

## Chapter 4

### SECURITIES MARKET IN THE REPUBLIC OF AZERBAIJAN

by  
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#### 1. Macroeconomic characteristics

Azerbaijan, as the other countries in transition, is included in the wide processes of economic development. Azerbaijan, passing through phase of the general economic growth, has entered the second phase of the economic development, where the main direction is the effective financial market formation. This is the basis of the country's institutional reforms. The increasing significance of financial market development is connected to such conditions, through which it will become possible to promote an increase in direct foreign investments, and the usage of the internal savings at the same time.

#### Macroeconomic Indicators

(Unit: million USD)

	2000	2001	2002	2003	2004
Gross Domestic Product (GDP)	5285.7	5720.6	6246.1	7.139.2	8.528
Compared with the same period of previous year (%)	111.1	109.9	110.6	111.2	110.2
Consumer price index compared with the same period of previous year (%)	101.8	101.5	102.8	102.2	106.7
Nominal average monthly wage compared with the same period if previous year (%)	120.2	126.7	121.2	121.4	126.2
Budget deficit	54.1	24.4	22.1	8.5	20.2
Saldo of trade balance	+319.3	+613.9	+481.6	+191.8	+75.7
Exchange rate AZM/USD (av.)	4464	4646	4853	4910	4913
Volume of deposits and savings (end-year)	n/a,	n/a,	465.1	621.6	1031.02
Population	8141.4 thousand (est. 2002)				

#### 2. Market overview

The main issuers are the privatized companies. A substantial proportion of stock issued also belongs to the banks. In 2003, the significant growth of insurance companies' issues took place in the market: 4 insurance companies registered in the SCS 7 issues with the total volume of USD 2.14 million.

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## Stocks Issues

(Unit: million USD)

Year	Privatization		Banks		Others	
	Number of issues	Volume of issues	Number of issues	Volume of issues	Number of issues	Volume of issues
2000	73	57.1	16	9.8	16	24.2
2001	181	146.3	11	3.8	4	2.0
2002	129	184.6	38	26.5	8	39.9
2003	58	9.7	13	14.1	20	20.9
2004	10	4.5	34	62.9	16	26.3

The majority of the deals in the securities market are conducted at the OTC market. But due to the efforts that SCS undertakes in 2004 one could see the essential growth in the volume of the trades conducted at the stock exchange.

## Stocks - Secondary Market

(Unit: million USD)

	2001	2002	2003	2004
Baku Stock Exchange	0.93	0.82	3.45	1.2
OTC	31.4	20.1	43.2	51.4

The corporate bonds issue still carries a fragmental character. But taking into consideration the wide perspectives of the borrowing market in Azerbaijan, this financial instrument is considered to be very well spread.

## Corporate Bond Issues

(Unit: million USD)

Year	Number of issues	Volume of issues
2000	2	1.65
2001	3	0.79
2002	5	2.5
2003	2	1.2
2004	14	18.2

The main instruments traded at the market are T-bonds. In spite of the fact that the interest rate is rapidly falling, the interest in this instrument still remains almost constant.

## T-Bonds

(Unit: million USD)

	2001	2002	2003	2004
Issues	125.9	119.5	100.8	16.3
Primary market	100.6	104.1	92.7	16.1
Secondary market	n/a,	1.9	6.1	1.3

### **3. Clearing and settlement system**

The State program of privatization of the state ownership in Azerbaijan Republic in 1995-1998 provided for the concept of the National Depository Center. According to the State Program, the Depository Center was formed as the depository and the registrar at the same time.

In order to improve the depository system and its activities, the Degree of the President of the Azerbaijan Republic as of May 14-th 1997 adopted the regulations "On the National Depository System" and "On the Rules of keeping the registry of the shareholders of the joint-stock companies created during the privatization of the state firms and specialized check investment funds". By the regulation on "National Depository System" the creation of the National Depository Center was stipulated.

On 18th September 1997, the National Depository Center was created. The National Property Committee was acting as a holder and founder of the block of shares of the National Depository Center. The shares of NDC were handed over to the State Committee for Securities under auspices of the President of Azerbaijan (SCS) after its creation. As a result, NDC was anew founded by the State Committee for Securities on 8th September 1999 and passed the national registration on 17th September 1999.

The National Depository Center has a license on depository and registrar activities given by the SCS.

According to all above-mentioned regulations, the National Depository Center is the state organization which plays the main role in the national depository system, engaging the depository activity and keeping the records on depositories, which are included in the depository system and supervising their activities.

To avoid counterpart risks, the clearing on securities transactions is carried out on «DVP» (delivery versus payment) basis with initial depositing the traded securities at the special account at the National Depository Center or the Baku Stock Exchange.

### **4. Regulatory and supervisory structure**

The State Committee for Securities under auspices of the President of Azerbaijan Republic (SCS) was created in 1998 by the Decree of the President of the Azerbaijan Republic. 75 employees are employed in this organization, which regulates and supervises the securities market.

The SCS registers the securities offered to the public and is responsible for the regulation and supervision of the entire process. The SCS has the authority and responsibility to supervise both the organization and the operation of the stock exchanges. Furthermore, the SCS undertakes the responsibility for the completion of the regulatory framework and the establishment of the necessary mechanism for the further improvement of efficiency of the stock exchange and the secondary markets.

The intermediary institutions need to obtain a license from the SCS in order to be able to deal in the securities transactions. The SCS determines the minimum conditions for granting a license. In case of ignorance and misuse of intermediary or due to weaknesses in the financial condition of the institution, the SCS is entitled to invalidate the operating license on a temporary and/or permanent basis.

In order to foster the development of the securities market in Azerbaijan, the SCS constantly undertakes all necessary measures. Up to date, the SCS adopted more than 70 legal acts, which

provide for regulating and developing the particular aspects of the securities market, protection of the rights of securities investors, corporate governance principles, disclosure procedures and overall formation of the organized securities market in Azerbaijan.

The major parameter of the effectiveness of the reforms conducted at the securities market is their sequence. By the year 2002 when the SCS evidenced the substantial growth in the number and volume of the transactions with the stocks, the indispensability of broker and dealer companies' involvement in these processes became obvious. Therefore, in July 2002, a new regulation was adopted by the SCS. Before this document was put into force, almost all transactions have been carried out via the notaries. The document having kept this right for the transaction counterparties made this way ineffective and taking too much time. The broker and dealer companies were given the rights to act on behalf of their customers or counterparties at the depositories and registrars. Therefore, because of another measures after the adoption of this document, up to this moment, almost all transactions at the secondary market are conducted via the broker and dealer companies.

In March 2004, new amendments to the Civil Code of the Azerbaijan Republic were brought into force. This document actually replaced the Law on the joint-stock companies and the Law on the securities. The new Civil Code opened a qualitatively new stage in the country's securities market regulation, marking the transition from the securities market formation to its further development.

## **5. Corporate governance**

The special attention in the new Civil Code is paid to the corporate governance principles. In addition to the information expressly required by the standard prospectus form, the corporation must also provide further information necessary to make the statements complete and not misleading the solicitation to the public to purchase shares, which is affected by means of a circular. The circular consists of concise information, mostly related to sale conditions and financial statements. The Code also provides for the better transparency of the joint-stock companies, protecting the rights of the minor shareholders, what gives them the right to obtain maximum information on the activities of the company.

On a yearly basis, joint-stock companies have to pass through an audit carried out by one of the officially licensed in Azerbaijan independent companies (including "big five") and publicly disclose the results of the audit.

According to the new regulations of SCS all joint-stock companies must provide transparency of their activities by disclosing the annual statement in mass-media and presenting it to the SCS.

There is also new normative act of the SCS concerning the use of insider information, which forces all insiders to let public know in advance about their intention to buy or sell their securities so that SCS can follow up this transaction and check if it is fraud or not.

The Administrative Code provides for the penalties for the non-observance of the corporate governance principles. For instance, in 2004, 104 joint-stock companies and the management of these companies were fined for a total amount USD 25 thousand.

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