

# Annex 2.2:

## Legal transition indicators

The EBRD conducted a Legal Indicator Survey (LIS) for the eighth consecutive year in 2002 to measure progress in legal reform in central and eastern Europe and the Commonwealth of Independent States, as viewed by local lawyers. The EBRD's Office of the General Counsel has developed measures to assess the extent to which key commercial and financial laws have reached internationally acceptable standards (extensiveness) and the degree to which these laws are implemented and enforced (effectiveness). The survey can also be used to analyse the perceived role of legal reform in promoting investment and growth in the region.

The results of this year's LIS reflect how lawyers and other experts familiar with the region perceive the state of commercial and financial legal reform in 2002.<sup>1</sup> These perceptions do not always correspond directly with the written legislation or regulations that exist in the various jurisdictions. Table A.2.2.1 provides an assessment of commercial laws, including pledge, bankruptcy and company law. Table A.2.2.2 provides an assessment of banking and capital markets laws.

The LIS results presented in the tables assess perceptions of legal reform in terms of both the extensiveness of legal reform and its effectiveness.<sup>2</sup> For commercial law, extensiveness measures the impact of the jurisdiction's pledge, bankruptcy and company law on commercial transactions.<sup>3</sup> For financial markets, extensiveness assesses whether banking and capital market legal rules approach minimum international standards, such as the Basel Committee on Banking

Supervision's Core Principles or the Objectives and Principles of Securities Regulation developed by the International Organisation of Securities Commissions (IOSCO). Effectiveness of legal reform measures the degree to which commercial and financial legal rules are clear, accessible and adequately implemented, both administratively and judicially.

Extensiveness indicators must be read in conjunction with effectiveness indicators to reach a more complete understanding of how legal reform appears to be progressing in any jurisdiction. Countries that exhibit a high extensiveness indicator in conjunction with a low effectiveness indicator reveal that, while the relevant legislation may be viewed as broadly in line with international standards, poor implementation may be preventing the proper utilisation of the legislation. For example, Azerbaijan and FYR Macedonia have had persistent and significant gaps between extensiveness and effectiveness for their commercial laws while Armenia and Georgia have significant gaps in their financial market indicators this year. These gaps indicate that relatively extensive laws are not perceived as being properly applied or enforced. When such gaps are extremely large, the value of extensive substantive legal reforms may be negated through poor implementation.<sup>4</sup>

The legal indicators reflect the subjective assessments of survey respondents as well as the views of EBRD lawyers with experience in working on commercial and financial transactions in the region. For a few countries the LIS respondents provided a wide range of assessments. In

these cases or where there were significant gaps between the extensiveness and effectiveness indicators, the EBRD's in-house knowledge of that country's legal system was utilised to take an overall assessment of the differing views. The LIS should not be considered a stand-alone tool for measuring legal reform. It is intended to supplement other forms of data. Accordingly, while the purpose of the LIS and the resulting analysis is to provide an impression of how local lawyers perceive the quality of laws and how well these laws work in practice, some caution must be exercised in interpreting the results.<sup>5</sup>

### Results of the LIS 2002

In 2001, LIS respondents noted for the first time that the effectiveness of legal reforms had improved for the majority of survey countries in both commercial law and in financial markets. As a result, the implementation gap between extensiveness and effectiveness indicators that the survey has consistently revealed began to close in both legal sectors. In 2002 this trend continued but to a lesser degree. The average implementation gap for commercial law decreased somewhat while the average gap remained relatively stable for financial markets.

For commercial law, a few large decreases in Armenia, the Czech Republic, Poland and the Slovak Republic accounted for a large part of the average change. The narrowing of the implementation gap in commercial law was due as much to a reduction in the extensiveness indicators as it was to increasing effectiveness. In 2002, 13 countries experienced a

<sup>1</sup> The survey was made available to respondents in both English and Russian.

<sup>2</sup> The scores for commercial law and financial markets are aggregate indicators that do not segregate the individual subject areas surveyed (e.g. commercial law results are not further broken down into pledge, company, bankruptcy etc). More in-depth analysis of the LIS sector indicators and data is presented in the EBRD's legal journal *Law in transition*, published by the EBRD's Office of the General Counsel.

<sup>3</sup> The LIS secured transactions questions focus on the ability of parties to contract for non-possessory pledges in movable property, to protect their pledges through registration in a centralised collateral registry and to enforce their pledges effectively. The LIS company law questions focus on the ability of parties to form a joint-stock company and for shareholders to effectively enforce their rights with respect to management and majority owners, and the accountability of directors and company management. The LIS bankruptcy questions focus on the ability of creditors to pursue insolvency proceedings and to utilise reorganisation and liquidation procedures in the event of an enterprise's insolvency.

<sup>4</sup> The EBRD factors in significant gaps between extensiveness and effectiveness when developing the legal indicators for each country.

<sup>5</sup> The EBRD endeavours each year to achieve as broad a response as possible for each country. In certain circumstances, the political situation in a country or a lack of available practitioners with the requisite qualifications has created a lower response rate. Those countries with less than four responses to the 2002 LIS were Albania, Armenia, Belarus, Bosnia and Herzegovina, FYR Macedonia, the Kyrgyz Republic, Latvia, Tajikistan and Uzbekistan. Results for these countries should be interpreted with caution. No responses were received for Turkmenistan.

reduction in their commercial law extensiveness indicators while the same number maintained or increased commercial law effectiveness indicators. This paradox can be explained in many countries by practitioners' increasing familiarity with commercial laws, revealing shortcomings in the legislation. At the same time, improvements have continued to be made in implementation and enforcement.

In general, perceptions of banking and finance were less positive this year. This may reflect increasing use of banking laws as well as increasing frustration with bank failures, insolvencies and other problems in various jurisdictions. Albania, Azerbaijan, Belarus, Croatia, Lithuania, Moldova and Slovenia recorded lower scores this year for the extensiveness and effectiveness of financial markets. For each of these jurisdictions, there was a decline in banking indicators, sometimes accompanied by a smaller decline in perceptions of capital markets. In contrast to this downward trend, Latvia's ratings for financial markets improved significantly. It has amended its banking legislation and made minor changes to securities clearance and settlement rules. Latvia amended its laws on credit institutions in an effort to harmonise with the banking laws of the European Union.

In addition to these general trends, some countries were perceived as having changed significantly in certain sectors. Croatia experienced declines this year in both its commercial and financial markets. With respect to commercial law, the decline in extensiveness and effectiveness may relate to perceived delays in both court and administrative processes. For example, in its recent strategy paper for Croatia, the European Commission found that the courts and judiciary are in need of substantial reform.

Other countries in central eastern Europe and the Baltic states (CEB) continue to be perceived as having relatively strong laws compared with other sub-regions. The Czech Republic's extensiveness scores in commercial law (which had been declining) increased this year, perhaps reflecting a recent change to its Civil Code and pledge law (see below). In contrast, Poland's extensiveness scores continue

to decline. Although standards for corporate governance increased as a result of changes in Poland's Commercial Code in 2001, some commentators have noted that minority shareholders remain critical of shareholder safeguards. Poland's bankruptcy law continues to be perceived as inadequate, and there is some disagreement whether secured creditors receive the highest priority in a liquidation proceeding. The law was also the subject of a legal challenge in the Polish Supreme Court, which was asked for an interpretative ruling on the constitutionality of the existing law's punitive provisions (these were ultimately upheld).

Bosnia and Herzegovina was perceived as having made significant improvement in its commercial and financial markets, albeit from a low starting point. Although Bosnia and Herzegovina only received a 1 for the effectiveness of its financial markets, there was a substantial increase in perceptions relating to implementation of its laws. It also received an upgraded rating for commercial law extensiveness. In line with World Bank recommendations, Bosnia and Herzegovina adopted a new law on registered pledges and pledge registry.

## Developments in commercial law

### Civil and commercial codes

Several jurisdictions undertook major reforms of civil codes or procedural codes in 2002. Estonia adopted a new general part of its Civil Code that has an impact on the formation of contracts. Moldova also adopted a new Civil Code in April 2002, which replaces the 1964 Soviet-era Code. Judges and other legal experts have criticised the legislation, however. The version adopted by the Moldovan Parliament differs considerably from earlier versions that were commented on by interested parties. In response, the International Monetary Fund (IMF) has stated that future financing is conditional on the new Code being revised. Moldova's commercial law indicators improved slightly.

In Ukraine the Parliament approved new Civil and Commercial Codes in December 2001 but these were vetoed by the President. Ukraine's indicator for the

extensiveness of commercial law declined but its effectiveness rating increased slightly, leading to a smaller implementation gap for 2002. In contrast, earlier this year Lithuania adopted a new Code of Civil Procedure that is not due to enter into force until January 2003, leaving Lithuania's commercial law indicators virtually unchanged.

### Pledge law

While there have been several reforms to pledge law during the year, these have been accompanied by implementation problems, such as delays in the creation of a registry system or failure to repeal previous legislation.

The Czech Republic amended the Civil Code, Notarial Code and Civil Procedure Code regarding pledge law. The amendments make it possible to pledge certain objects and property rights, including movables, immovables and receivables. The Czech amendments also make it possible to pledge all the assets of an enterprise. Lawyers may have taken account of the potential benefits of these changes when assessing Czech pledge law. However, the effectiveness of these new pledges depends on whether the newly created Electronic Register of Pledges is well-implemented by the Czech Chamber of Notaries.

In Azerbaijan confusion among practitioners is the probable cause of a lower rating for pledge law. Azerbaijan's new Civil Code, which includes pledge provisions, came into force on 1 September 2001 but it did not revoke the earlier Law on Mortgages, leaving it unclear which law governs pledges. In addition, the Azeri Government has issued a Presidential decree covering the registration of pledges over some assets (for example, securities and immovables) but it has yet to establish a registration system for most movable property.

In Moldova, as of 30 July 2001, a newly enacted Pledge Law governs security over movable assets. The Moldovan legislation is intended to improve on previous provisions governing pledges in movable property, but plans to create a new registry system for pledges have stalled, leaving a legal vacuum. Pledges under the new

Table A.2.2.1

## Legal transition indicators: commercial law

Country	2002			2001		
	Overall	Extensiveness	Effectiveness	Overall	Extensiveness	Effectiveness
Albania	3	3	3	2+	2+	2
Armenia	3+	3+	3+	2+	3-	2
Azerbaijan	2	2+	2	3-	3	2
Belarus	3	3+	2	3	3	3
Bosnia and Herzegovina	3	3	3	2-	1+	2
Bulgaria	4-	4-	4	4-	4	4-
Croatia	3+	3+	3+	4-	4-	4-
Czech Republic	4-	4-	4-	3	3	3
Estonia	4-	4-	4	4-	3+	4
FR Yugoslavia	3	3	3	3+	3+	3
FYR Macedonia	3+	3+	4-	4-	3+	4-
Georgia	3-	3-	3-	3	3	3
Hungary	4-	4-	4-	4-	4-	4-
Kazakhstan	4-	4-	4-	4	4	4
Kyrgyz Republic	3+	3+	3+	na	na	na
Latvia	3+	4-	3+	4-	4-	4
Lithuania	4-	4-	4-	4-	4-	4-
Moldova	4-	4-	4-	4-	3+	4-
Poland	3+	3+	4-	3+	4-	3
Romania	4-	4-	4	4	4	4
Russia	3+	3	4-	3+	3	4-
Slovak Republic	3+	3	3+	3+	3+	3+
Slovenia	3+	3+	4-	4-	4-	4
Tajikistan	1+	2-	1	2	2	2
Turkmenistan	na	na	na	2+	2	3
Ukraine	3	3	3	3	3+	3
Uzbekistan	3-	2+	2+	3	3	3

Source: EBRD.

law are valid only if registered but the registry does not exist. Moldova's pledge extensiveness indicator has increased while its effectiveness indicator has decreased. Similarly, the Slovak Republic adopted a new set of Civil Code provisions in summer 2002, including wide-ranging changes in its pledge law. However, these changes came too late to be captured in the 2002 LIS.

### Bankruptcy

Very little bankruptcy reform took place over the past year but it is notable that several jurisdictions have begun to review and draft new bankruptcy legislation. The governments of Armenia, Croatia, FYR Macedonia and Poland are all preparing new bankruptcy legislation. In Armenia and Croatia these reforms are the result of public recognition of the shortcomings of existing bankruptcy legislation.

The Moldovan Parliament passed a new law on bankruptcy in November 2001, which was a condition of the IMF for

future lending. The Ukrainian Parliament also amended its Law on Bankruptcy, in March 2002. The amendments define the qualifications, rights and duties for bankruptcy administrators and include procedures for a moratorium on satisfying creditor claims, conducting a creditors' meeting and undertaking reorganisation. The Slovak Republic has amended its bankruptcy laws to abolish the tax authorities' priority lien on movable and immovable assets. The existence of this priority has contributed to banks' reluctance to provide credit. The new provision is expected to become effective in January 2003.

### Company law

As with bankruptcy, there was little activity in company law and corporate governance during 2002. Amendments to Russia's Federal Law on Joint Stock Companies, which provides for increased minority shareholder rights, became effective in late summer 2001. The new law states that a company's charter may not set

general assembly (that is, annual meeting of shareholders) voting requirements at greater than a simple majority vote unless specified by the amended Joint Stock Companies Law. Under the amendments, shareholders are now given six months to file a complaint with a court in order to challenge a general assembly decision. As of 1 January 2002, the Joint Stock Companies Law no longer limits the number of issues that a shareholder with at least 2 per cent of the company's stock may propose for consideration by the general assembly. The amended law also allows shareholders to nominate candidates for all of the company's management bodies, including the audit commission.

On the management side, the amendments prevent the use of proxy voting by management and limit management's representation on the board of directors to one-quarter. However, these major changes do not appear to have improved practitioners' views of the extensiveness or effectiveness of Russia's company law

## Classification system for transition indicators: commercial law

### Extensiveness

- 1 Legal rules concerning pledge, bankruptcy and company law are perceived as very limited in scope. Laws appear to impose substantial constraints on the creation, registration and enforcement of security over movable assets and can impose significant notarisation fees on pledges. Company laws do not ensure adequate corporate governance or protect shareholders' rights. Bankruptcy laws are perceived as unable to provide with certainty or clarity the definition of an insolvent debtor, the scope of reorganisation proceedings or the priority of distribution to creditors following liquidation. Laws in these substantive areas may not have been amended to approximate those of more developed countries or these laws have been amended but are perceived to contain ambiguities or inconsistencies.
- 2 Legal rules concerning pledge, bankruptcy and company law are limited in scope and are subject to conflicting interpretations. Legislation may have been amended but new laws do not appear to approximate those of more developed countries. Specifically, the registration and enforcement of security over movable assets may not have been adequately addressed, leading to uncertainty. Pledge laws may impose significant notarisation fees on pledges. Company laws may not ensure adequate corporate governance or protect shareholders' rights. Laws appear to contain inconsistencies or ambiguities concerning, among other things, the scope of reorganisation proceedings and/or the priority of secured creditors in bankruptcy.
- 3 New or amended legislation may have been recently enacted (i.e., within the past five years) in at least two of the three commercial legal sectors that were the focus of the survey. However, the legislation could benefit from further refinement and clarification. Legal rules appear to permit a non-possessory pledge over most types of movable assets. However, the mechanisms for registration of security interests may still be rudimentary and appear not to provide parties with adequate protection. There may be scope for enforcement of pledges without court assistance. Company laws appear to contain limited provisions for corporate governance and the protection of shareholders' rights. Bankruptcy legislation appears to contain provisions for both reorganisation and liquidation but may place claims of other creditors above those of secured creditors in liquidation.
- 4 Comprehensive legislation exists in at least two of the three commercial legal sectors that were the focus of the survey. Pledge law appears to allow parties to take non-possessory pledges in a wide variety of movable property and contains mechanisms for enforcement of pledges without court assistance. The legal infrastructure, however, may not be fully developed to include a centralised or comprehensive mechanism for registering pledges. Company laws may contain provisions for corporate governance and the protection of shareholders' rights. Director and officer duties appear to be clearly defined. Bankruptcy law appears to include detailed provisions for reorganisation and liquidation. Liquidators appear to possess a wide variety of powers to deal with the property and affairs of a bankrupt.
- 4+ Comprehensive legislation exists in all three commercial legal sectors that were the subject of the survey. Legal rules are perceived as closely approaching those of more developed countries. These legal systems

appear to have a uniform (that is, centralised registration) system for the taking and enforcement of a security interest in movable assets and also provide for adequate corporate governance and protect shareholders' rights. In particular, the rights of minority shareholders appear to be protected in the event of the acquisition by third parties of less than all of the shares of a widely held company. Bankruptcy law seems to provide in a comprehensive manner for both reorganisation and liquidation. Liquidators appear to possess a wide variety of powers and duties to deal with the property and affairs of a bankrupt, including wide powers of investigation of pre-bankruptcy transactions carried out by the debtor. There may be specialised courts that handle bankruptcy proceedings. Liquidators are required to possess certain minimum qualifications.

### Effectiveness

- 1 Commercial legal rules are perceived as usually unclear and sometimes contradictory. The administration and judicial support for the law is perceived as rudimentary. The cost of transactions, such as creating a pledge over a movable asset, is perceived as prohibitive so as to render the law ineffective. There appear to be no meaningful procedures in place in order to make commercial laws operational and enforceable. There also appear to be significant disincentives for creditors to seek the commencement of bankruptcy proceedings in respect of insolvent debtors.
- 2 Commercial legal rules are perceived as generally unclear and sometimes contradictory. There appear to be few, if any, meaningful procedures in place to make commercial laws operational and enforceable.
- 3 While commercial legal rules are perceived as reasonably clear, administration or judicial support of the law appears to be often inadequate or inconsistent, creating a degree of uncertainty (for example, substantial discretion in the administration of laws and few up-to-date registries for pledges).
- 4 Commercial laws are perceived as reasonably clear and administrative and judicial support of the law is reasonably adequate. Specialised courts, administrative bodies or independent agencies may exist for the liquidation of insolvent companies, the registration of publicly traded shares or the registration of pledges.
- 4+ Commercial laws are perceived as clear and readily ascertainable. Commercial law appears to be well-supported administratively and judicially, particularly regarding the efficient functioning of courts, liquidation proceedings, the registration of shares and the orderly and timely registration of security interests.

### Overall score

The overall score is the average of the scores given for the two indicators, rounded up where the average did not fall exactly into the existing categories. A "+" after a number is used to indicate countries that have just made it to the highest tier of one category and are within a few points of reaching the next category in the scale. A "-" indicates countries that are at the bottom of a category where a significant improvement is required for that jurisdiction to fall more comfortably within the middle range for that category.

and corporate governance practices. This may be due to survey respondents being unfamiliar with such far-reaching changes.

### Developments in financial law

Across the region a number of countries were perceived as having worse financial laws in 2002 than in 2001. Azerbaijan, Belarus, FR Yugoslavia/Serbia, Georgia, Kazakhstan and Uzbekistan experienced a decline in their financial market ratings this year. As noted above, much of this change is due to declining ratings for

banking – a trend that has continued from the 2001 LIS. As lawyers become more familiar with banking laws and regulations, they appear to perceive these laws as less extensive than they originally thought when the laws were initially adopted. Recently the IMF has published detailed assessments of various countries' compliance with the Basel and IOSCO principles, providing information that allows lawyers to compare their financial market regulations with international benchmarks and regulations of other countries.

### Banking

In 2002 Albania considered a legislative amendment to create a deposit insurance scheme in its banking sector. The ensuing debate concerning the legislation caused depositors to panic and withdraw funds from the banking sector. In March the Supervisory Council of the Bank of Albania issued a press release aimed at calming public concerns surrounding the proposed insurance scheme.

Table A.2.2.2

## Legal transition indicators: financial regulations

Country	2002			2001		
	Overall	Extensiveness	Effectiveness	Overall	Extensiveness	Effectiveness
Albania	1+	2	1	2-	2	2-
Armenia	3-	3+	2	3	3+	3
Azerbaijan	1	1	1	2	2+	2
Belarus	2	2	2	3-	3	2+
Bosnia and Herzegovina	1	1	1	1+	1+	1
Bulgaria	3	3	3	3	3	3
Croatia	2	3	2-	3	3	3
Czech Republic	3	3+	3	3+	3+	3
Estonia	4-	4	3+	4-	4	3+
FR Yugoslavia	2-	2	2-	3-	3+	2
FYR Macedonia	3-	3-	3-	3	3+	2
Georgia	2+	3+	2	3-	3	2+
Hungary	3+	3+	4-	4-	4-	4-
Kazakhstan	3-	3	3-	3+	4	3
Kyrgyz Republic	2-	2	1	na	na	na
Latvia	4-	4	4-	3	3	3
Lithuania	3+	4-	3	3+	3+	4-
Moldova	3	4-	3-	3+	4	3
Poland	3+	4-	3+	3+	4	3
Romania	3+	4-	3	3+	4	3
Russia	3-	3-	3-	3-	3-	2+
Slovak Republic	3-	3	2+	3	3	3
Slovenia	3	3+	3	4-	4	4-
Tajikistan	3	3+	2-	2	2	2-
Turkmenistan	na	na	na	1	1	1
Ukraine	2+	3	2	2+	2+	2+
Uzbekistan	2-	2	2-	2+	3-	2

Source: EBRD.

In Azerbaijan at least three foreign banks are leaving the country, including HSBC, which announced its departure in March 2002. Commentators have noted that these departures are due to discriminatory treatment of foreign investors in Azerbaijan. For example, HSBC has been drawn into court disputes by the tax authorities even though the bank proved that it had not violated Azerbaijan's laws. The Azerbaijan Government announced in early 2002 that it would reform its laws to bring its banking supervision scheme in line with international standards but no new legislation has been adopted so far.

In October 2001 the IMF noted that Georgia had significant weaknesses in its banking sector. The National Bank of Georgia must seek court permission to suspend banking licences, greatly limiting its enforcement ability. The IMF also noted that Georgia needs to refine its "fit and proper" criteria for ownership of banks. The IMF also stated that Georgia must adopt anti-money laundering measures. The Georgian Parliament is

currently considering revisions to its law on commercial banking to rectify these deficiencies.

In Serbia (FR Yugoslavia) there have been important reforms in the banking sector, from the introduction of a new banking law to the closure of many insolvent banks, including (in January 2002) the four largest banks in Serbia. Despite these achievements, the banking system is still experiencing problems, with a low level of deposits and limited provision of credit. Donor organisations have identified the development of international accounting standards as a crucial next step for the Serbian financial sector.

In Ukraine new banking regulations came into effect in November 2001 and January 2002, relating to the establishment and registration of banks – including banks with foreign capital, affiliates, representative offices, branches and bank holding groups. Ukrainian respondents probably recognised these new regulations (resulting in an increase in Ukraine's banking

extensiveness rating) but they also continued to perceive a decline in the effectiveness of Ukraine's banking laws.

Armenia is taking action to strengthen confidence in its financial and banking sector. The Armenian Parliament is currently considering amendments to the law on credit organisations, which was adopted recently. These are intended to reduce perceived risk in the Armenian banking sector. In addition, Armenia has published the list of 26 banks that have been liquidated and had their registration revoked over the past few years.

### Capital markets

A greater improvement was achieved in the regulation of capital markets than in the banking sector in 2002. This activity was recognised by respondents in a number of countries. However, in many countries this improvement in capital market perceptions was not enough to offset the general decline in banking ratings.

## Classification system for transition indicators: financial regulations

### Extensiveness

- 1 Legal rules concerning banking and securities regulation are perceived as very limited in scope. For example, capital adequacy standards and restrictions on affiliated lending in banking appear non-existent. There may be no functioning stock exchange in this jurisdiction, or the capital markets' legal infrastructure may be in its earliest stage of development.
  - 2 Legal rules governing financial markets are perceived as limited in scope. Although regulations in banking may have been amended to accord with international principles, at least one important area of regulation is perceived as deficient – for example, capital adequacy, use of international accounting standards or use of consolidated comprehensive supervision. Oversight of securities markets appears limited and regulation of securities intermediaries and investment funds, for example, are either non-existent or rudimentary.
  - 3 Legislation for financial markets is perceived as reasonably comprehensive but could benefit from further refinement in some areas. Banking regulations appear generally to conform with the Basel Committee's Core Principles, although regulations concerning bank insolvency and deposit protection may not have been adopted. Further refinement to regulation of securities intermediaries and/or investment funds and creation of shareholder depositories and registers may be needed to achieve conformity with minimum international standards.
  - 4 Comprehensive financial market legislation is perceived as conforming generally with minimum international standards. However, refinement appears to be needed in at least one important area of either banking or securities regulation. For example, many jurisdictions in this category may need to enact rules concerning money laundering or bank insolvency. Legislation concerning shareholder depositories and registries seems to be in its early stages of implementation.
  - 4+ Banking and capital markets legislation and regulation are perceived as comprehensive and conform to minimum international standards.
- 2 Legal rules are perceived as somewhat unclear and sometimes contradictory. Supervision of financial institutions appears to exist only on an ad hoc basis. There appear to be few, if any, meaningful procedures in place to enforce the law. There may be a lack of adequately trained staff in either banking or capital markets regulatory authorities.
  - 3 Although legal rules governing financial markets are perceived as reasonably clear, regulatory and supervisory support of the law may be inconsistent, creating a degree of uncertainty. Although regulators may have engaged in corrective actions against failing banks and securities market practices, enforcement problems still appear to exist.
  - 4 Legal rules governing financial markets are perceived as readily ascertainable. Banking and securities laws appear to be well-supported administratively and judicially, particularly regarding the efficient functioning of enforcement measures against failing institutions and illegal market practices. For example, the regulator has taken corrective action to liquidate failing banks. Enforcement actions against individuals and securities intermediaries are evident, but might still benefit from more systematic and rigorous enforcement. Courts appear to have adequate authority to review enforcement decisions or other corrective actions for banks and/or securities firms.
  - 4+ Regulators appear to possess comprehensive enforcement powers and exercise authority to take corrective action on a regular basis. Examination of securities intermediaries and licensing of intermediaries seems to be frequent, as is the use of corrective action, such as prosecution for insider dealing, revocation of bank licences and liquidation of insolvent banks.

### Overall score

The overall score is the average of the scores given for the two indicators rounded up where the average did not fall exactly into the existing categories. A "+" after a number is used to indicate countries that have just made it to the highest tier of one category and are within a few points of reaching the next category in the scale. A "-" indicates countries that are at the bottom of a category where a significant improvement is required for that jurisdiction to fall more comfortably within the middle range for that category.

### Effectiveness

- 1 Legal rules governing financial markets are perceived as usually unclear and often contradictory. The regulatory support of the laws is rudimentary. Supervisory mechanisms seem to be either non-existent or poor. There appear to be no meaningful procedures to make financial laws fully operational.

In Armenia the National Assembly approved the Armenian Securities Commission's Programme of Activities for 2002 in March. The Programme included measures to increase the dissemination of information to the public concerning the activities of joint-stock companies and measures to ensure proper systems of financial accounting and auditing. The Commission has also been authorised to help joint-stock companies produce financial reporting that conforms with international accounting standards. The Securities Commission is empowered to conduct regulator inspections to expose violations of accounting and auditing rules.

On 1 January 2002, Hungary's new Capital Markets Law became effective, replacing the Securities Law of 1996, Commodities Exchange Law of 1994 and Investment Funds Law of 1991. This new

law dovetails with the Government's move to create one financial market regulator, the Hungarian Financial Supervisory Authority, and to establish common rules relating to the advertising and marketing of financial services. Under the new law, investor protection has been improved by mandating increased capital requirements for regulated firms and expanding disclosure and reporting obligations. The new Capital Markets Law also harmonises Hungarian law with relevant EC financial services directives.

In January 2002, Estonia's new Law on Securities Markets became effective. The new law is intended to make the capital markets more effective, transparent and trustworthy. It covers the public offering of securities, activities of investment companies and investment services offerings and provides for the supervision and regulation of these entities.

Lithuania has been active in revising its capital market regulations. In April 2002 a new Law on the Public Trading of Securities came into force. This is intended to harmonise Lithuania's securities regime with the requirements of the EU. The new law includes provisions that lower the threshold for requiring mandatory public take-over offers by a party (or parties acting together) acquiring shares in a listed company. The law also revises the procedures for submitting share prospectuses and reporting on major events. Lithuania also adopted a new Law on the Prevention of Money Laundering, which became effective in April 2001. The Lithuanian Securities Commission has prepared draft legislation on collective investment entities and investment-holding companies that are expected to harmonise Lithuanian law with EU directives and to bolster investments in Lithuania.