



## UKRAINIAN ASSOCIATION OF INVESTMENT BUSINESS

03150, Kyiv, 28 Predslavynska St., of. 304

Tel./fax +38 044 528 72 66, 528 72 70

e-mail – [office@uaib.com.ua](mailto:office@uaib.com.ua)

[www.uaib.com.ua](http://www.uaib.com.ua)

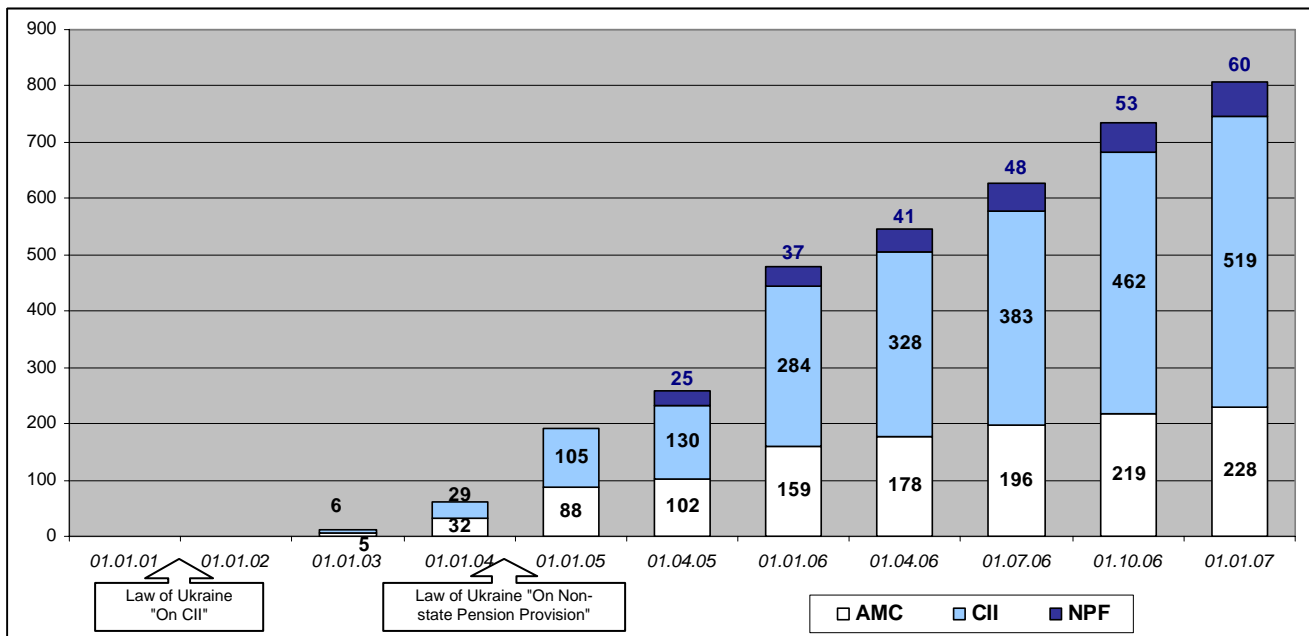
### The Collective Investment Market Development in Ukraine in 2006

2006 became a year of an active development of the collective investment market. The number of market entities and market volume value indicators were growing at high speed. Considerable achievements were demonstrated by the market also in terms of asset management quality.

In 2006, the Securities and Stock Market State Commission (hereinafter – the SSMSC) issued sixty nine licenses for the management of institutional investors' assets to new companies. Compared to the previous year, this indicator remained almost unchanged, though taking into account the number of issued by the UAIB by the end of 2006 Applications for license issue (eighty three), the number of new companies went up by almost seventeen per cent. The number of institutional investors, whose assets were managed by AMC, was growing even faster. Over 2006, the number of CII increased by 235 and amounted to 519 investment funds (growth of 82,75%). The number of registered non-state pension funds in 2006 went up by 79 (growth – 46,3%). Out of them, as of the end of 2006, sixty funds concluded agreements for asset management.

Therefore, as of **31.12.06**, there were already **228 companies in operation in Ukraine that managed assets of 579 institutional investors.**

Collective investment market development dynamics is shown on Chart 1.



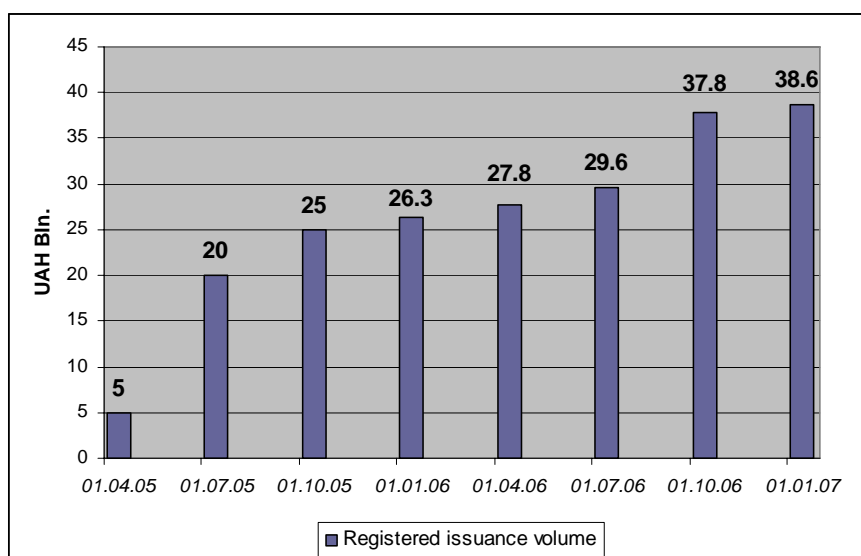
**Chart 1. Ukrainian collective investment market development dynamics since 01.01.01 through 01.01.07**

By the types of CII, the collective investment market was subdivided as follows (see Table 1).

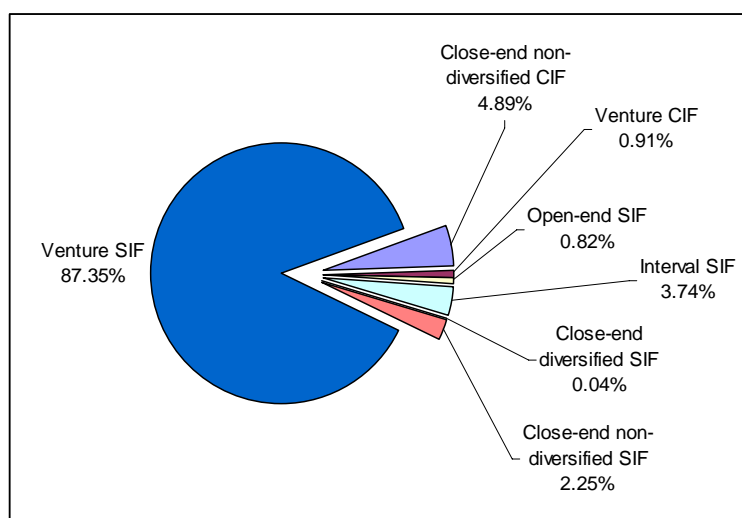
**Table 1. Ukrainian collective investment market development dynamics – by the types of funds**

Time period	Total	SIF					CIF	
		Open-end	Interval	Close-end diversified	Close-end non-diversified	Venture	Close-end non-diversified	Venture
01.01.2003	6		2			3		1
01.01.2004	29		6			20	1	2
01.01.2005	105	1	17	1	6	68	4	8
31.12.2005	284	4	19	3	20	199	20	19
31.03.2006	328	4	19	2	22	229	29	23
30.06.2006	383	5	21	2	26	274	29	26
30.09.2006	462	8	28	3	27	331	37	28
31.12.2006	519	10	25	3	29	377	42	33

The volume of registered CII securities' issuances grew by 46,7% over 2006, having attained at year end the amount of UAH 38,6 bln. (Chart 2). The greatest share within the issuances announced, just as within the breakdown of funds by types, belonged to venture funds – over 88% (see Chart 3).

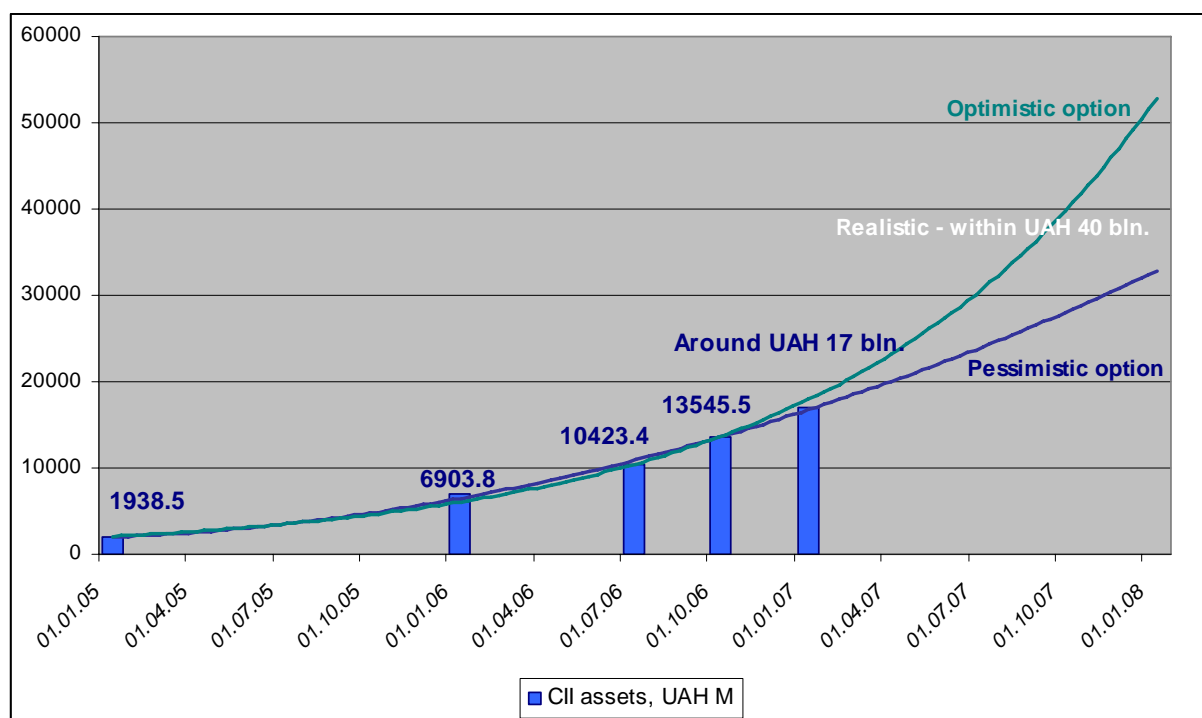


**Chart 2. CII securities' registered issuance growth rate in 2005-2006**



**Chart 3. Breakdown of the announced issuances of CII by the types and categories of funds as of 31.12.2006**

The real value of investment funds' assets as of 31.12.06 exceeded UAH 17 bln. The growth for 2006 comprised about 180%. If such situation continues in 2007, we could forecast the amount of the CII assets reaching UAH 40 billion by the current year end (Chart 4).



**Chart 4. CII assets dynamics over the period since 01.01.05 through 01.01.07, and forecasted CII asset amount as of 2007 end**

For the Ukrainian economy it is a fairly high growth rate. If in 2005 CII net assets comprised only 1,17% within the GDP structure, in 2006 the collective investment market's NAV reached volumes equivalent of 2,6% of the nominal Ukrainian GDP (see Table 2).

**Table 2. CII net asset value share within GDP structure**

Year	UAH M		Share of CII NAV within GDP, %
	GDP	CII NAV	
2005	418 529	4 898.0	1.17%
2006	537 667	13 926.3	2.59%

Therefore, the collective investments market becomes more and more powerful segment of the national financial market.

Continuing the analysis of CII performance in 2006, we would like to note that, as of 1 January 2007, out of 519 listed in the CII Registry investment funds only 351 investment funds complied with the standards set forth by the SSMSC. And only 338 funds (or 96,3%) of them filed annual reports with the UAIB in timely manner. Therefore, further analysis of the collective investment market will be performed on the basis of the reporting data of 338 investment funds. Their breakdown by categories looks as follows:

- Venture funds – 269 funds
- Close-end (non-venture) - 47 funds
- Interval – 17 funds

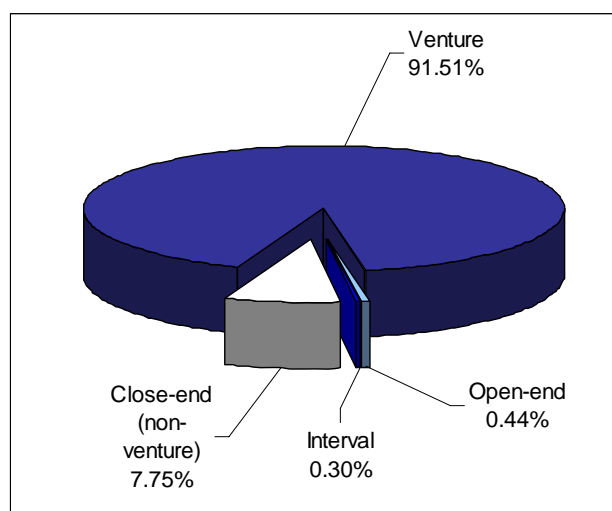
- Open-end – 5 funds.

Quantitative prevalence of venture funds also manifested itself in value indicators (see Table 3 and Chart 5).

**Table 3. CII net asset value dynamics over the period since 01.01.2005 through 01.01.2007, by the types of funds**

	01.01.2005	01.01.2006	01.01.2007	Annual growth
Open-end	3 382 607,20	27 962 024,88	61 959 356,88	121,58%
Interval	24 031 604,63	31 269 389,19	41 425 109,81	32,48%
Close-end (non-venture)	88 722 052,76	341 048 199,78	1 079 164 134,64	216,43%
Venture	1 406 520 887,51	4 497 762 161,99	12 743 714 610,58	183,33%
Total	1 522 657 152,10	4 898 041 775,84	13 926 263 211,91	184,32%

(UAH)



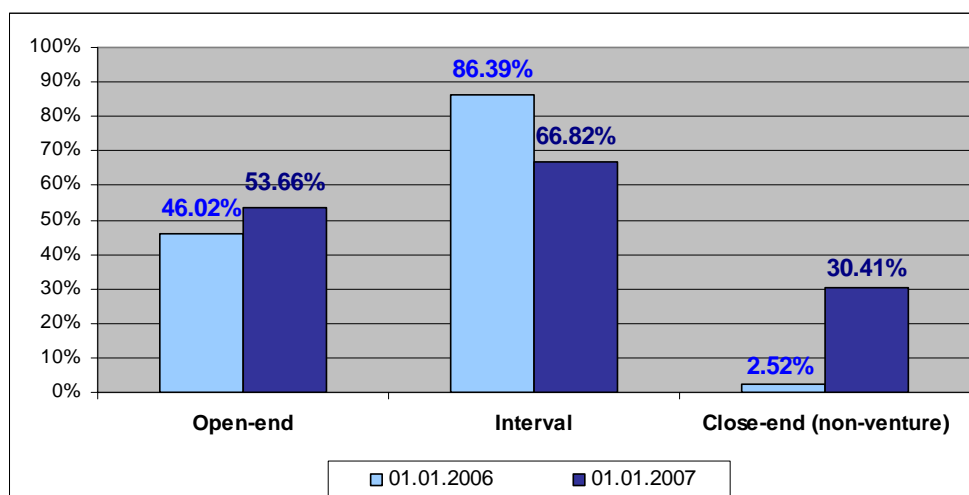
**Chart 5. CII NAV breakdown by the types of funds as of 31.12.06**

It should be pointed out that the non-venture segment of the collective investment market is developing faster than the venture funds. If as of the end of 2004 non-venture CII's NAV comprised 7,63% of the total CII market NAV, in 2005 – 8,17%, as of the end of 2006 – already 8,49%. Unfortunately, only 0,74% of that volume was comprised by diversified CII.

Positive changes occurred also in the volumes of natural persons' contributions into investment funds. Against the background of the entire market, there changes were not significant: net assets belonging to natural persons as of the end of 2006 comprised 2,79% of the total NAV (as of 31.12.05 this indicator amounted to 0,99%). The same picture is observed if we compare the volumes of moneys placed by natural persons into investment funds and on bank deposits – the gap of 275 times (Table 4). However, noticeable changes can be seen in case of the funds that are allowed to work with citizens. During 2006, the volumes of natural persons grew eight times, in the meanwhile, the net assets of non-venture funds increased only three times. The greatest growth was provided by close-end investment funds, where participation of natural persons increased from 2,52% to 30,41% over 2006 (see Chart 6).

**Table 4. Net assets of investment funds belonging to citizens and deposits of natural persons, as of 31.12.2006**

Date	CII NAV, UAH M	CII NAV belonging to citizens, UAH M	Share of CII NAV belonging to citizens within the total net asset value	Citizens' deposits, UAH M	Excess of deposits over CII contributions, times
01.01.2007	13 926,3	389,13	2,79%	106 885,0	275



**Chart 6. Dynamics of the natural persons' share within non-venture CII NAV structure over 2006**

The key reason for more active participation of citizens in investment funds was a high profitability of the latter compared to alternative investment directions. An average profitability of non-venture investment funds was 35,43%.

On the whole, an average market profitability amounted to 39,96% (see Table 5). The leader, just as a year ago, became the venture funds' segment with the profitability of 40,36%. The worst result was demonstrated by interval CII: their profitability comprised 14,96%.

*Note: funds' profitability should not be equated to their rate of return. The former indicator characterizes an overall result of the fund's operation, and the latter – the result of investments for the investor. Taking into account that different funds have different investment strategies, it is not expedient to determine the rates of return of different categories of funds and compare them.*

**Table 5. CII profitability in 2006**

	Profit, UAH	Assets_2005, UAH	Assets_2006, UAH	Profitability
Open-end	10 714 596,78	28 007 331,55	62 035 781,70	23,80%
Interval	5 616 621,66	32 776 712,36	42 296 999,94	14,96%
Close-end (non-venture)	307 535 341,97	388 025 237,63	1 274 932 376,97	36,99%
Venture	4 141 042 447,87	5 650 137 181,46	14 868 018 246,12	40,36%
Total	4 464 909 008,28	6 098 946 463,00	16 247 283 404,73	39,96%

High profitability rate of investment funds allowed them to expand their share within the profit from ordinary activities of Ukrainian companies and organizations from 3,4% in 2005 to 5,9% in 2006 (see Table 6).

**Table 6. Breakdown of Ukrainian companies and organizations' pre-tax profit from ordinary activities in 2005-2006**

Year	Pre-tax profit from ordinary activities, UAH M		CII profit share within the total profit of Ukrainian companies and organizations, %
	Total for the economy	CII	
2005	57 619,30	1 939,00	3,37%
2006	70 236,80	4141,04	5,90%

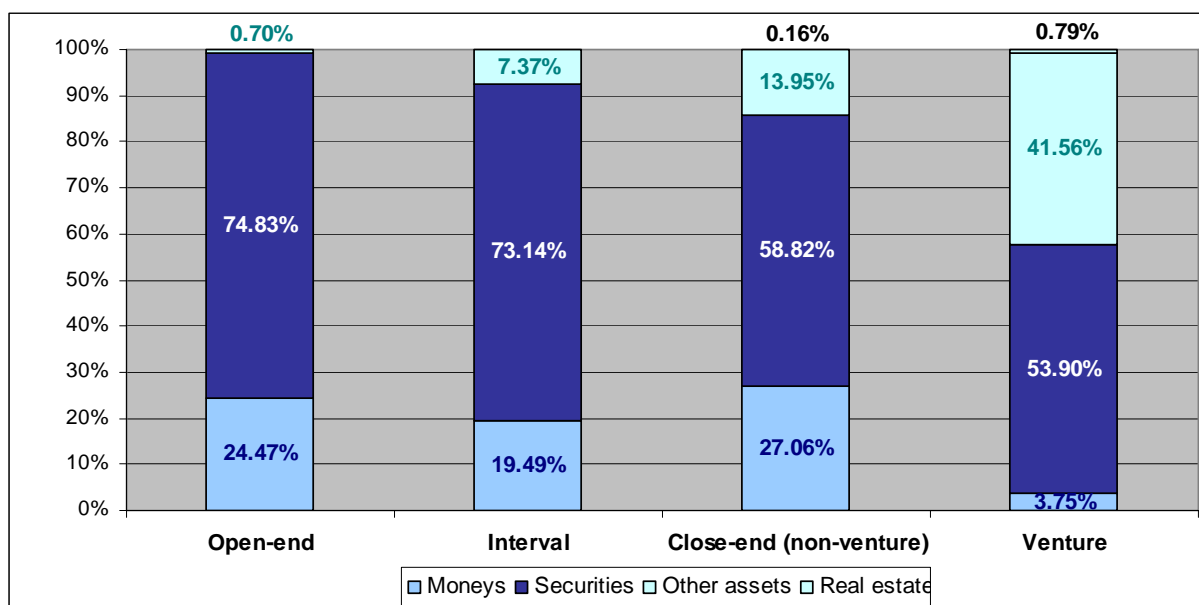
Analyzing the structure of CII investment portfolios, we should note that around 55% of the collective investment market assets was invested into securities (see Table 7).

**Table 7. CII asset structure, by the types of funds**

(UAH M)

	Moneys	Securities	Other assets	Real estate	Total
Open-end	15,18	46,42	0,43	0,00	62,04
Interval	8,24	30,94	3,12	0,00	42,30
Close-end (non-venture)	345,04	749,94	177,89	2,07	1 274,93
Venture	556,91	8 014,20	6 179,47	117,44	14 868,02
Total	925,38	8 841,50	6 360,90	119,50	16 247,28

The best result by the share of securities within CII portfolio was demonstrated by open-end funds, where securities comprised 74,8% (see Chart 7).



**Chart 7. CII asset structure by the types of funds, as of 31.12.06**

A substantial share of other assets within the structure of an aggregate investment portfolio of venture funds is due to the placement of those funds' assets into company corporate rights not in the form of securities, as well as to the presence of receivables.

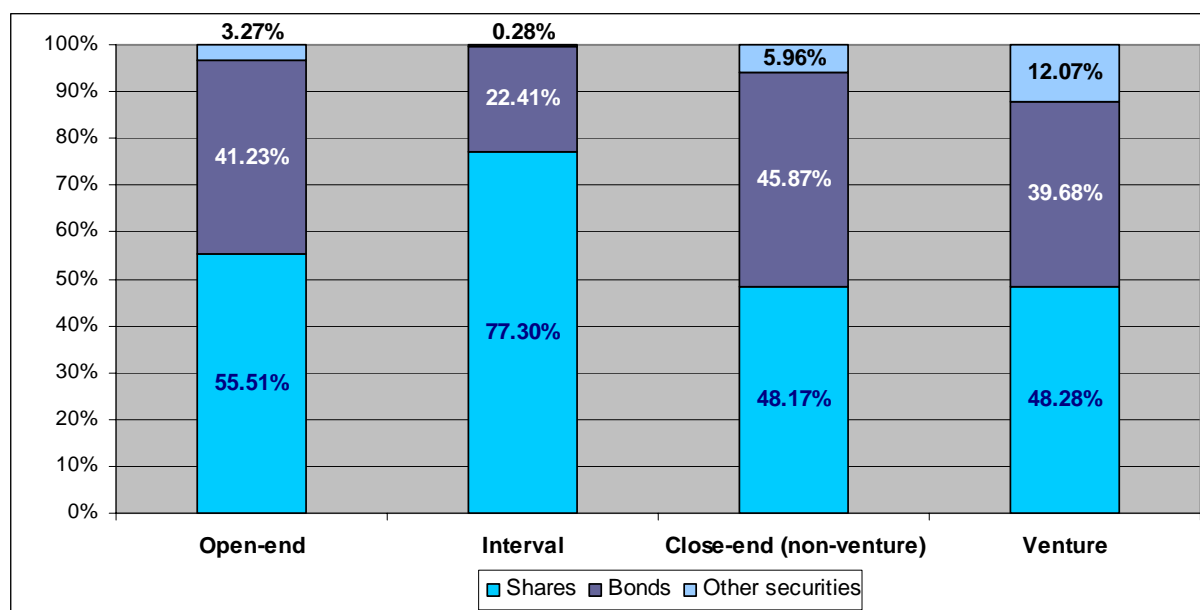
The major share of the investments into securities are the investments into shares – 48,41% of the investments into securities’ value, or 26,34% of the total value of the funds’ investment portfolio. In cash equivalent, the investments into shares amounted to UAH 4 280,3M as of the end of 2006 (see Table 8).

**Table 8. CII securities’ portfolio structure as of 31.12.06**

(UAH M)

	Shares	Promissory notes	Government bonds, internal	Municipal bonds	Corporate bonds	Savings certificates	Other securities	Total
Open-end	25,77	1,52	2,31	4,43	12,40	0,00	0,00	46,42
Interval	23,91	0,09	0,48	1,28	5,17	0,00	0,00	30,94
Close-end (non-venture)	361,23	26,68	0,00	21,45	322,58	18,00	0,00	749,94
Venture	3 869,39	923,08	0,00	0,01	3 177,09	42,00	2,62	8 014,20
Total	4 280,31	951,36	2,79	27,17	3 517,25	60,00	2,62	8 841,50

As it can be seen from Chart 8, shares are most trusted by interval CII, 77,3% of whose securities’ portfolio consists of shares.



**Chart. 8. CII securities portfolio structure by the types of funds, as of 31.12.06**

An object-based concentration of CII investments was also in favor of shares. As it can be seen from Table 9, the greatest share of moneys investment funds invested into *Spetskhimash* Company shares - UAH 300,5M (as of 31.12.06).

**Table 9. Ten most attractive issuers by the amount of CII investments, as of 31.12.06**

Security type	Category	Issuer	Value of securities included into CII assets, UAH
Shares	Common registered	<i>Spetskhimmash</i> – OJSC, whose shares are traded on USE and DSE; shares are held by 3 CII	300 521 013,40
Corporate bonds	Non-interest bearing registered	<i>Vyrobnychiy Viector</i> LLC – private placement	252 415 236,82
Shares	Common registered	<i>Sumy Machine-Building Science and Production Complex named after M.V.Frunze</i> – OJSC, whose shares are traded on PFTS; shares are held by 24 CII	220 486 494,20
Corporate bonds	Non-interest bearing registered	<i>TMO LIKO-HOLDING</i> LLC – private placement	193 230 164,48
Shares	Common registered	<i>Dogmat Ukraine</i> – CJSC, whose shares are held by 1 CII	170 297 000,00
Shares	Common registered	<i>YUGTRANS</i> (South Transport) OJSC, whose shares are traded on DSE: its shares are held by 2 CII	136 736 297,10
Shares	Common registered	<i>Ukrenergoatom</i> – OJSC, whose shares are traded on PFTS; shares are held by 8 CII	130 313 949,78
Shares	Common registered	<i>Turboatom</i> – OJSC, whose shares are traded on PFTS; shares are held by 5 CII	126 617 896,55
Corporate bonds	Interest-bearing registered	<i>Metallurgical Center</i> LLC – private placement	119 606 640,00
Corporate bonds	Interest-bearing registered	<i>Kyiv Securities Group</i> LLC – private placement	111 400 000,00

According to the rating of attractiveness of investments based on the number of investment funds that hold securities of respective funds in their portfolios, the first place went to *Ukrnafta* - 45 CII invested into the shares of that company (see Table 10).

**Table 10. Ten most attractive issuers by the number of investment funds that hold their securities in the portfolios, as of 31.12.06**

Security type	Category	Issuer	Number of CII that hold respective securities in their portfolios
Shares	Common registered	<i>Ukrnafta</i>	45
Shares	Common registered	Ukrtelecom	34
Shares	Common registered	Illicha Mariupol Metallurgical Works	31
Shares	Common registered	<i>Azovstal</i> Metallurgical Works	30
Shares	Common registered	Nyzhniodniprovsky Pipe-Rolling Plant	25
Shares	Common registered	Sumy Machine-Building Science and Production Complex named after M.V.Frunze	24
Shares	Common registered	Concern <i>Styrol</i>	23
Shares	Common registered	<i>Luhanskteplovoz</i> Holding Company	23
Shares	Common registered	<i>Azov</i>	22
Shares	Common registered	<i>Zakhidenergo</i>	21

The level of a fund's costs is one of the major factors that affect the competitiveness of particular entity, as well as of the market on the whole. CII performance analysis demonstrated that during 2006 there were positive changes in cost amounts. In terms of quantity, the cost amount almost tripled – from UAH 24,5M in 2005 to UAH 68,4M in 2006 (we remind you that the number of CII grew 1,8 times). At the same time, the quality of cost management improved: in 2005 costs comprised 0,77% of an average annual CII net assets value, and in 2006 – 0,697%. Within the cost structure, just as a year ago, the greatest share belongs to the fees paid to AMC– 75,1% (UAH 51,4M). In the past, that indicator comprised 68,2% of the total cost amount (UAH 16,7 M). Other most important CII cost elements are presented in Table 11.

**Table 11. CII cost structure, by the types of funds in 2006**

Cost item	Open-end		Interval		Close-end (non-venture)		Venture		Total	
	Share within NAV structure	Share within cost structure	Share within NAV structure	Share within cost structure	Share within NAV structure	Share within cost structure	Share within NAV structure	Share within cost structure	Share within NAV structure	Share within cost structure
Fee to CII AMC	2,52%	86,89%	2,79%	76,67%	1,42%	69,76%	0,465%	75,57%	0,524%	75,08%
Fee to securities trader	0,19%	6,57%	0,05%	1,37%	0,407%	19,93%	0,033%	5,37%	0,050%	7,17%
Costs related with securities circulation servicing		0,00%	0,03%	0,94%	0,001%	0,07%	0,043%	6,99%	0,041%	5,87%
Fee to CII custodian	0,04%	1,27%	0,13%	3,50%	0,06%	2,76%	0,015%	2,40%	0,017%	2,44%
CII banking costs		0,39%	0,02%	0,63%	0,012%	0,60%	0,016%	2,53%	0,015%	2,21%
<b>Total costs</b>	<b>2,90%</b>		<b>3,64%</b>		<b>2,040%</b>		<b>0,615%</b>		<b>0,697%</b>	

Along with the main fee, AMC received additional remuneration for quality asset management in the form of:

- Premiums – UAH 2,8M (0,09% of an average annual CII NAV);
- Bonuses calculated as a difference between the costs of the funds' assets' acquisition and the proceeds from their sale – UAH 48,0M (0,49% of an average annual CII NAV).

Therefore, the total amount of AMC fees in 2006 comprised almost UAH 120M. The greatest profits were generated by the AMC that had been operating in the market for a while, had regular clients and demonstrated themselves as efficient management companies.

AMC consolidated balance sheet structure analysis demonstrated their generally stable financial position. On the other hand, AMC assets consisted mainly of financial investments, the real value of which under current circumstances is fairly hard to evaluate.

**Table 12. Consolidated balance sheet of asset management companies as of 31.12.06**

Item	Amount, UAH	Share in balance sheet total
<b>Assets</b>		
Fixed assets	30 510 270,55	1,24%
Long-term financial investments: equity method	210 510 018,31	8,59%
Long-term financial investments: other financial investments	332 259 637,37	13,56%
<i>Total for section I</i>	601 348 873,60	24,54%
Accounts receivable	206 590 273,53	8,43%
Short-term financial investments	1 198 068 579,92	48,88%
Cash and equivalents: national currency	151 995 865,62	6,20%
Cash and equivalents: foreign currency	19 086 159,40	0,78%
<i>Total for section II</i>	1 846 687 049,65	75,35%
<i>Total assets</i>	2 450 936 586,34	100,00%
<b>Liabilities and Owners' Equity</b>		
Statutory and unit capital	1 499 328 195,68	61,17%
Retained earnings	243 415 131,87	9,93%
<i>Total for section I</i>	1 745 397 570,57	71,21%
<i>Long-term liabilities</i>	113 100 269,04	4,61%
<i>Short-term liabilities</i>	590 622 109,69	24,10%
<i>Total owners' equity and liabilities</i>	2 450 936 586,34	100,00%

One of the key indicators characterizing reliability of an AMC is the ratio of assets managed to owners' equity. As it can be seen from Table 13, on average, assets managed equal to tenfold AMC owners' equity amount. Such proportion of assets managed and owners' equity allows to say that the level of reliability of the collective investment market is acceptable. Furthermore, comparing the standards set forth by the SSMSC (non-venture CII assets may not exceed AMC owners' equity fiftyfold) to the performance of non-venture CII (see Table 14), one can notice that companies do comply with that standard and have a great potential to increase the volumes of assets that they could manage.

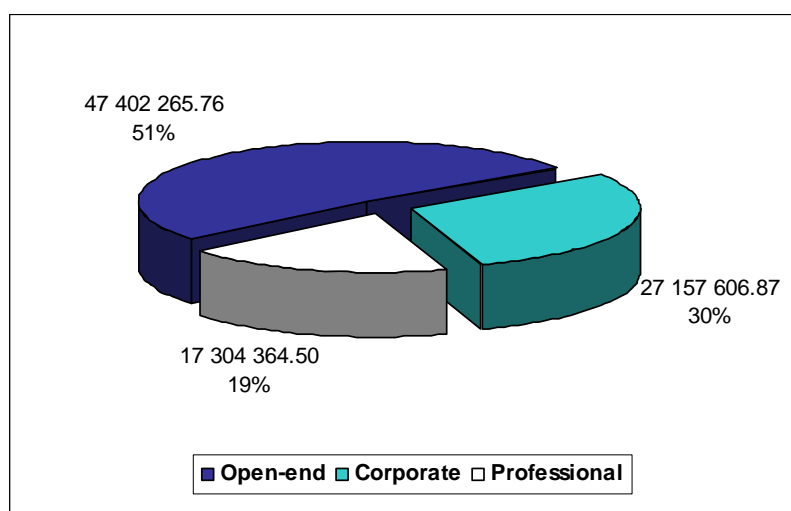
**Table 13. Comparison of combined indicators of AMC owners' equity amount and assets managed by AMC, as of 31.12.06**

Owners' equity	Assets managed	Ratio of owners' equity to assets managed
1 745 397 570,57	17 299 396 747,26	9,9

**Table 14. Comparison of combined indicators of the non-venture CII assets managed by AMC and the owners' equity of those AMC, as of 31.12.06**

Owners' equity	Assets managed	Ratio of the assets managed by non-venture CII to the owners' equity amount (according to SSMSC requirements)
460 323 712,63	1 379 265 159,0	3,0

As for the non-state pension provision market, here also quantitative increase is yet to be followed by a qualitative improvement. As of 31.12.06, NPF assets managed by AMC amounted to UAH 117,3M. The breakdown of that amount by fund categories is presented in Chart 9 below.

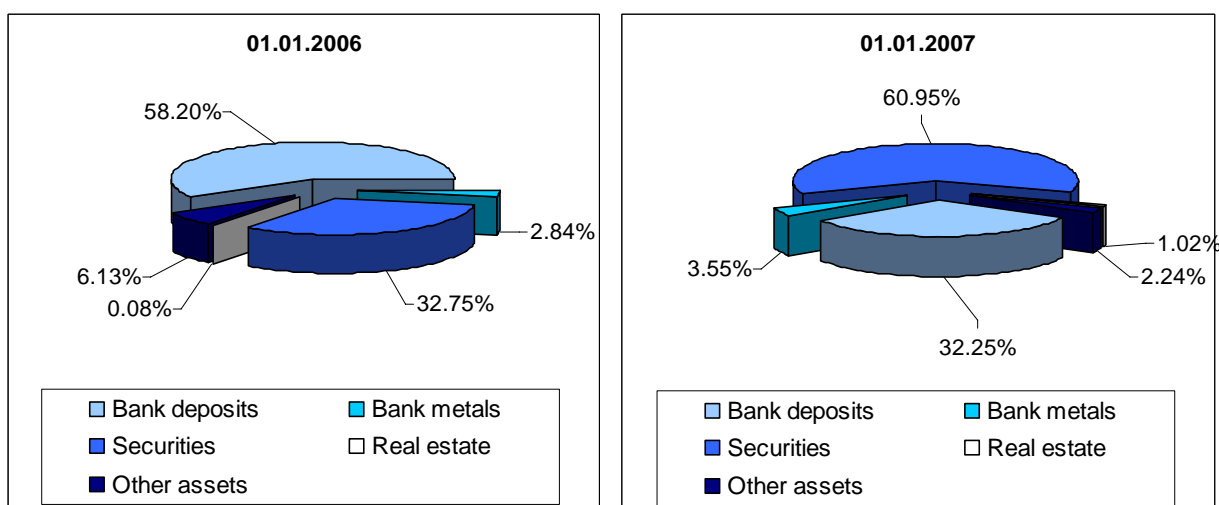


According to the information of Derzhfinposlug, as of 31.12.06 NPF assets comprised UAH 144,3M, in other words, 81,3% of the aggregate NPF market assets were managed by AMC-UAIB members.

**Chart 9. Breakdown of NPF assets by the types of funds, as of 01.01.07, UAH**

In the meanwhile, an analysis of the reporting of non-state pension funds demonstrates an improving quality of diversification, as well as a gradual transition of pension funds to the asset structure set forth by the legislation and investment declarations.

To this end in particular, it is enough to compare the structure of consolidated NPF portfolios in 2005 and 2006.



**Chart 10. Consolidated NPF portfolio structure in 2005 and 2006**

Diversification quality improvement is restrained by an insufficient number of financial instruments of investment class, as well as by small asset volumes of pension funds having problems with purchasing securities in the tranches offered in the stock market.

Collective investment's prospects are tied to the pension reform progress. The latter could not only give an impetus to the collective investment market, but also promote securities market development, considerably increase investments into the real sector of the economy, and reduce distortions in pension amounts. For CII, it could also provide an opportunity to fairly quickly improve qualifications of management companies, ensure presence of due material resources, and address other burning problems.

In case of a launch of the second pillar (savings) of the pension system, even during the first year of its existence more than UAH 2 bln. will arrive to the collective investment market, which is fifty times more than all NPF resources accumulated as of today (Table 15). In addition to that, in the nearest future the State is planning to establish a professional pension fund for the budget sector employees, which, according to expert forecasts, will bring additional UAH 4 bln. to the market during the first year of its operation. After that, a multiplier of these savings' growth progression will work.

As a result, the volume of investment resources concentrated in non-state pension funds may increase hundreds of times.

**Table 15. Dynamics of the annual volume of insurance contributions to the Retirement Savings Plan after introduction of the second pillar of the defined contribution pension system**

Indicator	2009	2010	2011	2012	2013	2014	2015
Annual volume of insurance contributions to the Retirement Savings Plan, UAH bln.*	2,813	5,129	8,219	12,16	17,077	23,046	26,31

\* The volume of insurance contributions to the Retirement Savings Plan was calculated based on the rate of contributions in 2009 - 2%, in 2010 - 3%, in 2011 - 4%, in 2012 - 5%, in 2014 - 6%, in 2015 and further on - 7%

Under such circumstances, the collective investment market development will become even more dependent on the organized stock market development. An increase of stock market volumes, transfer of transactions from non-organized market to the organized one, and improvement of the quality of work of stock exchanges, registrars, custodians and depositories, will ensure reliability and profitability of collective investment market transactions. In such situation, collective investment market participants need to step over the bounds of their narrow-departmental interests, start active lobbying of laws and new rules of work in the stock market, which, in their turn, will ensure quality investment activities.

Therefore, the analysis performed demonstrates that the collective investment market is continuing to develop and improve its results. Clearly, there are a lot of problems that need to be addressed. A constructive dialogue among the market participants and SROs that represent their interests on the one hand, and of the executive and legislative branches of the government on the other, is required to solve them successfully.