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PAYMENTS AND SECURITIES CLEARANCE AND SETTLEMENT SYSTEMS IN GEORGIA

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FOREWORD

Following the successful experience of Western Hemisphere Payments and Securities Clearance and Settlement Initiative (WHI) in the Latin American and Caribbean region, in September 2004, the World Bank launched the Commonwealth of Independent States Payments and Securities Settlement Initiative (CISPI). The CISPI aims to assess and strengthen payments and securities systems in the Commonwealth of Independent States with a view to improving their safety, efficiency and integrity. The long term goal of the initiative is to build institutional capacity within the region in order to sustain the continued development of payment and securities settlement systems.

A key component of the CISPI is the International Advisory Council (IAC), which is comprised of representatives of international and national institutions with experience in the field of payments and securities systems. In addition to representatives from the World Bank, this council includes members from the Secretariat of the Committee on Payment and Settlement Systems (CPSS) of the Bank for International Settlements (BIS), Banque de France, International Monetary Fund (IMF), and U.S. Securities Commission (SEC). Other central banks, securities commissions and international organizations are expected to join the IAC over the course of the program.

To assure quality and effectiveness, the CISPI includes two important elements. First, all studies are conducted with the active participation of country officials and the project builds on the existing work being undertaken in the respective countries. Second, the initiative draws on international and national expertise on the subject, through the IAC, to provide guidance, advice and alternatives to current practices.

The initiative is undertaking a number of activities. These include: the preparation of public reports containing a systematic in-depth description of each country's payments, clearance and settlement systems; the delivery of recommendations reports to country authorities on a confidential basis; the organization of IAC meetings to review country studies and provide input for future work; the organization of workshops focusing on issues of particular interest; the creation of a web-page (www.cis-pi.org) to present the outputs of the initiative and other information of interest in the payments systems area; and the promotion of working groups to ensure a continuation of the project activity.

The Kazakhstan Interbank Settlement Center (KISC) is currently acting as Technical Secretariat of the CISPI and is playing a major role in making the process sustainable. To this end, the initiative has helped strengthen KISC's in-house expertise. Additionally, practitioners in payments and securities clearance and settlement in some countries in the region have participated in the studies under the initiative through KISC coordination, and this has contributed to the broadening of knowledge and the transfer of know-how within the region. The endeavors of the working groups in coordination with the KISC will maintain the infrastructure created under the initiative and provide a permanent forum for the countries in the region to discuss, coordinate, and add a collective impetus to the work in the area of payments and securities clearance and settlement systems.

This report, *Payments and Securities Clearance and Settlement Systems in Georgia,* is one of the public reports in the CISPI series and was prepared with the active support of the National Bank of Georgia and the National Securities Commission of Georgia.

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ABBREVIATIONS AND ACRONYMS

ABG	Association of Banks of Georgia
ATM	Automated Teller Machine
BCP	Business Continuity Plan
BIS	Bank for International Settlements
CISPI	Commonwealth of Independent States Payments and Securities Settlement Initiative
CPSS	Committee on Payment and Settlement Systems
CSD	Central Securities Depository
FSU	Former Soviet Union
EFTPOS	Electronic funds transfer at the point of sale
GDP	Gross Domestic Product
GCSD	Georgian Central Securities Depository
GEL	Georgian Lari
GSE	Georgian Stock Exchange
IAC	International Advisory Council
IMF	International Monetary Fund
ISIN	International Securities Industry Numbering
KISC	Kazakhstan Interbank Settlement Center
MOF	Ministry of Finance
NBG	National Bank of Georgia
NSCG	National Securities Commission of Georgia
OECD	Organization on Economic Cooperation and Development
OTC	Over the Counter
RTGS	Real time gross settlement
RUR	Russian ruble
SEC	U. S. Securities Commission
SML	Securities Market Law
SRO	Self-Regulatory Organization
STP	Straight-Through Processing
SWIFT	Society for Worldwide Interbank Financial Telecommunications
TICEX	Tbilisi Foreign Exchange Clearinghouse
UFC	Union Financial Corporation
UNDP	United Nations Development Program
USAID	United States Agency for International Development
USD	United States Dollar
WHI	Western Hemisphere Payments and Securities Clearance and Settlement Initiative

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1 ECONOMIC AND FINANCIAL MARKET OVERVIEW

1.1 OVERVIEW OF RECENT REFORMS

Georgia gained its sovereignty in 1991 after the collapse of the Soviet Union. During the 1990s, the government launched a program of structural reforms to restore economic growth, with major reforms focused on privatization, banking sector reform, and inflation to achieve macroeconomic stability. A turning point in the formation of the Georgian economy occurred in 1994, when the National Bank of Georgia (NBG) introduced the Lari (GEL) as a national currency.[1]

Since 2001, the NBG has taken a number of important steps to develop a favorable legal environment for the banking system. In particular, several key amendments to Georgian banking legislation were introduced. In accordance with international best practices, the changes promoted the autonomy of the NBG with regard to the central government. With the new law in place, the activities of NBG and commercial banks also became more transparent and non-bank deposit-taking institutions fell within the scope of the NBG's control. In addition, a new real time gross settlement (RTGS) system was introduced and international accounting standards were implemented. Supervisory, licensing and bank resolution regulations were refined as well.

On April 5, 2004 the Ministry of Finance (MOF) started a central reform of the Treasury by (i) establishing a single treasury account, and (ii) putting in place a mechanism for refunds. The Treasury reform aims to improve the management of public funds through recording budget inflows and increasing the trust of taxpayers towards administering timely refunds.

In 2004, pursuant to the Budget System Law, special accounts were abolished. Consequently, the Treasury closed all special accounts and consolidated revenues under the budget. More than 10,000 transit accounts were closed at the NBG and all budget inflows are now recorded on the single treasury account. Thus, commitment control was established on the entire central budget except the expenditures of state organizations in the Autonomous Republic of Adjara (see below).

Since then, the reporting and recording of budget revenues and expenditures has become more detailed and comprehensive compared to the form previously produced by the NBG. After the implementation of the reform, a certain portion of government revenues is accumulated for refunds on a daily basis, which gives transparency and flexibility to the tax refund process. Respective legislative amendments were developed and introduced to budget, tax and customs legislation.

Technical equipment has also been replenished through the technical assistance of the United Nations Development Program (UNDP) and the United States Agency for International Development (USAID). New software was developed and installed by the local personnel of the Treasury. A reference book of treasury codes was published and given to commercial banks and taxpayers.

On April 26, 2004, a Regional Treasury office started operating in the territory of Adjara. Previously, the financing of state organizations in the territory was carried out by the MOF of Adjara through the planned funds transferred from the central budget by the National Treasury, an arrangement that triggered many problems. By setting up a Regional Treasury office, the execution, recording and reporting of budget expenditures improved. The

[1] Before that, in 1993, the NBG had introduced the so-called "Georgian Coupon" to function as a temporary national currency before the introduction of the Lari.

Regional Treasury is linked to the single consolidated database. The system of commitment control was established in Adjara, thus now covering the entire central budget.

Following this achievement, additional efforts were launched to develop similar procedures for expenditures of special state funds. Legislative amendments have been prepared and joint meetings held with representatives of the special state funds. As a result, based on an order of the MOF, the Treasury started monitoring expenditures of special state funds from September 1, 2004 in accordance with the rule on commitment and spending control.

A series of additional reforms are expected in the upcoming three years aimed at improving the performance and operational capacity of the Treasury. A single revenue and expenditure account will be set up to grant more efficiency to the management of public funds and international accounting rules will be introduced. Both measures are important for statistical and analytical purposes.

One of the key priorities of the NBG is to curb the currently very high level of dollarization in the country. It is difficult to conduct monetary policy with a high level of dollarization, as it limits the NBG's role as the lender of the last resort and weakens the scope of the NBG to influence interest rates. As a result of the NBG's targeted policy and the legalization of the economy, the level of deposit dollarization fell from 86.1 percent to 74.3 percent on the expense of the rising number of current accounts in national currency. The NBG expects this trend to be maintained in succeeding years.

To promote the reduction of interest rates and attraction of deposits in the national currency, the NBG has established a series of monetary instruments. Since 2003, overnight deposits and intraday credits were introduced. Daily auctions of foreign currencies began at the Tbilisi Foreign Exchange Clearinghouse (TICEX), which aimed to strengthen the NBG's role as the lender of the last resort and increase its influence over the formation of interest rates. As a result, interest rates on credit resources have been reduced in the current year.

Further, the NBG has reduced the reserve requirements, and commercial banks have released compulsory reserve requirements on funds attracted in national currency. At present, the minimum averaged reserve requirement for averaged funds attracted in national currency stands at 2 percent.[2] These measures will free additional assets in the banking system, will make the pulling of deposits denominated in GEL cheaper, and will encourage commercial banks to increase the share of transactions with assets and liabilities in the national currency, thereby leading to a decreasing interest rate margin.

In 2005 the number of commercial banks decreased to 21. The NBG has been pursuing a policy of banking sector consolidation and transparency, for which it has increased the capital requirements for banking institutions, and intensified financial intermediation functions. It has also concentrated on creating specific financial markets and in promoting a higher level of trust from the general public towards the banking system.

1.2 Macroeconomic Background

1.2.1 Real Sector

Georgia is a small transition economy with a population of about 5 million and a per capita Gross Domestic Product (GDP) of about USD 700. Prior to the collapse of the Soviet Union, Georgia exported agricultural and energy-intensive industrial products and enjoyed a fairly

[2] In the case of liabilities denominated in foreign currency the reserve requirements stands currently at 13 percent.

high standard of living compared to neighboring republics. After independence in 1991, however, the economy collapsed under the impact of civil war and the loss of preferential access to the former Soviet markets and large fiscal transfers from Moscow.

Georgia launched a program of structural reforms in 1994 to restore economic growth. The reforms registered some success, especially in the area of stabilization and liberalization. GDP grew about 10.6 percent per year during 1996 and 1997, and inflation was reduced to single digits. Many of the main elements of the legal and regulatory framework for a market-based economy and a sound financial sector were also developed during this period. Banking regulation and supervision was put in place, and a capital market and a framework for non-bank financial institutions were created. At the same time, the banking system was fully privatized.

While GDP growth slowed from 1998 to 2000 due to the shocks of the Russian financial crisis and severe droughts, economic growth was restored to an average annual rate of 5 percent from 2001 to 2002. The economy proved resilient in 2003, despite a weakening in fiscal performance and the political crisis that led to the “Rose Revolution,” which resulted in the election of a new government in March 2004. Real GDP grew by 11.1 percent led by the industry and communications sectors and construction of the Baku-Tbilisi-Ceyhan oil pipeline, which together accounted for about 3.5 percent of the growth.

In 2004 the economy continued rapid growth with an annual real GDP growth of about 8.5 percent and single digit inflation. Fiscal performance in 2004 was also positive, especially the improvement in revenue collections stemming from better tax enforcement. This permitted two supplementary increases in spending appropriations and faster-than-expected clearance of domestic arrears. In addition, important measures were introduced to strengthen fiscal institutions in an effort to ensure that the improvements are sustainable.

Large capital inflows, prompted mostly by greater investor confidence, have complicated the conduct of monetary policy since early 2004. In response, the NBG has undertaken largely non-sterilized interventions in the foreign exchange market and maintained a largely accommodating monetary stance. As a result, 12-month consumer price inflation has risen from a low of 3.6 percent in June 2004 to 7.5 percent at end-December and to 9.2 percent at end-January 2005.

As for other structural reforms, a comprehensive tax reform was recently passed. Energy sector reforms, especially the rehabilitation of infrastructure and rising utility bill cash collections, helped lower the sector's quasi-fiscal deficit from 5 percent of GDP in 2003 to an estimated 4.5 percent in 2004. Table 1 shows some selected economic indicators for Georgia from 2000 to 2004.

TABLE 1: GEORGIA'S MACROECONOMIC INDICATORS (2000-2004)

	Unit value	2000	2001	2002	2003	2004
Nominal GDP	USD	3045.77	3226.75	3574.98	4079.81	5369.86
GDP per capita	USD	654.48	698.64	779.57	895.57	1184.00
Growth rate in real GDP	%	1.8	4.8	5.5	8.6	8.4
Consumer price index	%	104.6	103.4	105.4	107.0	107.5
State Budget Revenue	Mln USD	324.15	359.37	391.39	449.35	971.51
Of which tax revenue	%	68.4	61.9	65.7	59.6	50.8
State Budget Expenditure	Mln USD	424.71	439.66	500.29	539.04	1054.03
State Budget deficit	Mln USD	-98.03	-80.24	-108.90	-89.69	-82.52
Percentage of GDP	%	-3.2	-2.5	-3.0	-2.2	-1.5
Unemployment rate	%	10.3	11.1	12.3	10.5	n/a
Money income of households	Mln USD	907.75	944.90	939.90	929.59	n/a
Expenditure	Mln USD	1498.94	1451.75	1638.80	1138.51	n/a
Nominal wages	USD	36.61	45.92	49.33	67.13	n/a
Growth in nominal wages	%	107.1	130.8	109.0	116.6	n/a
Minimum cost of living for :						
Average consumer	USD	50.84	50.24	53.68	57.54	72.33
Average family	USD	100.86	99.61	106.41	114.07	143.45

1.2.2 Monetary Sector

The monetary policy instruments of the NBG have undergone significant change in recent years. Overnight deposits and credit mechanisms were introduced, interbank credit auction moved to a daily regime, and minimum reserve requirements became less stringent.

The means of money supply regulation, such as the overnight deposit and credit facilities, interventions on interbank credit auction, and intra-month lending to the MOF, were used to reduce the pressure on the foreign exchange market. Changes to the reserve requirement, long-term lending to the government and purchases of foreign exchange provided long-term supply of money to the economy.

The year 2003 was distinguished with active interventions on the interbank credit auctions by the NBG to regulate liquidity of the banking system. These interventions served the task of not only collecting free monetary funds, but also supplying the system with additional liquidity, when demanded. Thus, in 2003, the main source of money supply was the one-sided non-sterilized interventions of the NBG on the TICEX. Foreign exchange was purchased when the supply of foreign exchange exceeded the demand thereon. This provided GEL 90.9 million in new cash in circulation and helped in achieving a major goal which is the re-monetization of the economy. Through this mechanism, the NBG was also able to better influence the formation of interest rates and limit the fluctuations in the exchange rate.

The inflation rate has remained moderate in recent years. This has been supported by appreciation of the Lari.

Since 2003, the volume of international reserves roughly doubled to reach USD 382.8 million. In relative terms, the months of imports of goods and services that are covered by international reserves has increased from 1.3 to 2.3.

Government lending was implemented within the limit defined under the “Law of Georgia on the State Budget of Georgia” and “Main Directions of Monetary and Exchange rate Policies” approved by the Parliament, and in accordance with the financial program agreed upon with the IMF. In 2003, the NBG provided a total of GEL 333 million in loans to the government, of which GEL 294.1 million was redeemed by the end of the year. The volume of T-bills in the NBG portfolio increased to GEL 5.8 million by the end of the year. As a result, government liabilities increased by GEL 40 million, amounting to GEL 817.1 million. Intra-month credits were part of government lending, and due to the irregular collections of taxes, were directed at the mitigation of reserve money supply fluctuations, balancing of cash flows, and optimization of budget expenditures.

More recently, the minimum reserve requirement mechanism has undergone significant changes. The current compulsory reserve requirement stands at 2 percent for bank liabilities in local currency and 13 percent for liabilities in foreign currencies. Differentiation of reserve requirements for the funds in national and foreign currencies, and the reduction of the requirement rate created incentives for commercial banks to increase the share of active and passive operations in the national currency, and facilitated the improvement of financial mediation in Lari in the banking system, and some reduction of the interest rate spread. Observance of the portion of reserve requirements in the form of an average balance enabled commercial banks to manage their daily liquidity better.

At present, priorities of monetary and foreign exchange policy are oriented towards the following goals:

- The key aim of the monetary and foreign exchange policy is to achieve and sustain price stability. According to the NBG plan, in the medium term (2005-2007) targeted annual inflation rate will be 5-6 percent.
- For the purposes of facilitating the re-monetization of the economy in a low inflationary environment, the NBG will supply money according to demand, taking into account the real growth rate of the economy and the targeted inflation rate. Furthermore, on the background of legalization of economy, utilization of the Lari as the only legal tender will increase, and the legalization tendency will be sustained. This will require an increase of the monetary base at a significantly faster pace than that of the country’s GDP.
- The draft 2005 Basic Directions Document for Financial and Monetary Policy envisages an increase of reserve money by 18-20 percent. In the mid-term, it is expected that the national currency will gradually acquire a savings function. Ultimately, the amount of bank deposits denominated in Lari will increase as well as the credits issues in this currency. This will facilitate an increase of the money multiplier in the banking sector and enhance effectiveness of the monetary transmission mechanism.
- Given the country's current balance of payments and the volume of external debt, the accumulation of international reserves remains a key priority of the NBG’s monetary policy. The main sources of inflow of foreign reserves is the financial assistance the country receives from international organizations and donor countries, as well as the purchases of foreign currency the NBG conducts in the market place. The NBG will lead its investment policy accordingly, so that by end-2005, the international reserves to imports ratio will reach at least 2.5 months.[3] The process of accumulation of foreign exchange reserves will also continue in the medium term to ensure unimpeded service of the country's foreign liabilities.

[3] Excluding the imports related to the construction of a major oil and gas pipeline currently underway.

It is expected that by 2006-2007 the country's foreign exchange reserves will amount to the equivalent of three months imports.

- In 2005, the foreign exchange policy shall still be based on a floating exchange rate regime. The exchange rate will be formed based on market principles, considering demand and supply for foreign exchange. In order to circumvent abrupt variations of the exchange rate, the NBG will apply two-side monetary interventions. Considering that the price stability is the ultimate goal, the NBG will try to facilitate to the competitiveness of the exporting sectors of the country. Thus, the NBG will aim to support a real effective exchange rate that will facilitate in the creation of healthy trade relationships with the partner countries.

1.3 FINANCIAL SECTOR

As of December 31, 2003, the banking sector included 19 local private commercial banks, and two branches of Turkish and Azeri banks. Compared with 2002, foreign investments in the capital of Georgian local commercial banks increased slightly and comprised 31.2 percent of capital. A total of 12 Georgian banks have foreign shareholders. The total value of foreign shares constitutes 16.8 percent of the banking sector's capital.

In mid-2005 the financial system in Georgia consisted of 21 banks, 50 non-deposit taking financial institutions, 16 insurance companies, three private pension funds, and one stock exchange. It remains small and dominated by banks, which account for about 80 percent of total financial sector assets. Total assets of the banking sector increased from 12 percent of GDP in 2000 to about 18 percent of GDP in 2004. Nevertheless, banking sector assets, as a percentage of GDP, remained substantially below the average of other CIS countries, which is close to 30 percent.

The strong growth of bank sector assets over the last four years reflects the steady expansion of the banking system. The growth of core financial indicators in 2003 was similar to that of previous years, with total banking sector assets increasing by 20 percent, net loans by 24 percent, liabilities by 23 percent, deposits by 25 percent, capital by 10 percent, and net income by 14 percent. By the end of 2003, banking system's assets reached GEL 1.3 billion. This was largely due to the growth in bank deposits and borrowings. Net loans constituted 55 percent of total banking sector assets, while cash and due from banks, securities, equity investments and other assets constituted 29, 3, 1 and 12 percent, respectively.

On the other hand, total liabilities of the banking sector reached GEL 984 million. Deposits accounted for 73 percent of total liabilities, while borrowings represented 21 percent and deposits of banks and other liabilities the remaining 6 percent. The increase in total liabilities was largely due to the 25 percent growth in deposits. Particularly noteworthy is the fact that deposits of individuals increased by almost 46 percent in comparison with the previous year. Bank deposits thus reached an amount of GEL 717 million by the end of 2003.

The banking sector loan portfolio grew by 24 percent in 2003 to GEL 781 million. Banks' lending activities were concentrated on private sector activities, which represented 93.4 percent of the total portfolio. Loans issued to individuals represent 33.5 percent of total loans, while those granted to financed trade and service represent 29 percent and 16 percent in the case of loans to mining and processing industries. As end-2003, the share of long-term loans in the total portfolio reached 50 percent, up from 38 percent in 2002.

During 2004, aggregate bank assets grew by about 25 percent reaching USD 890 million or 18 percent of GDP. This growth was mainly due to an increase in both consumer and corporate deposits by 35 percent (combined) bringing the total deposits in the banking system to USD 511 million equivalent. Stock of loans grew by 23 percent to USD 473 million.

The growth in credit was driven by growth in industry and trade.

The increased level of deposits is a reflection of the generally improved public confidence in the banking sector. This is due in part to the efforts of the NBG in dealing with problem banks, but more importantly the perceived successful implementation of the Government's reform program, including fight against corruption and streamlined business procedures which are attracting more resources into the formal economy.

1.4 CAPITAL MARKETS

Development of capital markets in Georgia and other CIS countries began in the early 1990s. There have been three main stages of Georgian capital market development.

Stage I (1991-1994)

This period was characterized by a large number (approximately 20) of stock exchanges. Only a few of these exchanges successfully entered the business, and almost all went bankrupt after a short period of time. None even considered the creation of a depository or registration systems for securities, or the regulatory agency. The number of brokers exceeded 700.

Stock trades constituted a minimal share of the total market activities, and the exchange of foreign currencies and commodities constituted the majority. The stock market was penetrated by shares and bonds of newly created private and joins stock companies, commercial banks, even foreign enterprises from other CIS countries.

Stage II (1994-1997)

The year 1994 has been considered a turning point in formation of Georgian economy. The NBG introduced the Lari as a national currency by exchange rate (1 Lari =1.3 million. coupons).[4] The Government started the process of privatization through the issuance of shares of small and medium enterprises. These shares, or "vouchers" as more widely known in the country, were actively traded on the surviving exchanges and on the over the counter (OTC) market. Vouchers were also traded over futures contracts and over foreign currency, mainly the United States dollar (USD) and the Russian ruble (RUR). None of the joint stock companies for which bonds and shares were successfully traded in 1991-1994 survived to the beginning of the second stage.

In 1994 the first Foreign Currency Exchange was established in Tbilisi and the first steps were taken towards establishing a securities market regulation with the introduction of temporary legal procedures. The MOF created an internal division responsible for capital market development and in 1996 established the National Securities Commission of Georgia.

In 1997 the MOF started issuing T-bills, with the NBG playing he role of primary market agent and registrar.

Stage III (1998 – present)

The concept and understanding of central securities depository activity in Georgia began to gain importance after the Law on Securities Markets was enacted in 1999. This was

[4] As mentioned before, in 1993 the NBG had introduced the "Georgian Coupon" to function as a temporary national currency before the introduction of the Lari.

preceded by several changes in other economic and legislation areas as well. This period has been characterized by increased stabilization of the political and economic situation in the country. More than 1,100 state enterprises have been privatized, and approximately 400,000 shareholders have been registered. The issuance of T-bills has become systematic. Thus, the main instruments represented in the Georgian capital market are shares of privatized enterprises and T-bills issued by the Ministry of Finance.

In 1997 the MOF and TACIS[5] launched a project on securities market regulation. In 1998 a World Bank project began to support the development of a new system of securities registration. In the same year, under a USAID project, the Barents Group LLC started implementing the global project on securities market development, introduced to the market the Georgian Stock Exchange (GSE), the Georgian Central Securities Depository (GCSD) and the National Securities Commission of Georgia (NSCG). At present, trading activities in the securities market is very low.

1.5 MAJOR TRENDS IN PAYMENT SYSTEMS

Since 1995, the NBG has played an active role in the development of more efficient interbank payment systems and has already achieved major improvements for interbank funds transfers in local currency.

Two relevant features of the payments system in Georgia are the intensive use of cash for all types of payments and the high percentage of foreign currency-denominated customer accounts at commercial banks. During 2000-2004, the ratio of banknotes and coins and of current account bank deposits to the monetary aggregate M1 remained very stable at around 74 and 24 percent, respectively, indicating that cash remains a major means for making payments in Georgia. The Lari is the unique legal tender in the country. Despite this, approximately 60 percent of demand deposits in commercial banks and 78 percent of total deposits are denominated in foreign currencies. With very few exceptions (i.e. cheques drawn on the NBG used by commercial banks for cash withdrawal purposes), cheques are not used in the country for payment purposes.

For larger transactions within the banking sector, the NBG operates an RTGS funds transfer system. The development and implementation of the RTGS system has been an important achievement since it has allowed for better integration between the NBG and the banks. It has given banks an efficient means to send and settle their payments on the same day of value on the accounts they hold at the NBG. Payment instructions ordered by commercial banks are sent electronically through the communications system of the NBG. Currently, all 21 commercial banks in the country as well as the NBG itself participate in the system. The National Treasury is not a direct participant of this system, and the Georgian Central Securities Depository does not use the system for securities market transactions cash leg settlements. Payment orders are processed in real time as long as sufficient funds are available on the account of the payer. In 2004 the RTGS system processed a total 4,198,925 transactions for a total value of GEL 20 billion. All transactions in this system are denominated in Lari.

The current compulsory reserve requirement stands at 2 percent for bank liabilities in local currency and 13 percent for liabilities in foreign currencies. In case participants do not have sufficient funds in its account, payments go into a queuing system with an automated release mechanism. At the end of the day, payments with insufficient funds are deleted from the

[5] Launched by the European Commission in 1991, the Tacis Programme provides grant-financed technical assistance to 12 countries of Eastern Europe and Central Asia and aims to enhance the transition process in these countries.

system. The NBG does not provide regular credit facilities to commercial banks for payment system purposes.

Card circuits are growing steadily in Georgia mainly as a result of payroll programs. Nevertheless, the card base is still low and the general infrastructure for cards to be used as payment instruments is clearly insufficient. There are three payment card processors centers in the country. The ATM network comprised approximately 70 machines by the end of 2004. Cards are used by the public mostly for cash withdrawals and the EFTPOS network is small.

Regarding local payments in foreign currency and cross-border payments, the NBG and all but one of the commercial banks are connected to SWIFT and payments are made through foreign correspondent banks.

The NBG has also been working intensively on developing an appropriate legal and regulatory framework. These efforts still need to be consolidated by achieving recognition at the level of the law of these initiatives.

A National Committee on Management of the Payment System (“National Committee”) was introduced in recent years to coordinate payment system reform and ensure an orderly and integrated development process through establishing a consultative authority representing all the stakeholders. The NBG and the National Committee have already agreed a long-term strategic plan for the development of payment systems in Georgia.

1.6 Major Trends in Securities Clearance and Settlement Systems

The NBG is the primary registrar of government securities and the MOF’s agent in the primary market for such securities. Government securities are represented by T-bills issued in the dematerialized form with maturities of up to 364 days. The primary market of T-bills consists of auctions organized by auction committee which includes representatives from the NBG and the MOF, and are performed through the NBG. Only certified commercial banks may participate in those auctions. Funds settlement occurs through the current accounts commercial banks hold at the NBG. Participating banks are obliged to pre-deposit the amounts indicated in their bids. The NSCG is the general regulator of Georgian securities markets, although in the case of T-bills its competence is limited to the case when such securities are traded through a stock exchange and/or to deals between a bank and a non-banking institution.

Regarding corporate securities, there are seven independent securities registrars for primary registration of corporate shares and the recording of ownership rights, and 17 brokerage companies. Securities transactions made at the GSE are settled through its own depository, the Georgian Central Securities Depository (GCSD).

In 2004 the GCSD had 2,683 accounts. Securities under custody at the GCSD amounted to GEL 144 million by the end of 2004. All corporate shares are dematerialized, as mandated by law. Currently, the GSE requires from brokers to pre-fund the cash and securities through the GCSD prior to submitting any offers for buying or selling securities in the GSE trading system. Securities are settled at the GCSD on a gross basis.

Settlement of the cash leg is organized through four commercial banks. Settlement of securities and funds is not simultaneous, although by means of the pre-funding requirement the GCSD eliminates principal settlement risk.

2 INSTITUTIONAL ASPECTS

2.1 General Legal Framework

2.1.1 Payments

The Legal Statute of the NBG, "Organic Law of Georgia on the National Bank" (the Organic Law), of October 2001 includes as a basic function of the NBG "to ensure the efficient operation of the payments system."[6] In addition, the basis for some payment system oversight powers is included in Article 63 that states: "the NBG may assist banks in organizing facilities for the clearing and settlement of inter-bank payments, and may establish such procedures and issue such regulations relating thereto as it shall deem appropriate."

This law also regulates the reserve requirements (Article 30 and 31), the use of debt securities for open market operations (Article 29), the use of bills of exchange, promissory notes and debt securities in discount operations (Article 32) and credits to other banks and non-bank depository institutions (Article 33). Chapter V deals with bank notes and coins.

Article 49 empowers the NBG to participate on its own or on behalf of the government in any clearing and payment agreement abroad, either private or public. The basis for the management of government payments and its role as fiscal agent is included in article 54 and 55, respectively. Article 61 allows the NBG to open accounts for commercial banks and non-bank depository institutions.

The Law of Georgia on Activities of Commercial Banks dated October 2001 gives the Temporary Administrator of a bank in process of liquidation the empowerment to make or suspend payments (Article 33). In this regard, there is no explicit protection to the payment systems in case the Temporary Administrator decides not to recognize the bank's obligations with the system. However, Article 37.7 includes the protection of security interests under collateral agreements in case of liquidation of the bank.

Other laws and regulations related to the payments system are:

- The Civil Code.
- Regulation on cashless payments.
- Regulation on opening and maintenance of foreign exchange accounts (deposits) for resident individuals and legal entities.
- Regulation on opening and maintenance of national currency and foreign exchange accounts (deposits) for non-resident individuals and legal entities.
- Provisional instruction on maintenance of settlement, correspondent, foreign exchange, government budget, current and other types of bank accounts.
- Regulation on rules for carrying out cash transactions in credit institutions.
- Agreement with commercial banks on "correspondent accounts" and real-time gross settlement system services.

There is no legal basis for the use of electronic documents and signatures. At present, the NBG is preparing two regulations to cover the legal gap through an enhanced regulatory framework. These are the "Provisional Decree on Information Security in Automated Systems" and the "Provisional Decree on Electronic Funds Transfers."

[6] Article 2e of the Organic Law of Georgia on the National Bank.

2.1.2 Securities

According to article 6 of the Law on State Debt, March 1998, the MOF is the registrar of securities, credit and other liabilities issued by the central government. Articles 14 and 15 include the legal basis for the issuance of securities in either a dematerialized or physical form. Currently, all securities are issued in a dematerialized form.

The Regulation on Issuance, Allocation, Circulation, Registration and Repayment of Treasury Bills Issued by the MOF (so-called "T-Bills Regulation") also includes the basis for the issuance of T-Bills in dematerialized form (Article 1.3). The MOF keeps the primary registry of T-Bills auctions (Article 4.2), while commercial banks keep the beneficial owners registry (Article 4.3 and 4.4).

The same regulation contains a definition for repurchase agreement or repo as a "buy and sell back transaction." It is now clear, however, if such a definition would be applicable in all cases or only when T-bills are used as the underlying security. In particular, Article 4.3 indicates "a repo is an agreement on selling securities at a fixed price on the condition of further repurchase whereas the party possessing excess cash temporarily delivers it to the other party."

The Securities Markets Law (SML) was approved in December 1998. This law establishes the legal basis for the licensing and obligations of a central securities depository (Article 28 and 38) and Securities Registrars (Article 29 and 40) and their revocation (Article 31). The basis for public held securities dematerialization is included in Article 10. The legal basis for ownership transfer and custody arrangements ("nominee-beneficial owner") is included in article 10.3. Article 41 of the SML gives stock exchanges and the central securities depositories (CSDs) self-regulatory powers.

The SML also regulates the functions and responsibilities of the National Securities Commission (Chapter VIII). Article 49.e of the SML law charges the NSCG with the supervision of Regulated Securities Market Participants, which include the CSDs, securities registrars, and stock exchanges. In the case of government securities, the competence of the NSCG is limited to the case when such securities are traded through a stock exchange and/or to deals between a bank and a non-banking institution.

Other relevant regulations for securities settlement include:

- Rules of the Stock Exchange (Arbitration, Charter, Code of Ethics, Code of Procedures, Trading, Listing, Membership), 1999.
- Rules of the Central Securities Depository (Arbitration, Charter, Code of Ethics, Code of Procedures, Operations and Procedures, Listing, Membership), 2000.
- Rules of Securities Registrars.

2.2 THE ROLE OF FINANCIAL INSTITUTIONS: PAYMENTS

2.2.1 Banking Institutions

The primary participants in the Georgian payments system are banks. Banks are regulated by the "Law of Georgia on Activities of Commercial Banks," which defines financial entities as commercial banks, investment banks, mortgage banks, financial companies, savings and lending institutions for housing or other real estate and credit unions.

The NBG is the regulatory and supervisory authority of these institutions. The NBG regulations mainly refer to authorization and revocation to operate, the definition of minimum capital, minimum liquidity and solvency requirements, the reduction of systemic risks, and the supervision, external auditing and rating of financial entities.

The banks fulfill the typical financial intermediation activity in the short, medium and long term. Banks offer payment services to their customers that range from bank-to-bank transfers to the issuance of plastic cards. Cross-border payments are also possible through the standard mechanisms (correspondent banking, SWIFT, etc.). Banks can perform all the operations and provide all the services not explicitly forbidden by the law or regulations issued by the NBG.

Since 1998, the individual accounts the branches of commercial banks used to have at the NBG were consolidated into a single account. The single commercial bank account is currently held and maintained in the NBG.

Box 1: The People's Bank of Georgia

The People's Bank of Georgia plays a special role in the financial system and in the payment system in particular. It is the one of the largest banks in Georgia, with 70 branches and more than 3,000 staff.

The bank acts as an agent of the MOF for pension disbursement throughout the country. All pensioners are serviced through the bank's branch network. Pensions are mostly paid in cash, but some have already been moved to the bank's local payment card project. Bank officials confirmed the issuance of 75,000 cards, and more than 300,000 cards are ready to be distributed.

A small percentage of state salaries are also paid through the bank branches in the regions where NBG cash service is unavailable.[7]

2.2.2 Other Institutions that Provide Payment Services

Payment card operators

There are three payment card processing centers in the country.

Georgian Card is a payment cards processing company established in 1996 by a group of commercial banks: Republic Bank, United Georgian Bank, and Bank of Georgia, the Georgian Post Bank, TBC Bank, and French Bank MHB and a foreign investor, the French company "IMEDI." Since 1999, Georgian Card has undergone Europay/Mastercard and Visa International licensing, and acts as a service provider for these institutions. Along with that, Georgian Card serves 24 hours as a processing company for a local and international debit cards.

Union Financial Corporation (UFC) is another payment cards processing company that was established in 1997. UFC provides processing services to Intellect Bank (MasterCard) and TBC Bank (VISA), along with the new retail payment services based on the use of the Internet and mobile technologies.

[7] Salaries of public officials in Georgia are paid mostly in cash through the NBG branches.

The third card processing facility belongs to the People's Bank.

Remittance Services Providers

International family remittances play an important role in Georgia. These payment-flows amount up to approximately 7 to 8 percent of the country's GDP. The big share of those payments is conducted via private payment companies like Anelik, the Kaukasus Express, and Western Union, among others. The former two firms share the main part of this payment market.

At present, there are no specific rules and regulations of these enterprises. Neither is there a precise statistical recording and evaluation of the payment flows nor a specific monitoring or supervision of the payment companies by a respective domestic authority is currently in place.

2.3 THE ROLE OF FINANCIAL INSTITUTIONS: SECURITIES

2.3.1 Securities Market Participants

The following are the key securities transaction intermediaries in Georgia:

Issuers: Private sector corporations with instruments registered by Georgian registrars.

Registrars of securities: There are seven independent securities registrars for primary registration of corporate shares and the recording of ownership rights in Georgia.

Broker/dealers: There are 17 brokerage companies in Georgia. These brokers are the only participants of trades in GSE, and do so usually on behalf of their customers. In addition these intermediaries are required to own shares of the GSE.

Pension funds: Pensions and Insurance Holdings (GPIH) is the only active insurer with a private pensions license. However a number of other companies intend to apply for licenses in light of changes to the tax code designed to encourage retirement savings.

2.3.2 Exchanges

The GSE is the only stock exchange in Georgia. It was established in 1999 as a non-for-profit joint stock company. Only licensed brokerage companies are the shareholders of GSE. Securities traded at the GSE need to be transferred to the nominee accounts of broker-dealers in the Securities Registry prior to trading.

The GSE is a self regulatory organization (SRO). Accordingly, their members are regulated by the rules of the Exchange. The GSE is directly regulated and supervised by the NSCG.

2.3.3 Securities Clearance and Settlement Institutions

The GCSD is the only securities depository in the country. It was created by the GSE in December 2000. The charter capital of the GCSD is GEL 110,000, divided into 110,000 common shares with nominal value of GEL 1.

The GCSD provides depository, clearing and settlement services for shares transactions undertaken on the GSE and settlement services for OTC trades. The GCSD provides the special services assigned by the rules of the NSCG.

The GCSD is recognized as a SRO and it is supervised by the NSCG. The GCSD monitors the participants to ensure that their actions are in accordance with the depository's rules and procedures.

Membership is open to banks, investment companies and brokerage companies. The GCSD has its own formal participation criteria. The criteria are based on minimum capital requirements as established by the SML and the rules of the NSCG.

2.4 MARKET STRUCTURE AND REGULATION

The financial sector is regulated by three main bodies. The NBG has responsibility for regulation of the commercial banks and non-bank deposit taking financial institutions. The NSCG is charged in the SML with the authority to supervise stock exchanges, CSDs, and brokers-dealers. The insurance sector is supervised by the Insurance State Supervision Service of Georgia.

At this time, coordination between various regulators and the government remains limited. As the financial sector continues to develop in Georgia, coordination between these entities will become increasingly important.

2.5 THE ROLE OF THE CENTRAL BANK

The 1991 Constitution designates the NBG as the Central Bank of Georgia. Its activities are regulated at the highest level by the Constitution (Articles 95 and 96). The highest body of the NBG is the Council of the National Bank, whose members are approved by the Parliament.

At the national level the NBG offers its banking and treasury services through nine branches located in the main cities, whose operations are coordinated by the headquarters in Tbilisi. At the beginning 2004, 709 employees worked at the NBG and its branches.

The Constitution stipulates the following basic functions of the NBG: currency regulation, international exchange and credit, issuance of the legal tender, lender of last resort, banker of the credit institutions, and fiscal agent of the government. With respect to liquidity, the law stipulates that the NBG is responsible for studying and adopting monetary, exchange, and credit measures for regulating the money in circulation and, in general, the liquidity of the financial market and the normal functioning of the economy's internal and external payments, while supervising the stability of the value of the currency. It fulfills this objective, among others, by performing open market transactions, granting transitory liquidity support to credit institutions, and intervening in the foreign exchange market as purchaser or seller.

2.5.1 Monetary Policy

The main priority of the NBG's monetary and exchange rate policy is price stability with the goal of maintaining an inflation rate that allows for steady economic growth and poverty reduction in the country.

2.5.2 Involvement in the Payments System

The NBG works actively to modernize the payments system in Georgia, specifically through the development of new, more sophisticated automated applications and the provision of electronic services. The goal is to facilitate transactions made by financial intermediaries and the capital market and to make these transactions safer, more efficient, and less expensive.

Although the NBG Organic Law mentions explicitly only efficiency as the main NBG objective in the area of payment systems, in practice the NBG's major concern is the safe and sound operation of the RTGS.

The NBG is an owner and operator of the local RTGS. Consistent with its responsibility as monetary authority and its role in preserving financial stability, and as direct provider of the large-value payment system applications, the NBG permanently monitors the payment systems and undertakes reforms to insure the compliance of the system with the Core Principles for Systematically Important Payment Systems, developed by the Bank of International Settlements (BIS).

Oversight of payment system participants is also important task of NBG. Box 2 depicts the main features of the payment system oversight function of the NBG.

Box 2: The Payment System Oversight Function of the NBG

According to the NBG Organic Law dated October 2001, the NBG has legislative authority for the oversight of clearance and settlement systems. The basis of this is expressed in Article 2e which includes as a basic function of NBG "to ensure the efficient operation of the payments system", and Article 63 which states that "the NBG may assist banks in organizing facilities for the clearing and settlement of interbank payments, and may establish such procedures and issue such regulations relating thereto as it shall deem appropriate".

In absence of secondary legislation or any NBG document on payments system oversight, the available instruments are regulation and moral suasion in the context of central bank's activities. In practice, the payment system oversight function is not performed at all within the NBG.

Moreover, NBG with the Committee on Management of Payment Systems plays a significant role in raising the awareness of public in payment system. This implies organization of seminars and workshops, accumulating friendly statistical data and education.

2.5.3 Supervision of Financial Entities

The NBG is in charge of the prudential supervision of banks as well as of several other types of financial intermediaries.

In recent years, the NBG has adopted many measures to make the banking supervision more efficient in order to establish a safe and sound banking system. The NBG supervisory policies and practices are based on the Core Principles for Effective Banking Supervision issued by the Basel Committee on Banking Supervision.

Special attention was paid to improving the quality of on-site inspection. The NBG uses the

CAMEL rating system to assess commercial banks' activities and exercise supervision.[8] In 2003, the NBG conducted 17 on-site inspections of commercial banks.

As to the offsite surveillance, the NBG verifies and monitors monthly the correctness of commercial banks' financial statements and their consistence with minimum prudential standards. Periodically, every 10 days, the NBG has been checking and monitoring banks' compliance with the minimum reserve requirements.

Regulations and procedures related to licensing, ownership, management, capital adequacy, credit policy, asset classification, credit concentration and large exposures, market and other risks, internal control and audit, onsite inspection and offsite surveillance, accounting standards have been improved.

The NBG increased the minimum amount of required capital for Georgian banks, guided by a Euro Directive for minimum capital requirement of EUR 5 million. In this regard, the President of the NBG issued a decree on defining the minimum capital requirement at GEL 12 million for commercial banks. Already licensed commercial banks and foreign bank branches should start increasing their capital in a given timeframe in order to fully comply with the new requirement by the end of 2008.

The NBG also issued the "Regulation on Loan Concentration and Large Exposures for Commercial Banks" to improve supervisory policy with the regard to the lending activities in the banking sector. In 2003, the NBG prepared the "Methodological Manual for Consolidated Financial Reporting at Commercial Banks" in which it defines the procedural issues and criteria related to the preparation of consolidated financial reports.

To facilitate the practical implementation of corporate governance principles in the banking sector, the NBG initiated the adoption of the principles of the Organization on Economic Union Cooperation and Development (OECD) on corporate governance. This document requires bank managers to pay special attention to implementing corporate governance principles for the purpose of: facilitating the effective use of capital, taking into account the interests of a wide range of stakeholders, promoting accountability of the bank's management to its shareholders, and increasing foreign and domestic investor confidence for attracting a long-term capital.

According to current legislation, only the NBG has the right to declare a commercial bank insolvent and bankrupt. Accordingly, the NBG developed the Regulation on Declaring Commercial Banks Insolvent and Bankrupt.

2.5.4 Deposit Insurance

In 2003, the NBG began defining the principles for setting up a deposit insurance scheme. The NBG learned the experience of developed countries in deposit insurance schemes and took into consideration principles regarding deposit insurance outlined by the relevant Euro Directive. As a result, the President of the NBG approved the document "Methodological Instruction on Main Principles of Structure and Operation of the Deposit Insurance System." This document outlines the main issues concerning the primary stage of introducing the deposit insurance system. Some of the main principles are:

- The deposit insurance should be mandatory for all the banks operating in Georgia.
- The deposit insurance scheme should not apply to the type of deposits not included in the Euro Directive.
- The deposit insurance scheme should cover only Lari-denominated deposits.

[8] CAMEL stands for a bank's: capital (c), asset quality (a), management (m), earnings (e), and liquidity (l).

- Insured deposits should be paid within three months of the insured event.

The deposit insurance scheme is not operating at present. The NBG carefully considered the right timing for the deposit insurance scheme to be introduced. The NBG outlined certain preconditions, which include: stable macroeconomic environment in the country, stable banking sector and ability to attract initial resources required for the primary stage of the deposit insurance fund. Only once those pre-conditions are met, it will be possible to implement the planned deposit insurance scheme.

2.5.5 Anti-Money Laundering Measures

At the initiative and with active participation of the NBG, the Financial Monitoring Service has been established. The core function of the service is to combat money laundering by trying to prevent the legalization of possible illicit income through the Georgian banking system.

The methods of money laundering prevention are described in Anti-Money Laundering Law.

2.6 ROLE OF THE SECURITIES REGULATOR

The securities regulator in Georgia, NSCG, is charged in the SML with the authority to supervise stock exchanges, CSDs, and brokers-dealers.

The NSCG is a legal person subject to the public law and is not subordinated in any way in its activity to any other state agency or institution. The NSCG is comprised of a chairman and four members. The chairman and the members shall have experience or expertise in governmental, legal, financial or business matters. They are appointed or removed by the country's President and approved by the Parliament. The chairman and the members are appointed for a term of five years.

Article 49e of the SML includes as a function of the NSCG "to monitor, inspect, investigate and supervise the activities of Regulated Securities Market Participants for compliance with the legislation on securities" and 49g "to designate legal persons as Self Regulatory Organizations and revoke such designations."

The NSCG may carry out inspections of the activities of securities market participants to determine whether they are operating in conformity with the requirements of legislation on securities.

2.7 THE ROLE OF OTHER PRIVATE AND PUBLIC SECTOR ENTITIES

2.7.1 National Committee on Management of Payment Systems

The National Committee on Management of Payment Systems is the main body for cooperation in the area of payment systems. By law, this Committee functions under the umbrella of the NBG and is considered as an advisory body. The Committee is chaired by the NBG Governor and has a very broad representation, including the National Securities Commission, the MOF/Treasury, the Bankers' Association and the commercial banks, the non-bank financial institutions, the clearinghouses and payment service providers, the GSE, the GCSD, and brokers/dealers.

The Committee has a medium-level, sub-committee called "Strategy Formulation and Developing Working Group" to deal with technical issues through one or more technical sub-groups.

The primary objective of the Committee is to coordinate the development and modernization of the payment systems and ensure an orderly and integrated development process through establishing a consultative authority representing all the stakeholders and development elements. By doing so, the Committee shall support and promote the achievement of sound, robust and reliable payment, securities clearance, plastic cards and foreign exchange settlement systems, as foundations for economic and financial systems growth and stability in Georgia.

Box 3: Functions of the National Committee on Management of Payment Systems

The main functions of the National Committee on Management of Payment Systems are:

- Define the strategy for development and modernization of the national payment system in Georgia, and submit to the NBG.
- Develop and submit for approval to the NBG proposals for amendments to be made in legal acts of the NBG, and for the necessity to adopt new normative acts, as well as medium and long term plans and objectives for the development and modernization of payment systems in Georgia.
- Promote and facilitate cooperation among all the stakeholders in the development and modernization of the payment systems.
- Monitor and oversee the work carried out by the Strategy Formulation and Development Working Group and its sub-groups.
- Study the development of the payment systems regimes outside of Georgia and assess their importance to Georgia national payment system.
- Agree with the members on the possible options and design of perspective settlement systems, for further implementation. For implementing particular projects, develop recommendations on priorities of implementation and financing.
- Submit to the NBG for approval the uniform rules, procedures, standards and unified formats developed by the Committee to ensure smooth integration of the national payment system into the international systems.
- Develop recommendations for improving the mechanisms of monitoring the running projects.
- Develop recommendations regarding the cooperation with the foreign payment systems authorities and international organizations.
- When necessary, develop the mechanisms to stimulate private sector in creating payment system projects.
- For creating a solid legislative and normative-legal framework, ensure the establishment of mechanisms to control the security, confidentiality, robustness and regularity of the payment systems, as well as those to manage the related risks.
- Facilitate the process of formation of information resources for payment systems; support the NBG in the compilation and publication of national payment and settlement systems data.
- Assess the possible impact that running or pending projects may have on market participants and consumers.
- Be authorized to instruct the Strategy Formulation and Development Working Group regarding the issues of development and modernization of the payment systems.

2.7.2 Association of Banks of Georgia

The Association of Banks of Georgia (ABG) was established in 1994 by the leading commercial banks to protect the rights and interests of the banking community, raise a mutual trust between commercial banks, and support efforts to develop the financial system of the country.

The ABG has been conducting research of the economic and banking sectors of Georgia, preparing information and analytical materials, concerning the monetary, credit, budget and fiscal policy. The ABG is playing an important role in organization of trainings and educational courses for bank managers and employees, providing courses material, tests, technical support, and experts from different local and international institutions.

Participating in the development of the payment system also was considered as a priority of the ABG. At present, however, the ABG is not active in this area and its sole involvement is through its participation in the National Committee on Management of Payment Systems.

3 PAYMENT MEDIA USED BY NON-FINANCIAL ENTITIES

3.1 CASH

The NBG is the issuer of the national currency, the Georgian Lari, which is the sole legal tender for commercial transactions. Despite this, approximately 60 percent of demand deposits in commercial banks and 78 percent of total deposits are denominated in foreign currencies. The NBG has responsibility over the definition of the characteristics of banknotes and coins, and over their production, distribution and eventual withdrawal.

Currently there are six denominations of coins (named Tetri): 1, 2, 5, 10, 20 and 50; and seven different banknotes with denominations of GEL 1, 2, 5, 10, 20, 50 and 100.

During the 2000-2004 period, the ratio of banknotes and coins and of current account bank deposits to the monetary aggregate M1 remained very stable at around 74 and 24 percent, respectively, indicating that cash remains a major means for making payments in Georgia.

3.2 PAYMENT MEANS AND INSTRUMENTS OTHER THAN CASH

3.2.1 Cheques

Cheques are not a generalized payment instrument in Georgia. There are only some cheques drawn on the NBG by commercial banks for cash withdrawal purposes.

3.2.2 Payment cards

The number of payment cards in circulation in Georgia is small. Cards are used by the public mostly for cash withdrawals and the EFTPOS network is small.

There are three payment card processors centers in the country. The ATM network comprised approximately 70 machines at the end of 2004.

It is expected that the card base will grow in Georgia mainly as a result of government payroll and pension payment programs. There are 70,500 public employees in Georgia, and since 2004 a few payment card salaries projects have been piloting in Tbilisi. Of an estimated total of 895,000 pensioners, 50,000 already have a local payment card issued by the People's Bank.

Recently, the NBG signed an agreement with Visa International by which Visa will clear local transactions made with locally issued payment cards and submit the results to the NBG for final settlement through the RTGS. By significantly lowering processing fees, this step aims to encourage people to use Visa cards in paying for goods and services.

3.2.3 Electronic Funds Transfers

In Georgia the only electronic funds transfer system for interbank transactions is the RTGS system operated by the NBG. Non-financial entities transfer funds via the RTGS system regularly. However, the RTGS system itself does not handle this transactions directly (i.e., the system does not handle so-called third-party information). Therefore, as the payment message and the funds transfer are handled separately for this type of funds transfers, in most cases transactions are completed by the opening of the following business day.

Some banks are already making available to their customer payment services through an Internet portal. Funds transfers can be made at the intrabank level only so far.

3.3 NON-CASH GOVERNMENT PAYMENTS

The public sector has a very important role in the payments system of Georgia. Annually, the average number of government transactions channeled through the NBG constitutes approximately 21 percent of outgoing payments and more than 1,000,000 payment orders are received by the NBG from the MOF.

The MOF handles all payment instructions to and from the public sector bodies through the National Treasury. There are 11 Treasury branches in Georgia mainly involved in regional budget planning and payment requests collection from the public entities. Each payment request submitted on paper (electronic presentment is not available at the moment) to the Treasury branch has been checked to verify it corresponds with the disbursement plan approved by the MOF. Then, it is forwarded to the Treasury head office in Tbilisi for registration and further MOF payment authorization. Information between Treasury branches and head office is channeled via e-mail, fax, modem or post.

All government payments are channeled through the Operational Department of the NBG. The Treasury holds several accounts at the NBG – one consolidated account for collections and several accounts for disbursements.[9]

The Treasury does not have direct access to the RTGS and submits payment instructions on paper or e-mail to the NBG Operational Department where these are manually entered into the system and processed for further settlement. At the same time, the Treasury is not able to manage its funds on the basis of real time information. It obtains reports from the NBG only at the end of the day or early during the following morning.

Regarding government collections, these are consolidated at the single account at NBG. Taxpayers initiate payments through commercial banks, which then forward the collected amounts to the Treasury's single account via the RTGS. All collections must contain a nine-digit number budget classification code inside a message which is used by Treasury for sorting and accounting. Nowadays there are 80,000 legal entities registered in Georgia, 20,000 of which are active taxpayers.

Salaries of public employees are paid mostly in cash through the branches of the NBG. A small percentage is paid through People's Bank branches in those few regions where NBG cash services are unavailable. However, since 2004 a few payment cards salaries projects have been piloted in Tbilisi.

Pensions are fully distributed via the commercial banks network. The People's Bank was awarded a contract recently to provide this service to the Treasury until 2007.

[9] The consolidated account for collections was introduced on April 1, 2005 as a first step towards implementation of a single treasury account at NBG towards the end of 2006.

4 PAYMENTS: INTERBANK EXCHANGE AND SETTLEMENT CIRCUITS

4.1 LARGE VALUE PAYMENT TRANSFER SYSTEMS

In Georgia there is one large-value payments system, the RTGS, operated by the NBG. However, due to the fact that, with the exception of cash, no other instrument is generally accepted as payment instrument in Georgia, both large value payments and retails payments are processed via the RTGS.

The beginning of the RTGS dates back to 1994 when the NBG connected its branches via an electronic information exchange system. In 1997, under the supervision of the IMF, the RTGS was established and commercial banks were connected to the system.

In 2003 manual paper-based interbank transactions denominated in local currency via the NBG were eliminated and since then all interbank payments through the accounts of the NBG are settled fully electronically. The system design allows a straight through processing (STP) for interbank payments (i.e. business to business only).

In 2003, around 4,753,705 transactions for a value of GEL 12.3 billion were settled by the system. The figures for 2004 were 4,198,925 transactions worth GEL 20 billion. The theoretical capacity of the system amounts to 5 transactions per second; for an operating day of presently 6.5 hours this means a theoretical capacity of 117, 000 payments a day. Therefore, the average theoretical capacity is clearly sufficient to process the volume of all Georgian interbank payments at present and in the foreseeable future.

The National Committee on Management of Payment System is regarded as the governing body of the system. It establishes the regulations of the system and decides upon the strategic issues of the future development.

4.1.1 Access Policy

Currently, 21 commercial banks and nine NBG branches having access to the system. Only the headquarters of the commercial banks are connected to the NBG system. To become a RTGS participant the opening of a current account within the NBG is mandatory. In order to gain access to the system the participants have to fulfill particular minimum requirements. These are included in the bilateral contract arrangements between the NBG and the commercial banks. The following issues are regulated in these arrangements:

- technical requirements like authorization, electronic signatures and encoding
- registration requirements at the NBG
- requirement of a banking license
- disposition of special responsible and trained personnel
- messaging format requirements
- requirement to have at least a correspondent account at NBG

The exclusion of the system is not explicitly regulated. Consequently, it is to be applied solely on a discretionary basis by the NBG.

4.1.2 Liquidity Risk Management

All transactions processed through the RTGS are settled via the current accounts held by banks at the NBG. The balance at the end of a processing day is kept on this account and becomes the opening balance for the next processing day, given no additional transfers within the different NBG accounts of the commercial banks are made in the meantime. Moreover, there are compulsory reserve accounts to meet the legal reserve requirements. Foreign currency-denominated current accounts at the NBG are available and are voluntary as the RTGS only handles transactions denominated in Lari.

The system provides settlement on a real time basis if the participants have sufficient liquidity on their settlement accounts to cover the payment orders. Otherwise, the payment orders go to a queuing system until sufficient funds become available. Thus a positive balance requirement is in place and overdrafts of the accounts are impossible. Information regarding balances in the current account and in the queues is available in real time.

Regarding the queuing mechanism, commercial banks are able to redirect and reprioritize their payments waiting in a queue. For the time being, the NBG neither provides any intraday liquidity facilities nor alternative instruments assisting to meet the liquidity needs of the participants. Moreover no active gridlock mechanism or any other measures to support the payment flows are currently in place.

The operational day at 09:00 a.m. At this time, the NBG reconciles the balances at the settlement accounts in the RTGS and in the current accounts of participants. The information of the participants' available liquidity in the RTGS is manually uploaded (using floppy disks) by NBG staff from the general ledger. After having compared the balances, the system becomes available for payments at 09:30 a.m. The system is continuously processing until the first cut-off time at 4:00 p.m. The NBG intervenes in the system from 4:00 p.m. until 5:00 p.m. It starts processing its own payments on behalf of the government to feed the system with additional liquidity, monitors and analyses participants' queues and undertakes appropriate measures to release payments. The final cut-off time is 5:00 p.m. Pending payments still left in the queues would be cancelled after 5:00 p.m. Having closed the operation day, the NBG prepares and distributes electronic reports to the participants. The reports include a review of all the payments that were settled for each individual participant. Further statistics (e.g. providing information on payments settled in the past or some more-inclusive general analysis) are not available for the participants.

4.1.3 Operational Risk Management

The RTGS architecture is based on internet technologies. The core server is located at the NBG while each participant is connected to the main site via workstations. The workstations have implemented control facilities to check the requirements for the payment orders are fulfilled before sending them to the NBG for settlement. In case of idle workstations at participants, the NBG is not able to verify the cause of the status. Hence, the NBG has no detection system to inform participants suffering from any technical disruptions.

The system has a V-shaped structure and processes solely electronic messages in SWIFT formats. In order to gain access to the system, the participants use the local susceptible infrastructure. The NBG is scheduling to extend the requirements for the participants in terms of establishing the provision of a second communication line to overcome the current connection disruptions. As a further requirement, each message is signed by an electronic signature and verified by the NBG. To date there is no legislation in place ensuring the legal validity of electronic signatures.

Archiving and data replication occur at the end of each operational day. The back up facility has been established and is located about three kilometers from the main site and consequently has the same risk profile. The availability of the service is furthermore supported by the existence of an independent electricity generation facility and a separate more stable electricity network. An explicit business continuity plan or disaster recovery plan does not exist. Emergency cases are tested infrequently and not according to a predefined plan. The NBG acknowledged this issue as being important for the reliability and security of the system and launched different measures to partially improve these shortcomings. The measures include:

- Pushing commercial banks to have an alternative communication line to connect to NBG.
- Clustering of the two servers to automatically switch from one to another in case of emergency.

4.2 CROSS-BORDER PAYMENT SETTLEMENT SYSTEMS

At present, foreign currency-denominated interbank payments cannot be settled directly via the RTGS. Instead, the payments must be converted in GEL, then transferred to the counterparty, and finally reconverted to foreign currency. Payment orders have to be delivered manually and paper-based. The service is at a remarkable cost. Settlement of these transactions is conducted abroad through ordinary correspondent bank procedures.

4.3 FOREIGN EXCHANGE SETTLEMENT SYSTEMS

In Georgia there is a single formal trading system for foreign exchange transactions, which is operated by a private company, TICEX. Since 1993, the official exchange rate of Georgia's national currency against foreign currencies has been set as a result of trades held at the TICEX. In 1995 the TICEX obtained a formal license from the MOF to pursue foreign exchange activities.

The NBG is the biggest shareholder of TICEX with a 16 percent share. Twelve commercial banks are incorporated to equal amounts at around 7 percent. The currencies traded are the following: USD, Euro, British Pound and Swiss Franc, where in fact just the former two play an essential role. The estimated share of the foreign exchange trade volume via TICEX amounts to less than 50 percent of the whole domestic foreign exchange market. The remaining foreign exchange trades are traded OTC and settled via ordinary interbank connections. The main features of TICEX are described in Box 4 below.

Box 4: Foreign Exchange Trades at TICEX

The trades at TICEX are conducted electronically from 11:00 a.m. to 12:00 a.m. daily. The necessary processes to achieve settlement are manual. Paper payment orders are sent to the NBG, and settlement occurs via the current accounts commercial banks hold wit it. The settlement is executed indirectly through the RTGS of the NBG on a gross basis. To settle these payments, the foreign currency leg has to be converted into GEL in order to transfer the payment to the respective counterparty. Subsequently, the re-conversion into the original traded foreign currency is conducted.

A foreign exchange transaction costs a fixed price between USD 3 to 4 plus a variable amount of 0.25 percent of the amount of the trade. Therefore, a large number of trades (i.e. all OTC trades and even a relevant share of the trades made at TICEX) are settled on a bilateral basis settling the foreign currency leg via correspondent banks abroad. Apart from some credit limits, some commercial banks use there are no particular measures in place to control the liquidity and credit risks of those transactions.

The established risk controls consist of a guarantee fund of TICEX of an estimated amount of GEL 250,000 and a fine of 5 percent of the trade volume if a party fails to fund its obligation.

4.4 MAJOR PROJECTS AND POLICIES BEING IMPLEMENTED

Over the years, cooperation through the National Committee on Management of Payment Systems has proven to be an effective means for relevant stakeholders to express their views and opinions regarding the proposed reforms and their implications.

In this regard, the NBG and the National Committee on Management of Payment Systems have already agreed a long-term strategic plan for the development of payment systems in Georgia. Box 5 summarizes the main issues outlined in the "Strategic Plan for Development of Georgian Payment System 2002-2006."

Box 5: Key Issues in Strategic Plan for Development of the Georgian Payment System 2002-2006

1. Further development of the NBG's RTGS system.
2. Further improvements to the legal framework of the national payments system.
3. Development of a reliable telecommunications infrastructure for the payment system.
4. Foreign exchange and securities settlement systems development.
5. Improvement of intraday liquidity management in the NBG's RTGS. Introduction of an automated repurchase agreement facility with government securities being used as collateral.
6. Development of net settlement system for small value payments.

The current challenge is to move ahead with the implementation of the strategy, for which the revitalization of the Committee and its sub-structures is crucial.

5 SECURITIES, MARKET STRUCTURE AND TRADING

INSTRUMENTS

5.1 FORMS OF SECURITIES

Articles 14 and 15 of the SML include the legal basis for the issuance of securities in either a dematerialized or physical form. Currently, all securities in Georgia are issued in a dematerialized form.

5.2 TYPES OF SECURITIES

The main types of securities in Georgia are corporate equities and government debt securities.

There are three general classes of equity securities:

- *Ordinary shares*: These shares confer the right to get dividends and a liquidation quota, both proportional to the amount of capital they represent. Each ordinary share represents one vote.
- *Preferred shares*: These shares enable their holder to obtain a certain amount of the profits with preference over the ordinary shares. They can be obtained: (i) in a cumulative way; (ii) temporarily cumulative; (iii) permanently cumulative; or (iv) with an additional participation. These shares may involve the right to the preferred collection of liquidated and realized profits or of a fixed dividend, cumulative or not. They might also carry preferred rights in the event of liquidation of the company. With respect to voting rights, the law sets forth that they may not have the right to vote, but they can allow participation with a voice to company's statutory meetings.
- *Participation stocks*: These shares represent an interest in the corporate capital but do not carry voting rights. A public offering of participation shares is subject to the same requirements as any other type of stock.

The main debt instruments are:

- *T-Bills*: These are government securities issued by the MOF with maturities of up to 364 days.
- *Corporate shares*: These securities represent the debt of private firms, including corporations, co-operatives and civil associations. In practice, this last instrument is seldom traded in Georgian markets.

5.3 SECURITIES IDENTIFICATION CODE

An alphabetic identifier is used to identify securities for trading purposes. This identifier does not follow the criteria of the International Securities Industry Numbering (ISIN).

5.4 TRANSFER OF OWNERSHIP

The legal basis for ownership transfer and custody arrangements (“nominee-beneficial owner”) is included in Article 10.3 of the SML. In principle, this regime is applicable to corporate shares only. Government securities would fall under this regime if they are "publicly held securities" as defined in the law, (i.e., if they are admitted for trading on a stock exchange).

In practice, all securities are held in book-entry form, and ownership transfers occur by means of book entries in the system of the GCSD, in the case of corporate shares, or the Registry of the NBG in the case of government securities.

This transaction also requires the issuer or the registration agent to record a change in ownership. Transfer of securities is perfected by delivery of the security after settlement.

5.5 PLEDGE OF SECURITIES AS COLLATERAL

The legal basis for the pledge is included in the civil code, however, there is not a specific legal framework for the securities used as collateral in financial market transactions. Additionally, there are no rules regarding procedures for the execution of those guarantees in case of a default.

In practice, all securities are stored at the safekeeping accounts in GCSD in dematerialized form. An account holder may instruct the GCSD to transfer securities positions from the safekeeping account to relevant pledge account. As soon as securities have been transferred, they can be used as collateral.

5.6 TREATMENT OF LOST, STOLEN, OR DESTROYED SECURITIES

All securities in Georgia are dematerialized so they cannot be lost or stolen.

5.7 LEGAL MATTERS CONCERNING CUSTODY

The "nominee-beneficial owner" scheme of the SML constitutes the basis for the protection of custody arrangements. However, the current settlement process introduces custody risk from the time the transaction is executed to the time the securities are registered again in the securities registry at the name of the beneficial owner. This is because the details of the beneficial owner during the indicated time are only available in the broker-dealers books.

MARKET STRUCTURE AND TRADING SYSTEMS

5.8 PRIMARY MARKET

MOF T-bills are publicly offered though the Treasury Bills Auction. The auction is conducted on Wednesdays at 10:00 a.m. Primary dealer banks, commercial banks and resident and non-resident individuals and legal entities – through the commercial banks – are eligible to participate in the auction. T-bills are issued in the national currency. The auction is conducted using the multi-price method. The MOF defines the amount of the T-bills offered at the auction, which are sold at discount and redeemed at nominal value.

Auctions are organized by an Auction Committee that includes representatives of the NBG and the MOF, and are performed through the NBG. Fund settlement occurs through current accounts that commercial banks hold at the NBG. Participating banks are obliged to pre-deposit the amounts indicated in their bids.

TABLE 2: T-BILLS AUCTION STATISTICS (1998-2004)
(in GEL million)

Year	Original Issuance Amount	Demand	Actual placement	Average weighted interest rate
1998	82,2	50,0	47,4	32,4
1999	4,8	7,1	3,9	14,1
2000	40,0	63,4	39,2	17,1
2001	81,9	84,2	68,1	30,3
2002	259,3	365,0	250,2	42,8
2003	227,9	372,6	226,9	42,9
2004	139,3	334,0	139,3	20,7

Source: NBG.

T-bills primary auctions share by types of investors is presented at the diagrams below:

Diagram 1. T-bills primary auctions share by types of investors (quarterly in 2003)

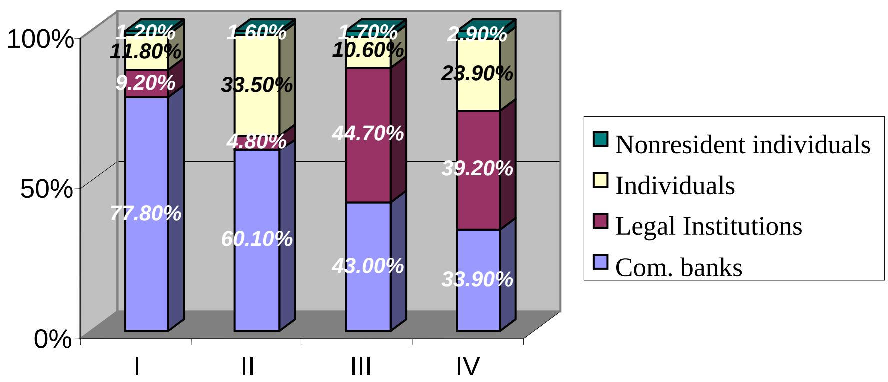
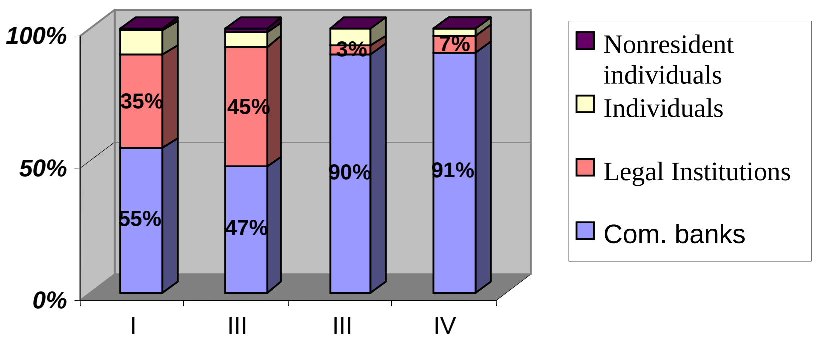


Diagram 2. T-bills primary auctions share by types of investors (quartarly in 2004)



In the corporate sector, after the extensive privatization of previously state-owned enterprises in the 1990s, there have been almost no new issuances either of equities or of corporate debt securities.

5.9 SECONDARY MARKET

Secondary market trading includes T-bills and corporate shares. In recent years secondary market activity has remained low. In 2004 volumes started growing again (see Table 3).

Secondary trading of shares is performed only at the GSE. T-bills, on the other hand, can be traded either at the GSE or on the OTC market.

5.10 STOCK EXCHANGE TRADING

The GSE has an electronic trading system through which the broker-dealers submit their orders which are traded, matched and confirmed automatically. The trading results are automatically forwarded on the same day from the GSE trading system to the GCSD settlement system. The information forwarded to the GCSD includes: time and date of the transaction, seller member identity, buyer member identity, seller's account number (code), buyer's account number (code), name of securities, amount of securities, buy/sell price of securities and overall value of the transaction.

In 2004 there were 1,094 trades executed with an overall volume of 30.51 million shares and value of GEL 46.68 million. The total number of trade sessions for the period was 102. An average daily turnover accounted for GEL 457,609.

TABLE 3: MAIN TRADING INDICATORS AT THE GSE

	2000	2001	2002	2003	2004
Number of trades	601	1591	1347	913	1094
Average trades per day	8	16	13	9	11
Volume (securities)	4,354,640	10,862,784	11,454,842	7,903,864	30,510,783
Daily average volume	54,433	109,725	111,212	79,039	299,125
VALUE (GEL)	5,892,326	13,077,244	8,411,354	1,735,290	46,676,153
Daily average value	73,654	132,093	81,664	17,353	457,609
Number of trading days	80	99	103	100	102
Number of trading sessions	80	99	103	100	102

Source: GSE.

5.11 OVER THE COUNTER (OTC) MARKET

Currently, there is no information about the OTC market for securities in Georgia. Due to GSE rules, OTC activity is limited to T-bill trading.

TABLE 4: T-BILLS TRADES IN THE SECONDARY MARKET

Year	Value (GEL)	Number of Deals
2002	40,333,000	124
2003	116,236,200	469
2004	84,961,500	294
2005 (Jan-Apr)	3,673,100	13

Source: NBG.

6 CLEARANCE AND SETTLEMENT CIRCUITS FOR GOVERNMENT AND CORPORATE SECURITIES

6.1 ORGANIZATIONS AND INSTITUTIONS

6.1.1 Stock Exchange

The GSE was established in 1999 as a non-for-profit joint stock company. Only licensed brokerage companies are the shareholders of GSE.

The GSE is a SRO. Accordingly, its members are regulated by the rules of the exchange. The GSE is directly regulated and supervised by the NSCG.

6.1.2 Central Securities Depository

The GCSD was created by the GSE in December 2000. Charter capital of the GCSD is GEL 110,000, divided into 110,000 common shares with nominal value of GEL 1.

The GCSD provides depository, clearing and settlement services for shares transactions undertaken on the GSE and settlement services for OTC trades. In 2004 the GCSD had 2,683 accounts. Securities under custody at the GCSD amounted to GEL 144 million by the end of 2004.

The GCSD is recognized as a SRO and supervised by the NSCG.

6.2 SECURITIES REGISTRATION AND CUSTODY PROCEDURES

There are seven independent securities registrars that perform a primary registration of corporate securities and record ownership rights in Georgia.

The T-Bill Central Registry is run by the NBG. The registry contains information on the primary owners derived from auction results and other information. Sub-registers are run by commercial banks in the case of T-Bills purchased in the secondary market by commercial banks or their clients. The auction is conducted by authorized individuals from the MOF and NBG. Secondary market transactions on T-Bills are done by means of private arrangements that have to be signed by commercial bank managers and informed to the NBG. The NBG keeps records of the transactions in the secondary market, but does not include any changes in the T-Bill Central Registry.

All publicly held securities can be dematerialized at the GCSD. The GCSD maintains three categories of the securities accounts: (i) direct accounts owned by an individual or a legal entity (except members) and where securities in beneficial ownership of the individual or the legal entity are recorded; (ii) private accounts of a member (broker-dealer) owned by a member and where securities in beneficial ownership by the member are recorded; and (iii) accounts of a member's client owned by a member and where securities in a nominee holding of the member are recorded in compliance with the agreement concluded with the beneficial owner. In addition, there are accounts for pledges.

Each member opens an account under the GCSD rule that ensures segregated safekeeping of the member's and its clients' securities in compliance with the SML.

According to the Agreement on Nominee Holding, an account holder authorizes the GCSD to register the securities of the former with the Securities Registrar on behalf of the latter, and to execute other transactions with these securities on behalf of the account holder. Written agreement shall be concluded according to the Operational Procedures of the GCSD as an integral part of the application for opening of the securities safekeeping account.

In order to deposit securities at the GCSD, a pre-requisite for trading at the GSE, the registered owner of the securities instructs a Securities Registrar to register its securities, partially or in total, in the name of the GCSD, as a nominee holder. In compliance with applicable Operational Procedures, the securities safekeeping account of an account holder is credited with the admitted securities only when the GCSD receives notification from the registrar that these securities have been registered on its behalf. Deposit is final and any disputes occurred in relation to the ownership rights shall be settled by the mutual agreement of the relevant parties or by decision of a court or through arbitration.

An account holder may instruct the GCSD to transfer securities positions from the safekeeping account to the relevant trade or pledge accounts or other safekeeping accounts. Orders for the transfer of securities must be made in writing with the form specified by the Operational Procedures of the GCSD.

Participants are provided with reports on the safekeeping of assets and transfers undertaken to and from participants' accounts. Also participants are provided with reports on their pre-trade and post-trade positions on a regular basis. Brokers have the ability to check their trading assets.

6.3 SECURITIES CLEARANCE AND SETTLEMENT PROCESSES

Settlement is based on the principle of advance delivery of securities by the selling party and the advance payment of cash by the buyer. At the GCSD, transactions are settled on a trade-by-trade basis. Stock exchange operations with securities are settled on the settlement date (T).

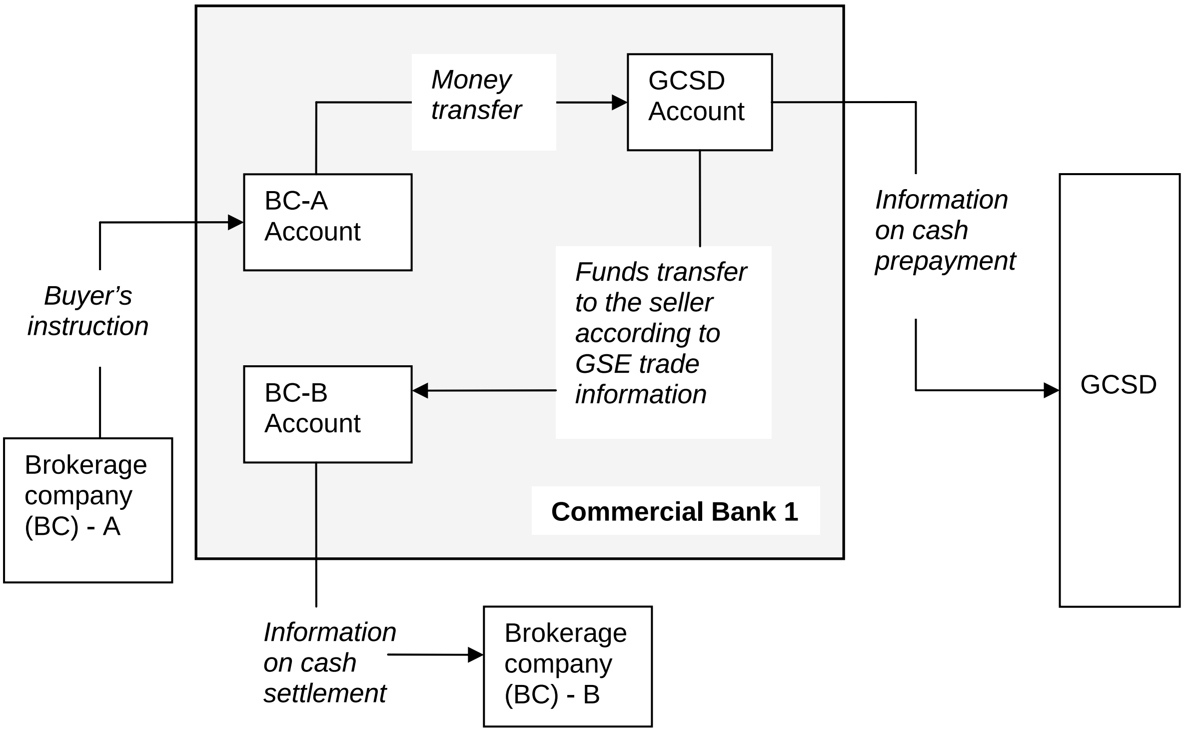
Securities traded in the GSE need to be transferred to the nominee accounts of broker-dealers in the Securities Registry prior to trading. Then, the broker-dealer presents the proper documentation to the GCSD so that the relevant securities can be included in the nominee brokerage accounts for trading. Some entities and individual persons have a direct account in the GCSD. In this case, the securities have to be transferred to the brokers trading account, as they are the only entities allowed for trade in registered securities.

The settlement system uses commercial bank money for the cash leg settlement. Each member should open an account in the four settlement banks: United Georgian Bank, Bank of Georgia, TBC Bank and Cartu Bank where, according to the rules, each broker has to hold a cash account. The GCSD also has cash accounts with each of the above mentioned banks.

Potential buyers need to transfer the necessary amount of funds to the broker's cash account opened in the one of the four settlement banks. Brokers, prior to the trade (minimum up to three hours or a day before the trade), transfer this money to the GCSD cash account in the same bank. Having received the confirmation from the bank about the transfer of the funds, the GCSD, according to the broker's instructions, transfers the funds to its specific trading account, blocks such funds, and submits information about the balances to the GSE.

Trading results are automatically forwarded from the GSE trading system to the GCSD settlement system.

Figure 1: Flow Chart of the Securities Settlement Process



If there is a sufficient number of securities in the seller's securities trading account and a sufficient amount of cash for the settlement in the buyer's cash trading account, the GCSD transfers the amount of securities indicated in the transaction, on T from the seller's securities trading account to the buyer's securities trading account. In addition, the GCSD transfers funds from the buyer's clearing account to seller member's clearing account. After settlement, the GCSD transfers any remaining cash balances in the clearing accounts from the bank account of the GCSD to the member's respective bank accounts with the settlement banks through an intrabank transfer.

Transactions are considered final immediately upon the GCSD receipt of the relevant transaction information from the GSE. Settlement is considered final and irrevocable when both cash and securities are credited to the seller's and buyer's accounts respectively.

The GCSD does not act as central counterparty and does not guarantee the settlement of trades.

Furthermore, the GCSD has formal documented internal controls in place covering its operations. These controls are regularly updated and are subject to review by the supervisory board and regulatory bodies. At this stage, a disaster recovery or contingency plan has not been prepared and tested. However daily data back-ups are undertaken and important documents are stored. No disaster recovery facility is available. The GCSD undertakes annual audits of the financial accounts by the external auditors. There are also regular audits of the internal controls, with a double checking system whereby the manager monitors all records of account operators.

6.3.1 Procedures in Case of Non-fulfillment of Obligations

If the terms for transfer of securities from the seller's securities trading account to the buyer's securities trading account are not satisfied on the settlement date, the GCSD will return securities from the seller's securities trading account to the related safekeeping account and also will return funds reflected in the buyer member's clearing accounts, (i.e. from the GCSD's bank account to the buyer member's bank account with the same Settlement Bank).

6.4 GUARANTEE SCHEMES

The GCSD requires pre-funding of cash and securities prior to the trade. Counterparty risk exposure between participants is low as the GCSD provides almost simultaneous settlement involving the pre-funding of cash accounts and deposit of securities prior to trade.

6.5 SECURITIES LENDING

The GSE does not have an automated securities lending facility or other mechanisms thereof. For the time being, securities lending is not regulated in Georgia.

6.6 INTERNATIONAL LINKS AMONG CLEARANCE AND SETTLEMENT INSTITUTIONS

Currently, there are no links with other CSDs. For the purpose of facilitating the settlement on securities simultaneously admitted to trading on exchanges of a foreign country, the GCSD may enter into an agreement with a foreign depository. The GCSD may maintain securities on its accounts in foreign depositories. The GCSD may set procedures for receipt and delivery of securities deposited with the foreign depository.

7 CLEARANCE AND SETTLEMENT CIRCUITS FOR GOVERNMENT SECURITIES

7.1 THE REGULATORY ENVIRONMENT

The normative document which regulates primary market of Georgian T-bills is the "Regulation on Issuance, Allocation, Circulation, Registration and Repayment of Treasury Bills." The provision was approved under Decree of the MOF and the NBG on August 8, 1997.

7.2 THE CLEARING AND SETTLEMENT PROCESS

7.2.1 Primary Market

T-bill operations are limited to the primary market. The only entities allowed to participate in the auctions are commercial banks. However, commercial banks may bid on behalf of their clients: individuals and legal entities. The auction process is manual.

Auctions are held by the auction committee consisting of five members appointed by the President of the NBG and two appointed by the MOF. According to the schedule approved by MOF, auctions take place on the premises of NBG.

The committee makes an announcement of auctions, as well as the amount of T-bills to be auctioned, maturity and bidding deadlines through mass media six days before the auction.

Prior to the auction, participants submit paper bids in sealed envelopes and place them in a box located on the first floor of the NBG. They can also send their bids by e-mail. These procedures are described in the agreements between the NBG and commercial banks.

Bank clients wishing to buy or sell T-bills submit their bids together with corresponding funds prior to the auction to their corresponding commercial bank. Commercial banks submit the bids to the NBG on their behalf. The NBG does not permit further alteration or withdrawal of submitted bids.

The deadline for accepting both sealed and electronic bids is 10:00 a.m. of the day the auction takes place. Members of the committee examine the accuracy of completed bids, the existence of all requisites and signatures, and the conformity of the sum indicated in a bid, with the amount pre-funded at the NBG. Incorrectly completed bids are declined. In case the necessary pre-funded amounts at the NBG are insufficient to cover presented bids, bids might be partially accepted.

Members of the committee manually enter the bidding information to the electronic system and verify identity of paper bids with entered information.

7.2.2 Secondary Market

Secondary market transactions are very rare and take place mainly through OTC private agreements. The procedures are described in Box 6.

Box 6: Procedures to Trade T-bills in the Secondary Market

1. The seller informs the mediator (brokerage or commercial bank) to sell its T-bills for a defined rate and sum.

2. The seller or mediator prints four forms of T-bills transfer and signs them.

3. The buyer signs the relevant forms.

4. A commercial bank verifies, seals and signs the forms. The commercial bank changes the-sub register. If the seller or buyer has account at different banks, both banks have to seal and sign the forms.

5. Due to the agreement, one of the sides (the bank of the broker) has to submit all the forms to the NBG. The NBG has to verify the documents with the information from the Primary Auction. Later, forms are signed by one or two auction committee members. Forms are sealed by the NBG Money–Credit Department seal. One original of these forms is left at the NBG.

6. The commercial bank leaves one of the forms and changes the sub-register. One form is for the seller and the one for buyer. If two banks are in trade, an additional copy is necessary.

7. As soon as all seals and signatures are received, the process of selling is started and the transfer of money takes place. Direct money transfers from one bank to another are not possible. Money has to be transferred to the NBG account of the correspondent bank. On the second day, the NBG gives the commercial bank receipts on money received. The entire process takes from two to three days to be completed.

8 THE ROLE OF THE CENTRAL BANK IN CLEARANCE AND SETTLEMENT SYSTEMS

8.1 RESPONSIBILITIES

The NBG is the owner and operator of the local RTGS. Although the NBG Organic Law mentions efficiency as the main objective in the area of payment systems, in practice the NBG's major concern is the safe and sound operation of the RTGS.

Consistent with its responsibility as monetary authority and its role in preserving financial stability, and as direct provider of large-value payment system applications, the NBG permanently monitors the payment systems and undertakes reforms to ensure the compliance of the system with the Core Principles for Systematically Important Payment Systems, developed by the BIS.

Neither a payment system oversight unit segregated from the operations department to oversee the system, nor an oversight concept is in place at the moment. The monitoring and supervision of the RTGS system is conducted by the respective departments at the NBG. Furthermore, the NBG does not have any regular publications covering payment system developments. Statistical information on the payments system is not available on a regular and structured basis.

8.2 SETTLEMENT

All transactions processed through the RTGS are settled via the current accounts held by banks at the NBG. The balance at the end of a processing day is kept on this account and becomes the opening balance for the next processing day, given no additional transfers within the different NBG accounts of the commercial banks are being made in the meantime.

Foreign exchange transactions made at the TICEX are settled through the RTGS.

8.3 THE RISK CONTROL POLICY

The system operated by the NBG is designed as a pure RTGS system. Therefore, payment orders are processed if, and only if, participants have the necessary funds in their current accounts at the NBG. The NBG does not provide any credit facilities for payment system purposes.

Payment orders with insufficient funds go to a queuing system, through which system participants are able to redirect and reprioritize their payments waiting in a queue.

Regarding operational risk, for the RTGS there is an established set of requirements potential participants should comply with in order to become direct participants in the system. Although most of these requirements are technical in nature, in practice access is limited to commercial banks as a banking license is required to participate in the system.

8.4 PRICING POLICY

Several payment services offered by the NBG are priced, basically with the purpose of cost recovery. For Lari-denominated transactions sent through the RTGS, there is a differentiated price scheme based on the hour of the day a payment instruction is sent to the system for settlement. A fixed-amount per transaction is applied before 2:00 p.m. and another, much higher, for transactions sent after that hour. Table 5 below summarizes the pricing policy for the RTGS.

TABLE 5: TARIFFS APPLICABLE IN THE RTGS OPERATED BY THE NBG

Time of settlement	Price
09.30 - 14.00	GEL 0.03
14.00 - 15.00	GEL 0.20

For the settlement of foreign currency-denominated transactions, the NBG applies a fixed percentage over the amount of the transaction.

9 SUPERVISION OF SECURITIES CLEARANCE AND SETTLEMENT SYSTEMS

9.1 SECURITIES REGULATOR SUPERVISORY AND STATUTORY RESPONSIBILITIES

The securities regulator in Georgia, the NSCG, is charged in the SML with the authority to oversee stock exchanges and CSDs. Government securities are regulated by the MOF and NBG. The NSCG is a legal person subject to public law and is not subordinated in any way in its activity to any other state agency or institution.

Among other functions, the NSCG has the following responsibilities under the SML:

- Approve prospectuses for public offerings of securities and ensure compliance by issuers with the terms and obligations.
- Present official explanations and recommendations on issues concerning the securities market, advise the President, the Parliament, the NBG and other state bodies and institutions regarding all aspects of the securities market, and propose legislation and amendments that will further the development of the securities market.
- Issue, amend, suspend or revoke licenses of Regulated Securities Market Participants.
- Monitor, inspect, investigate and supervise the activities of regulated securities market participants for compliance with the legislation on securities.
- Recommend and establish accounting standards that may be required for the securities market in consultation with any other institutions set up for the purpose of establishing such standards.
- Approve and repeal rules and amendments adopted by SROs.
- Impose sanctions under the established rules for the violations of legislation on securities, and publish findings of such violations and sanctions.
- Develop relationships with foreign securities market regulatory bodies under Memorandum of Understandings and agreements for information sharing purposes.
- Identify, avoid and eliminate any violations with regard to issuance and circulation of securities and any other violations for this purpose.

9.2 SELF-REGULATORY ORGANIZATIONS SUPERVISORY AND STATUTORY RESPONSIBILITY

The GSE and GCSD are SROs according to the SML. As SROs, they are empowered to prepare rules for its members and supervise compliance with such rules and apply sanctions against members for non-compliance with its rules.

The rules, charter and inner regulations (collectively "rules") of SROs are approved by the NSCG. In an emergency, the NSCG may take, alter, supplement, suspend or impose requirements or restrictions with respect to any matter or action subject to regulation by the NSCG or an SRO under the SML, if the NSCG determines is necessary in order to maintain or restore a fair and orderly public securities market and ensure prompt, accurate and safe clearance and settlement of transactions in securities.

In order to implement the self-regulatory powers, the GSE adopted a number of rules, including trading rules, code of ethics, dispute resolution rules, arbitration code, etc. Any brokerage company meeting the requirements of the Georgian legislation, the Exchange Charter and the stock exchange rules may become a member of the exchange. The present rules define rules and procedures for admission to market shareholder membership, requirements set forth for exchange members, admission to trading, regulations for suspension of participation in the trading and termination of membership as well as the issues relating to conditional shareholder members.

The main rights of exchange members are to:

- Participate in exchange organized share trading in accordance with the established rules.
- Be informed on the main results of the exchange’s economic and financial activities and on record-keeping and monitoring on the exchange, according to the established rules.
- Appeal to the Permanent Arbitration of the exchange for conflict resolution.
- Enjoy all rights of shareholders, according to the Georgian legislation.
- Appeal the Supervisory Board regarding the decision made by the directors of the exchange, which offends member's rights.

Main obligations of exchange members are to:

- Sign a convention to join owner-members joint liabilities, meet the Charter and other regulatory requirements and implement decisions of the exchange managing bodies.
- Ensure the compliance with norms of the Ethics Code approved by the exchange owner-members general meeting.
- Maintain technical, technological and commercial confidentiality, disclosure of which may harm the exchange its members and clients.
- Make timely payments of exchange membership fees and other dues.
- Promote the achievement of the exchange Charter goals, protect its interests, and help to boost its reputation and prestige.
- Duly inform the exchange managing body on any changes in their financial or legal status, which may affect the responsibilities towards the exchange, its members and clients.
- Possess respective license for broker activities.
- Own no more than 10 percent of the exchange shares directly or via related persons.
- Give the exchange a written consent on inspection of its records and books, aimed to verify received information.
- Meet the requirements set by the NSCG regulatory rules, including requirements pertaining to the company's capital.
- Be a member of the Central Depository.

APPENDIX: STATISTICAL TABLES

The first series of tables (A) are statistics on payments and securities clearance and settlement in Georgia and were completed following a standard model prepared in the context of the CISPI. Due to data availability constraints, however, the tables differ slightly from the standard model. The second series (B) are more general statistics related to the financial sector.

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SERIES B

General Financial System Statistics

SERIES A

TABLE A1: BASIC STATISTICAL DATA

	2000	*2001*	*2002*	*2003*	*2004*
Population (in thousands)	4,634.8	4,601.5	4,571.1	4,543.0	n.a.
GDP (million US dollars)	3,045.9	3,206.4	3,401.5	3,992.9	5,148.8
GDP per Capita (US dollars)	654.5	694.2	741.7	876.5	1,135.3
Exchange rate Lari/US $)					
Year end	1.9750	2.0600	2.0900	2.0750	1.8250
Average	1.9762	2.0730	2.1957	2.1457	1.8003

Source: National Bank of Georgia, State Department of Statistics of Georgia.

TABLE A2: SETTLEMENT MEDIA USED BY NON-BANKS

	2000	*2001*	*2002*	*2003*	*2004*
Total notes and coins	329.2	365.7	417.2	473.2	676.2
Held by the public	315.0	348.9	390.8	441.5	616.0
Transferable deposits in domestic currency	51.3	45.3	62.0	75.3	202.7
Households	0.2	2.9	4.2	9.0	21.2
Corporate sector	41.4	26.6	41.4	47.9	135.4
Other	9.7	15.8	16.3	18.5	46.1
Narrow money supply M1	391.2	429.9	509.0	579.9	836.5
Transferable deposits in foreign currency	98.3	184.7	147.1	197.0	268.7
Households	…	43.9	44.3	76.8	71.8
Corporate sector	…	62.4	67.0	73.8	135.8
Other	…	78.4	35.8	46.4	61.1
Broad money aggregates					
M2	382.1	403.8	462.3	527.4	846.1
M3	618.2	732.4	863.6	1,062.4	1,511.9

Source: National Bank of Georgia.

TABLE A3: SETTLEMENT MEDIA USED BY CREDIT/DEPOSIT TAKING INSTITUTIONS
(GEL million)

	2000	*2001*	*2002*	*2003*	*2004*
Required reserves at the Central Bank					
In domestic currency	38.9	53.3	72.2	81.4	92.3
In foreign currency	n.a.	n.a.	n.a.	n.a.	n.a.
Excess reserves at the Central Bank:	23.1	12.5	26.5	35.0	73.8
In domestic currency	23.1	10.9	19.1	25.0	68.0
In foreign currency	0.0	1.6	7.4	10.0	5.8
Institutions' borrowing from the Central Bank	3.1	0.4	0.0	6.7	n.a.
Transferable deposits at other institutions	…	…	0.2	0.1	0.3

Source: National Bank of Georgia.

TABLE A4: INSTITUTIONAL FRAMEWORK

	Number of Institutions	Number of branches	Value of accounts (in GEL million)
Central Bank	1	9	67.2
Commercial Banks	21	162	74.0
Of which:			
Private banks	19	162	73.4
Foreign banks	2	0	0.6
Non-bank financial institutions	409	…	n.a.

Source: the National Bank of Georgia.

TABLE A5: BANK NOTES AND COINS
(in GEL million)

	2000	*2001*	*2002*	*2003*	*2004*
Total currency issued*	329.2	365.7	417.2	473.2	676.2
Total banknotes issued	366.9	360.2	413.3	468.6	666.2
Coins issued	10.0	9.3	9.9	11.0	12.1
Notes and coins held by banks	14.2	16.8	26.4	31.7	60.2
Notes and coins circulating outside banks	315.0	348.9	390.8	441.5	616.0

Source: National Bank of Georgia.

TABLE A6: CASH DISPENSERS, ATMS AND EFTPOS TERMINALS

	2004
Cash dispensers and ATMs	
Number of networks	3
National	3
Regional	0
Number of terminals	70
EFTPOS:	
Number of networks	3
Number of terminals	20

Source: Payment Card Operators.

TABLE A7: NUMBER OF PAYMENT CARDS IN CIRCULATION

	2004
Cards with a cash function	n/a
Cards with a debit/credit function	39,210
of which:	
Debit cards	39,210
Credit cards	n.a.
Cards with a cheque-guarantee function	n.a.
Retailer and fidelity cards	n.a.
Stored-value cards	n.a.

Source: Payment Card Operators.

TABLE A8: INDICATORS OF USE OF VARIOUS CASHLESS PAYMENT INSTRUMENTS
(volume of transactions)

	2001	*2002*	*2003*	*2004*
Payments by cards	n.a.	n.a.	n.a.	n.a.
Paperless credit transfers	3,257,905	5,745,395	5,024,869	4,198,925
Direct debits	**…**	40,653	257,411	731,227

Source: National Bank of Georgia.

TABLE A9: INDICATORS OF USE OF VARIOUS CASHLESS PAYMENT INSTRUMENTS
(value of transactions, in GEL million)

	2001	*2002*	*2003*	*2004*
Payments by cards	n.a.	n.a.	n.a.	n.a.
Paperless credit transfers	5,178.1	9,227.0	12,354.8	20,038.9
Direct debits	**…**	7.3	152.3	331.3

Source: National Bank of Georgia.

TABLE A10: PAYMENT INSTRUCTIONS HANDLED BY SELECTED INTERBANK TRANSFER SYSTEMS
(volume of transactions)

	2000	*2001*	*2002*	*2003*	*2004*
Large value system (NBG's RTGS)					
in domestic currency	n.a.	3,257,905	5,786,048	5,282,280	4,930,152
in foreign currency	…	…	…	…	…

Source: National Bank of Georgia.

TABLE A11: PAYMENT INSTRUCTIONS HANDLED BY SELECTED INTERBANK TRANSFER SYSTEMS
(value of transactions, in GEL million)

	2000	*2001*	*2002*	*2003*	*2004*
Large value system (NBG's RTGS)					
in domestic currency	n.a.	5,178.1	9,227.0	12,354.9	20,038.9
in foreign currency	…	…	…	…	…

Source: National Bank of Georgia.

TABLE A12: SECURITIES AND ACCOUNTS REGISTERED IN CENTRAL SECURITIES DEPOSITORIES

	2000	2001	2002	2003	2004
GCSD					
Number of securities registered	269	282	282	278	299
Number of participants	37	37	34	25	16
Number of accounts	456	1 376	1 840	2 140	2 683
Number of foreign investors	3	7	13	18	47

Source: Georgian Central Securities Depository.

TABLE A13: SECURITIES HOLDINGS IN CENTRAL SECURITIES DEPOSITORIES
(in GEL million)

	2000	*2001*	*2002*	*2003*	*2004*
GCSD					
Government Securities	39.00	68.00	250.00	226.00	138.00
Corporate Shares (book value)	9.05	44.53	22.01	13.34	44.90
Memorandum Item:					
Market Capitalization	n.a.	n.a.	n.a.	n.a.	n.a.
Government Securities	-	-	-	-	11.58
Corporate Shares	64.88	184.02	218.40	449.88	335.53

Sources: Georgian Central Securities Depository and National Bank of Georgia.

TABLE A14: TRANSFER INSTRUCTIONS HANDLED BY SECURITIES SETTLEMENT SYSTEMS
(volume of transactions, in millions)

	2000	*2001*	*2002*	*2003*	*2004*
GCSD					
Government Securities	0.0	0.0	0.0	0.0	0.003
Corporate Shares	10.39	24.59	42.74	18.83	52.10

Source: Georgian Central Securities Depository.

TABLE A15: TRANSFER INSTRUCTIONS HANDLED BY SECURITIES SETTLEMENT SYSTEMS
(value of transactions, in GEL million)

	2000	*2001*	*2002*	*2003*	*2004*
GCSD					
Government Securities	0.0	0.0	0.0	0.0	0.001
Corporate Shares	17.35	67.94	18.87	5.06	144.64

Source: Georgian Central Securities Depository.

TABLE A16: PARTICIPATION IN SWIFT BY DOMESTIC INSTITUTIONS

	2000	*2001*	*2002*	*2003*	*2004*
Domestic SWIFT users	20	20	20	20	20
Of which					
Members	19	19	20	20	19
Sub members	1	1	0	0	1
Participants					
Worldwide SWIFT users	7,125	7,199	7,466	7,527	7,667
Of which					
Members	3,542	3,847	4,006	4,085	4,224
Sub members	2,978	3,027	3,079	3,051	3,019
Participants	605	325	381	391	424

Source: SWIFT.

TABLE A17: SWIFT MESSAGE FLOWS TO/FROM DOMESTIC USERS

	2000	*2001*	*2002*	*2003*	*2004*
Total messages sent	71,440	90,677	106,735	119,663	143,368
Of which					
Category I	37,717	50,404	64,112	75,532	91,825
Category II	9,564	10,648	12,231	11,903	12,793
Total messages received	144,661	173,981	190,067	210,283	251,818
Of which					
Category I	48,929	66,524	75,812	84,515	111,646
Category II	4,639	5,433	5,269	4,143	4,662
Global SWIFT sent traffic	1,274,856,642	1,533,906,047	1,817,443,994	2,047,564,360	2,299,074,199

Source: SWIFT.

SERIES B

TABLE B1: NUMBER OF FINANCIAL ENTITIES

	2000	2001	2002	2003	2004
Commercial Banks [3]	30	27	25	23	21
Non-Bank Depository Institutions(Credit Unions)			5	42	50
Insurance Companies	16	21	24	22	16

Source: National Bank of Georgia.

TABLE B2: ASSETS

(year end, in GEL million)

	2000	2001	2002	2003	2004
Commercial banks - Total assets	765	880	1,116	1,336	1,373
Commercial Banks – Net Loans	402	447	588	731	900

Source: National Bank of Georgia.

TABLE B3: DEPOSITS

(year end, in GEL million)

	2000	2001	2002	2003	2004
Demand deposits	171	226	235	353	524
Time deposits	141	161	224	344	425

Source: National Bank of Georgia.

TABLE B4: EQUITY

(year end, in GEL million)

	2000	2001	2002	2003	2004
Commercial Banks	230	272	297	353	373

Source: National Bank of Georgia.

TABLE B5: EQUITY MARKETS NUMBER OF FINANCIAL ENTITIES
(year-end, in GEL million)

	2001	2002	2003
GSE Aggregate Market Cap.(M GEL)	187	217	442
GSE Aggregate Trading volume.(M GEL)	11	5	0.6
Change y-o-y		-54,0%	-87,7%
GSE Trading Volume/Market Cap	6,0%	2,4%	0,1%
Stocks traded on the GSE	94	93	73

Source: Galt &Taggart Securities.