registers issues of these securities. Further on, it supervises the banking activity of financial organizations and bank groups, including their activity as investors in the capital market. Concerning the activity of financial organizations as professional capital market participants, the Bank of Russia, in fact, defines the procedures for some operations (for example, trust of securities, procedures for depositary registration etc.). It also participates in the capital of infrastructural organizations of the capital market (for example, MICEX) and carries out “indirect regulation” of the capital market through these participations.

The Bank of Russia also defines procedures for banking operations, for accounting and reporting of the banking system of the Russian Federation.

Thus, even though the Bank of Russia’s powers over capital market participants directly affect only the financial organizations operating in this market, its overall influence on the financial market is very high. Because of these powers, the Bank of Russia is the second in importance among the State regulators of the capital market.

3.3. The Ministry of Finance of the Russian Federation

According to the Regulation on the Ministry of Finance (approved by the Decree of the Government of the Russian Federation of June 30, 2004, No. 329), it carries out a number of functions related to capital market and its participants. First of all, Ministry of Finance approves terms of issue and circulation of federal state securities, makes decisions on particular issues of these securities, and reports on the results of their issue. At the same time, the Ministry of Finance is itself an issuer of the federal state securities.

Further, it acts as a regulating authority for the state securities of subfederal level and municipal securities; it performs the official registration of the terms of issue and circulations of these securities, approves standards of disclosing information on these securities.

Besides, the Ministry of Finance remains a regulator in the area of pension savings investments for financing savings part of labour pension, as well as a regulator for insurance companies including their financial investments in securities (supervising functions in relation to insurance companies are exercised by Federal Insurance Supervision Service which is subordinate to the Ministry of Finance). The Ministry of Finance also approves the normative legislative acts concerning standards of accounting and financial statements.

3.4. Other State bodies

The law enforcement system in the capital market also includes tax authorities, financial control and monitoring bodies, the antimonopoly agency, the judiciary system and law enforcement agencies. However a detailed analysis of their functions and tasks is out of scope for the present publication.

3.5. Selfregulating organizations

The system of capital market regulations includes, besides state bodies, Self-Regulating Organizations (SROs). They are created by professional capital market participants to maintain proper conditions for their professional activities, compliance with the standards of professional ethics in the capital market, protection of investors' and other clients' interests, and establishment of the rules and standards of trading in securities ensuring efficient activities in the capital market. SROs for this type of activities may be also established by management companies and specialized depositaries of the investment funds, in accordance with the Federal Law "On investment Funds".

SROs are created as nonprofit organizations. They establish rules, obligatory for their members, for conducting professional activities in the capital market, and standards of trading in securities. They also control compliance with these rules. Membership in a SRO is voluntary.

At present five organizations of professional capital market participants and collective investment institutions have SRO status in Russia:

- The national association of capital market participants (NAUFOR) includes brokers, dealers, managers and depositaries. As of the end 2007 it consists of 404 organizations. NAUFOR has headquarters in Moscow and branches in 14 regions of the country;
- The professional association of registrars, transfer agents and depositaries (PARTAD) consolidates depositaries and registrars. As of the end of 2007, 101 organization were members of PARTAD.
- The National Equity Association (NFA) includes organizations that hold licenses to conduct broker, dealer, depositary activities and trust management of securities; most of these are financial organizations. As of the end of 2007, the NFA had over 245 members;
- The League of Management Companies of Russia (LMC) that, according to FFMS data, includes 80 management companies as of the end of 2007;
- The noncommercial partnership of professional capital market participants of the Ural region (PUFRUR) – the only SRO which has an office outside Moscow (in Ekaterinburg). The members of PUFRUR, according to FFMS data, as of the end of 2007, are 26 professional market participants from the Ural region.

It should be noted that rather often professional capital market participants are members of several SROs simultaneously. Therefore it is impossible to evaluate precisely the general involvement of professional market community into self-regulating activities. Nevertheless, by our estimates, approximately 30%-35% of the total number of professional capital market participants are members of at least one self-regulating organization; the highest level of participation in SRO is among registrars – over 60%. It is necessary to note that in the last years the member base of leading SROs has stabilized, and the membership in the self-regulating organizations has actually become a standard of professional work among large professional capital market participants.

4. Main events of 2007

January	
January 1	FFMS Order of 02.11.06 06126пз "On modification in regulations on trade organization activity in the capital market" comes into effect, ordering stock exchanges to suspend trade at 18.00 to grant reports to the traders and to conduct clearing of transactions.
January 9	New "Rules of securities' admission to trade at RTS" come into effect, providing new requirements, including requirements for admission and circulation of exchange bonds. The requirements for entering securities in the quotation lists "B" and "И" are also defined.
January 10	Amendments to the law "On capital markets" affecting the issue of the Russian depository receipts (RDR), come into effect.
January 11	Amendments to the law "On banks and banking" and "On the Central bank of the Russian Federation", simplifying acquisition of shares (units) in financial organizations, including non-residents, come into effect.
January 21	The State Duma adopts amendments to section 1062, part 2 of the Civil Code of the Russian Federation, granting judicial protection to claims connected with settlement derivative financial instruments.
January 24	FFMS Order of June 22, 2006 No. 0667/пз-н "On approval of regulation on disclosing information on transactions" comes into effect, defining the order of reporting on over-the-counter transactions.
January 29	MICEX and RTS are approved as affiliated members of World Exchange Federation (WEF).
January 30	The RTS START trading floor starts working at RTS; RTS START is intended for placement and circulation of issuers of small and average capitalization. The first issuer is "BF Communar".
February	
February 1	Board of directors of MICEX makes the decision to develop a forward contracts market on capital assets.
February 2	Drastic (around 7%) fall within one trading session of the prices on OJSC "Savings Bank of Russia" shares of after rumors on the possible price of stock placement during forthcoming SPO.
February 7	Trading in the RTS forwards market suspended due to software failures.
February 15	Decree of the Government of the Russian Federation of February 1, 2007 No. 63 "On approval of the Rules of placement of PF pension reserves and control over their placement" significantly changing requirements to the structure of pension reserves, comes into effect.
February 24	SPO of Sberbank completed, US\$ 8.83 billion raised.
February 27	Fall of the Chinese capital market and general recession in the world markets. The main Russian indexes fall significantly (MICEX index by 4.14%, and RTS index by 3.28%).
March	
March 1	The largest slump of the MICEX index in 2007 – by 4.35% (the RTS index decreased by 3.28%).
March 8	Instruction of the Bank of Russia No. 130 "On the order of receiving the preliminary consent of the Bank of Russia on purchase and (or) receiving to trust of shares (units) of financial entities", simplifying procedures of dealings in stocks of financial entities, comes into effect.

March 21	The results of placement of the additional share issue of OJSC RTS placed via closed subscription are made available. 721.1 million roubles raised.
March 22	Completed all preparatory works necessary for issue and circulation of exchange bonds. FFMS designates the first serial number to the stock exchange allowing to form an identification number of the exchange bond for its admission to trade.
March 26	The internal documents of MICEX and RTS providing for completion of trade at 18.00 come into effect.

April

April 3	Regular order of work of the CJSC "DCC" is disturbed and staff are evacuated after report of explosives at the facilities rented by the depository.
April 4	Rules on tendering in the MICEX futures market come into effect, formation of traders list begins.
April 11	Problems with telephone networks and access to exchange services at the RTS Stock Exchange due to technical problems.
April 19, 20	Failures and following suspension of trade occur on the MICEX Stock Exchange due to breakdowns in electric supply and in communication networks.

May

May 11	The State Duma gives preliminary approval to the Bill "On the central depository".
May 15	Plans are published for creation of the International Stock Exchange "St.Petersburg" (IXSP), formed by NP "SE St.Petersburg" and Swedish OMH group.
May 17	Vladimir Milovidov takes the position of FFMS Director.
May 18	IPO of VTB Bank completed, US\$ 7.97 billion raised.
May 25	First placement on MICEX of mortgage securities issue backed by pool of mortgages under credits (issuer – CJSC "First mortgage agent AIZhK", 2.9 billion roubles placed).
May 29	Shares of OJSC "RTS" are included in the RTS Board system.

June

June 1	FFMS Order of March 29, 2007 No. 0732/пзн "On nonuse of the Item 9.1 of Regulations on clearing activity in the capital market" comes into effect, canceling ban on combining clearing under forward contracts with clearing under other securities transactions.
June 4	FFMS Order of April 24, 2007 No. 0750/пзн "On approval of internal funds sufficiency specification for professional capital market participants and of the management companies of investment funds, share investment funds and nonstate pension funds" is published (effective January 1, 2008). Since January 01, 2008 the required internal funds are doubled.
June 14	The sector of innovative and growing companies begins work at MICEX. Its first issuer is the fund "FINAM – Information technologies".
June 15	The FFMS Order of March 06, 2007 No. 0721/пзн "On approval of the order of licensing of the kinds of professional activities" comes into effect, providing inter alia initial licensing without limiting its term of validity.
June 15	The trade opening at the RTS forwards market experiences delay because of a procedural failure.
June 26	The FFMS announces completion of preparations of a normative base required for beginning RDR issue and circulation.
June 26	The trade in futures contracts on federal loan bonds starts on FORTS. Delivery of the base asset is carried out as address transactions at MICEX.
June 29	MICEX begins trade in settlement futures on MICEX index.

July	
July 6	The FFMS Order of April 03, 2007 No. 0737/пзн "On approval of securities management procedure" is published, establishing uniform requirements to securities management procedure, requirements to the objects of management, limitation of activity of the managing company, the order of defining management results.
July 31	The first public offering of stocks of OJSC "Armada" in the MICEX sector of innovative and growing companies and the RTS START segment, for the total volume of 29.7 million dollars.
August	
August 8	The FFMS initiates a meeting on Russian capital market infrastructure development perspectives. The meeting participants arrived to conclusion that it is necessary to increase the capital of the CJSC "DCC" and the transparency of all the infrastructure organizations' activities.
August 16	The largest slump of the RTS index in 2007 - by 3.52% (the MICEX index decreased by 2.46%).
August 17	The trade at the RTS forwards market suspended because of software failure.
August 20	The trade at the RTS forwards market suspended because of software failure.
August 23	The trade at the RTS forwards market suspended because of technical failure.
August 23	MICEX decides to allow the placement of the pilot issue of exchange bonds.
September	
Sept 5	M.Fradkov, the Chairman of the RF Government, visits MICEX and conducts a meeting on the FFMS.
Sept 7	The FFMS Order of July 26, 2007 No. 07-86/пз-н "On approval of the list of stock exchanges, after listing on which the stocks of foreign joint stock companies and bonds of foreign commercial organizations can be admitted as pension reserves for NPF". Nine stock exchanges are included into the list, including RTS and MICEX.
Sept 9	The trade at the RTS spot market suspended because of technical failure.
Sept 11	Slump in the leading indices of the Chinese capital market. The leading Russian stock indices are not affected.
Sept 12	The resignation of the Russian Government with M.Fradkov as its head. The stock indices slightly decrease.
Sept 14	V.Zubkov is appointed the Chairman of the Russian Government. There is no significant change in the stock indices.
Sept 14	The State Duma passes in a first reading the amendments to the Law "On capital market" related to the activities on securities trust management.
Sept 17	The RTS classical market adopts the technology of "central counterpart for deals"
Sept 23	The FFMS Order of August 08, 2007 No. 07087/пз-н "On amendments of the order of licensing of the kinds of professional activities" comes into effect, The license applicant receives a right to apply to SRO for receiving a license claim.
Sept 25	The new Cabinet of Ministers is announced. The stock indices decrease, on the average, by 1.7%.
Sept 22	10th anniversary of MICEX index.
Sept 26	The stocks of OJSC "Surgutneftegaz" show average growth of 9% on rumors that the company will keep its private status.

October	
October 1	V.Putin, the President of the RF, announces his intentions to run as the head of “Edinaya Rossiya” political party at the forthcoming elections to the State Duma. The stock indices increase, on the average, by 3%.
October 8	Day clearing session introduced at the RTS forwards market.
October 9	The stocks of OJSC “Gazprom нефт” show growth of 7.8% because of the rumors that some of the large assets of OJSC “Gazprom” will be transferred to the company.
October 12	The trade opening at the RTS forwards market experiences delays because of a software failure.
October 25	The FFMS approves the Regulations of the Community council of the capital market participants.
October 26	The NDC and ING BANK (EURASIA) sign an interdepository agreement that enables a fast settlement procedure to serve foreign investors.
November	
Nov 1	The daily turnover of securities transactions at MICEX (including basic trade sessions, negotiated deals mode and repo deals) reaches its historical maximum of 275.53 billion roubles (or 11.17 billion dollars).
Nov 14	The order of the FFMS of October 9, 2007, No. 07-102/пз-н “On approval of the Regulations of trade organization activity in the capital market” is registered. The Regulations allow the trade organizers and stock exchanges to break down the trade day into the main (9am to 6pm) and supplemental (after 6pm) sessions. Effective date January 1, 2008.
Nov 22	The FFMS, for the first time, officially admits the fact of tampering with the prices of one of the companies.
Nov 23	The common registered stock of OJSC “YukOS” is withdrawn from trade as the record is entered into the Uniform State Register of Legal Entities about the liquidation of this legal entity according to court’s decision.
December	
Dec 2	State Duma members’ elections. The securities’ quotations are not affected.
Dec 6	The trade at the RTS forwards market suspended because of technical failure.
Dec 6	Federal Law No. 334-ФЗ is signed. It introduces amendments to the law “On investment funds” that, among other things, introduce the institution of qualified investors.
Dec 6	Federal Law No. 334-ФЗ is signed. It introduces amendments to sections 7 and 11 of the law “On investment funds” that allow the depositaries created as non-commercial partnerships to be transformed into joint-stocks companies.
Dec 10	D.Medvedev is named as a candidate for President of the Russian Federation The quotations of stocks of OJSC “Gazprom” grow by 3%.
Dec 12	The order of the FFMS of October 23, 2007, No. 07-105/пз-н “On approval of the Regulations of trade organization activity in the capital market” is registered. The Regulations define the procedure of qualifying the foreign financial instruments according to international standards. Effective date February 1, 2008.
Dec 12	The main composite Russian stocks indices reach their all-time high values (MICEX – 1969.91; RTS – 2359.85).
Dec 13	The RTS forwards market sets a record on day trading transactions volume: 126.7 billion roubles (or 5.18 billion dollars).

Dec 18	The order of the FFMS of November 13, 2007, No. 07-108/пз-н "On approval of the procedures for auditing the organizations the regulations and control of which is entrusted to FFMS". Among other things, the procedures include participation of the specially authorised SRO employees in field audits. Effective date 01.03.2008.
Dec 20	FFMS approves the list of the Community council at the FFMS including 18 people.
Dec 22	The new "Rules of securities' admission to trade at RTS" come into effect, providing new requirements, including requirements for admission of the new financial instruments, Russian depository receipts and securities issued on behalf of foreign states.
Dec 25	The FFMS Order No. 07-112/пз-н "On amendments for the norms of internal funds sufficiency specification for professional capital market participants and of the management companies of investment funds, share investment funds and nonstate pension funds" is published. The amendments provide for decreasing the norms of internal funds sufficiency if the responsibility is insured or on petition from a self-regulating organization. Effective date 22.02.2008.
Dec 27	The CJSC "DCC" Board of Directors decides to hold an extraordinary shareholders meeting on January 25, 2008, and to propound the question of increasing the registered capital by 800 million roubles.
