



USAID
FROM THE AMERICAN PEOPLE

Capital Markets Project

Comments on Public Draft SSMSC Regulation on Self-Regulatory Organizations of Professional Stock Market Participants and Suggested Changes in Legislation Needed to Make Self-Regulation Work Effectively¹

*Robert D. Strahota, Securities and Governance Consultant
USAID Capital Markets Project
July 11, 2007*

Thank you for inviting our comments on the above Draft Regulation and suggestions for related legislative changes. The comments on the Draft Regulation below are divided into General Comments and more specific Chapter-by-Chapter Comments. In addition, we have attached a copy of the Draft Regulation that has been marked to indicate how the changes we suggest might be included. The suggested legislative changes follow after the comments and mark-up. As always, representatives of the Capital Markets Project are available to meet with you at your convenience to discuss these comments.

General Comments

1. The Draft Regulation is a significant improvement over the earlier non-public draft on which we provided comments in October 2006.² We are pleased to see that a number of suggestions in our comments are reflected in the Draft Regulation.

2. In addition to the Draft Regulation, the SSMSC should adopt a strategy and action plan for SRO development. Elements of a proposed strategy and action plan were summarized in our earlier comments and set forth in more detail in the text and in Appendix C of the October 27, 2006 draft of Mr. Strahota's CMP SRO Report, which was delivered to SSMSC. Essentially, the strategy proposed at that time indicated that there were only three realistic candidates for sole SRO status under the 2006 Law, PFTS Association, UAIB and PARD. The proposals recommended that the SSMSC take a number of proactive steps to facilitate the licensing of each of these organizations as sole SROs.

We have not had an opportunity to discuss the initial proposals in any detail with the SSMSC. However, based upon the discussions we have had, we are in agreement that it makes sense to propose a broader strategy and action plan that outlines several alternatives for achieving the SRO objectives of the 2006 Law. This revised strategy and action plan are set forth in

¹ "Report and Recommendations for Development, Operation and Regulatory Oversight of Self-Regulatory Organizations in the Ukrainian Capital Market", Appendix D-2. USAID Capital Markets Project.

² See October 18, 2006 Memorandum of Comments from Ann Wallace and Bob Strahota, which was included as Appendix D (now Appendix D-1) to Mr. Strahota's draft "Report and Recommendations for Development, Operation and Regulatory Oversight of Self-Regulatory Organizations in the Ukrainian Capital Market" (hereinafter, the CMP SRO Report).

Appendix C to the CMP SRO Report. Both this Memorandum and the recommended Strategy and Action Plan in Appendix C are being delivered to the SSMSC in advance of the other parts of the revised CMP SRO Report. We suggest that after the Commission has had an opportunity to review both of these documents, it would be helpful if Mr. Strahota were permitted to make a presentation and explanation before the SSMSC regarding the key points in both documents and make himself available to answer any questions that the SSMSC may have.

3. The draft regulation should be revised so that substantially all of the self-regulatory authority over members of an SRO, including disciplinary sanctions, also applies to individuals associated with the SRO members (associated persons). Despite the fact that it contains a number of commendable provisions, the Draft Regulation would still result in the SSMSC not having implemented Principle 7 of the IOSCO Objectives and Principles of Securities Regulation (2003). As explained in our earlier comments and in the CMP SRO Report, in order for Principle 7 to be considered implemented, an SRO must be able to demonstrate that it has the capacity to carry out the purposes of governing laws, regulations and SRO rules consistent with the responsibility delegated to the SRO, and to enforce compliance by its members **and associated persons** subject to those laws, regulations and rules.³

Failure to provide for an SRO having self-regulatory authority over associated persons of member firms leaves a major loophole in the self-regulatory process since most firms, as legal entities, may be expected to engage in violations through the acts of their agents, the associated persons. While it is currently possible for SROs to discipline their member firms, in many cases, including those that involve the most serious violations, disciplining the firm without disciplining the individuals responsible is not enough. Also, some forms of firm discipline may be unrealistic.

Consider for example the situations where a securities trader firm has hundreds of clients, a UAIB member is the portfolio manager for a public investment fund with hundreds of investors, or a PARD member is the registrar for several major companies with thousands of shareholders. If an individual employed by one of these firms (who may or may not be one of the three persons required to be certified by the SSMSC) were to engage in serious violations of securities legislation or SRO requirements, such as theft involving falsification of records, misuse of confidential information for personal purposes such as insider trading, or personal trading ahead of an investment fund's trades, clearly the individual needs to be sanctioned. The individual violated the law and caused substantial damage to investors. Ideally, the individual should be fined and suspended or barred from further participation in the securities industry or association with any member regardless of whether the individual is currently certified by the SSMSC. If the individual's member firm were negligent in not supervising the individual and could reasonably have prevented the violations if it acted properly and had adequate controls in place, the firm also should be sanctioned, probably with a monetary penalty. However, in these circumstances, it is usually not realistic to suspend or revoke the firm's authority to do business. Doing so will cause more harm than good to the many investors for which the firm is providing services. Also, if the firm is put out of business, all the other individuals in the firm that had no involvement in the one individual's violations lose their livelihood? The primary wrongdoer in the above examples is the individual.

³ IOSCO Methodology for Assessment of Implementation of the IOSCO Objectives and Principles of Securities Regulation (2003), p. 33-35. Associated persons for these purposes generally include directors of a firm that are actively involved in the securities business of the firm, managers of the firm and employees of the firm who deal with customers, or handle cash or securities. We recommend using this definition in the Draft Regulation.

Whether or not the individual is a certified SSMSC professional, it is the individual that should be sanctioned and denied further participation in the securities industry,

Securities regulation in Ukraine will not be effective either via direct SSMSC regulation or via SRO regulation until it is recognized that the SSMSC needs authority to sanction individuals for all securities law violations and that the SROs need authority to regulate and discipline all associated persons of their member firms. Our recommendations that SROs have regulatory authority over associated persons of their member firms are not in any way intended to replace SSMSC's authority over certification of individuals who work for these firms. They are intended to strengthen the overall scheme of regulation by also providing SROs with authority to ensure that the associated persons of members as well as the member firms themselves comply with the law and with the SRO's requirements. Indeed, as explained below, it is also essential that the SSMSC seek broader legislative authority over individuals who violate the securities laws.

We appreciate the fact that the SRO provisions of the 2006 Law do not refer to associated persons of member firms. Also, we note that Article 13 of the 1996 law and SSMSC Regulation 631/3071 (June 10, 1998), "On the Approval of Certification of Individuals Engaged in Professional Activities with Securities in Ukraine" authorize the SSMSC to levy monetary penalties against individuals only in certain circumstances, in each case subject to the Code of Ukraine on Administrative Violations. These are major shortcomings of the 1996 and 2006 Laws that extend beyond the SRO issues.

As set forth in our proposed legislative changes, it is essential that the SSMSC seek broader legislative authority to levy monetary penalties against individuals so the SSMSC itself can enforce the securities legislation more effectively, and to resolve any doubts that the SROs also have this authority with respect to both violations of the legislation and violations of SRO governing instruments, rules and procedures.

These shortcomings in securities legislation and the SSMSC's inability to delegate authority that it does not have may be the reason that the SSMSC has chosen not to address regulation and discipline of associated persons of SRO member firms in its Draft Regulation. We understand the delegation problem. **However, this should not prevent the Draft Regulation from recognizing at this time, before any legislative changes are made, that SRO's have an independent legal basis for requiring associated persons of member firms to be subject to SRO regulation and discipline.**

In addition to delegated authority from the regulator, SROs often enforce their own rules and securities laws against their members and individuals who work for their members by reliance on the law of contracts. Parties may agree by contract to regulation and to sanctions when one party breaches a contractual obligation. As membership SROs, the three sole SROs may enter into uniform written membership agreements with each of their member firms whereby the member firm agrees to be bound by the governing instruments, rules and procedures of the SRO, including disciplinary rules that may provide for monetary penalties. In turn, associated persons of member firms may be required by contract with the SRO and as conditions of their employment by an SRO member firm and the member firm's membership in the SRO, to be bound to comply with SRO governing instruments, rules and procedures. Set forth below are basic examples of the language that we would include in the Draft Regulation as a requirement to be included in written agreements between the SRO and each member firm and between the SRO and each associated person of a member firm. The draft regulation should require that copies of these agreements must be retained by the SRO in its records so that they are available to the SSMSC upon request.

Member firm provision

By its signature below, the undersigned member firm (firm), as a condition and in consideration of its becoming a member of [insert name of SRO] (SRO), submits to the authority of the SRO and agrees to comply, and use its best efforts to ensure that all associated persons of the firm comply, with all requirements of the governing instruments, rules and procedures of the SRO. The undersigned firm further agrees to be comply with all rulings, orders, directives and decisions of, and disciplinary sanctions imposed by the SRO, subject to right of appeal or review as provided by law.

Associated Person Provision

By my signature below, and as a condition and in consideration of my employment by [insert name of member] (member) and member's becoming a member of [insert name of SRO] (SRO). I submit to the authority of the SRO and agree to comply with all requirements of the governing instruments, rules and procedures of SRO. I further agree to comply with all rulings, orders, directives and decisions of, and disciplinary sanctions imposed by the SRO, subject to right of appeal or review as provided by law.

In our comments on the governing instruments and other documents of PFTS Association, UAIB and PARD, we have recommended that language substantially equivalent to the above should be used to ensure adequate regulation of member firms and associated persons.

4. Amendment of Article 120 of Commercial Code. We are pleased to see the language that SSMSC has included in the last part of Chapter 3 and the first part of Chapter 5. The language strikes an appropriate balance between the authority that an SRO needs to exercise and the concern that the SRO's rules and requirements are not anticompetitive. Despite this language, however, as noted in Section IV.I.1 of the CMP SRO Report, Article 120 of the Commercial Code remains applicable to SROs organized as economic associations. Article 120 provides, in part:

“Association does not have a right to interfere in economic activity of enterprises – participants of association.”

This provision, which is currently included in substantially the above language in the PFTS Association, UAIB and PARD charters, is very troublesome because it might be used as grounds for SRO members (and associated persons) objecting to legitimate SRO regulations and disciplinary actions that are essential to make self-regulation work. For these reasons, we believe that Article 120 should be amended and we have included a suggested amendment in our suggested legislative changes.

5. Delegation of Authority Provisions. These provisions, which were included in the earlier draft, have now been deleted. We understand that the SSMSC intends to address the delegation issue separately by amending Resolution No. 203 (October 1, 2002) regarding delegation of authority to SROs. We agree.

6. Corporate Governance Provisions. Since Ukraine has a good corporate governance code whose adoption is now voluntary, SSMSC should consider requiring the boards of SROs to adopt the code because SROs have public interest obligations and can set an example for a companies. However, insofar as independent directors are concerned, I suggest that some time be permitted to phase in any such requirement. The first priority is educating finding qualified people and educating them about the role of independent directors.

Chapter-by-Chapter Comments

Preamble; 2nd Paragraph. We recommend insertion of the phrase “of professional stock market participants other than depositories and stock exchanges” following the word “organizations”. This change is essential to make it clear, as provided in Article 16.4 of the 2006 Law, that the regulation only implements the provisions of the 2006 Law that make it mandatory for stock market participants, other than stock exchanges and depositories, to be members of at least one SRO. It is also important to make it clear that the establishment of the three types of sole membership SROs under the 2006 Law does not undermine the separate SRO status of SSMSC licensed stock exchanges. The importance of this distinction is explained in Section IV.I.2 of the CMP SRO Report and in the recommended Strategy and Action Plan. In those documents, we point out that one of the strategies that SSMSC may use to implement the sole securities trader SRO provisions of the 2006 Law is to make a distinction between (i) securities trader member regulation, which would become the responsibility of a sole securities trader SRO that is not connected with any one stock exchange, and (ii) and market regulation, which would remain the responsibility of each stock exchange that is licensed by the SSMSC.

Also, while securities depositories are not SROs under current legislation, as pointed out in Section IV.I.3 of the CMP SRO Report, depositories, like stock exchanges, are natural SROs because of the rules and procedures they must apply to their members or participants in order to make clearance and settlement of securities and other depository activities work effectively. Accordingly, the Draft Regulation should allow for the possibility that duly qualified depositories may become SROs in the future as Ukraine’s securities regulation continues to evolve. This approach also is consistent with Article 16.4 of the 2006 Law.

Chapter 1; 3rd Paragraph. Closely related to the above comment, we also recommend that the last sentence of this paragraph refer also to depositories in order to be consistent with Article 16.4, and in order make the statement in the first sentence of this paragraph 100% correct.

Chapter 2. Fostering investor protection by the SRO and its members, and providing a dispute resolution mechanism, such as arbitration, should be added to the list of SRO functions.

Chapter 3; 5th Paragraph. This paragraph should be revised to make it clear that only a sole securities trader SRO may set up trade or information systems. There is no logical reason to expect the other two types of membership SROs to do so. Also, we would add the words “stock exchanges.” Finally, while we agree that a sole securities trader SRO should have the right to set up a stock exchange or trade and information system, it does not follow that all securities traders, who are required by law to be members of the sole securities trader SRO will wish to use that trading system and the legislation does not require them to do so. The fifth paragraph should make clear that membership in a sole securities trader SRO does not obligate the member to become a member or participant in the trading system or exchange.

As pointed out in the CMP SRO Report and our proposed Strategy and Action Plan, consolidation of securities traders in one SRO and consolidation of securities trading are separate issues. Achieving one of these goals does not necessarily ensure achieving the other.

Chapter 3; 6th paragraph, subsection 1. We would add the words “and operations.”

Chapter 4; 2nd Paragraph. To comply with the requirements of the 2006 Law, there should be added to the procedure for acquiring SRO status in this Chapter the requirement that the applicant must demonstrate to the satisfaction of the SSMSC that its members (participants) include over 50% of the licensed professional securities market participants who are engaged in the securities activity for which the applicant seeks to be registered as the sole SRO.

We suggest addition of the items indicated as part of the application process.

Chapter 4; 3rd Paragraph. Since the minimum assets requirement for sole SRO status is already set forth in Article 48 of the 2006 Law, we recommend adding at the end of this paragraph the phrase, “which shall not be less than assets of UAH 600,000.” Also the reference to audited financial statements in Article 4.1 should make clear that the financial statements must demonstrate the required level of financial responsibility.

Chapter 4; Article 4.3; 2nd paragraph. We understand that current practice of the SSMSC is to require SRO registrations to be renewed every three years. This practice is not required by the 2006 Law or prior laws. Since there will be only one SRO per category of professional securities market participant, there is some risk with a renewal period for certificates; for example, if there were an unforeseen delay by the SSMSC, all members of the SRO would be in violation of the 2006 Law even though they were not responsible for the delay. For these reasons, an SRO registration should remain effective indefinitely until the SRO withdraws it or the SSMSC establishes that the SRO no longer meets the requirements of SRO status. We also believe that it would be desirable to make this change in the SSMSC’s current procedures because it would require the SSMSC to put more emphasis on inspecting the sole SROs, rather than simply assuming everything is satisfactory for three years until a registration is renewed.

Chapter 5. In this Chapter we would add as a ByLaw requirement the contractual undertakings recommended above for members and associated person.

Chapter 5; 3rd Paragraph; subsection (a) and Chapter 6; Article 6.2, 1st requirement. We recommend deletion of both of these subsections. As a matter of best SRO practices, SRO members as a body should not have the right to approve all of an SRO’s rules and procedures. They should have a right to approve charter amendments and perhaps they should have a right to approve certain fundamental ByLaws. If an SRO is to function as an effective SRO, it would be preferable for rules and procedures of the SRO, including rules relating to, membership, dues and fees, and all rules pertaining to discipline, member conduct and member regulation to be established by the Board of the SRO. An SRO needs the ability to act flexibly and more frequently than annually with respect to changes in these rules. In the United States, for example, hardly a week goes by without the NASD submitting for SEC approval changes in NASD rules that have been approved at the NASD Board level without approval or ratification by the NASD membership. The Annual General Meeting of an SRO meets only once per year and it is costly and burdensome to convene extraordinary general meetings. To be effective and responsive to regulatory changes, the Association’s Board should be given authority with respect to the above matters. We have provided a similar comment to PFTS Association, UAIB and PARD, urging each of them to amend their charters

so that Board approval is permitted for a broader class of SRO requirements. In the case of SROs the safeguard over imprudent board action in adopting rules is the requirement of SSMSC approval, not membership approval.

Chapter 5; Article 5.1; Other Procedures. One of the criticisms we have heard from SROs is that the SSMSC requirements for SROs should be specific and not open ended. For these reasons, if the reference to “other procedures is retained, we suggest adding at the end “as required by SSMSC regulations.

Chapter 6; 1st Paragraph. As previously suggested, we believe that paragraph 1 should be revised to reflect the intent of the 2006 Law as follows:

“Every professional stock market participant shall be a member (participant) in at least one SRO, which must be the SRO for the type of professional stock market activity in which the participant is primarily engaged. A professional stock market participant that is a licensed securities trader must be a member of a securities trader SRO.”

If this provision is not included, there is a risk of “regulatory arbitrage” where, for example, a licensed securities trader might join a depository SRO to avoid self-regulatory provisions of the sole-securities trader SRO that are specifically designed to ensure compliance by all securities traders with SRO rules applicable to securities traders. The need for SRO regulation is greatest for securities traders and it is essential that all professional market participants who are primarily securities traders must be members of a sole securities trader SRO.

Chapter 7. This Chapter should apply more broadly to changes in an SRO’s Charter, ByLaws, Rules and Procedures and we have marked it up accordingly. However, the Chapter appears unnecessarily long and repetitive. We recommend that an attempt be made to condense it into 1-2 succinct paragraphs.

Chapter 8; Article 8.6; 2nd Paragraph. At the end, we would add “that replaces a registered SRO” since the 2006 legislation envisions only one SRO per category of market participant.

Chapter 9. As a matter of procedural fairness, the following should be added at the end of the fourth point under the first paragraph of this Chapter: “for failure to comply with or enforce applicable legislation or regulations, including statutory responsibilities of the SRO”.

The second and ninth powers of the Commission regarding inspection of SROs are essentially the same and should be combined.

Regulation on Self-Regulatory Organizations of Stock Market Professional Participants

Regulation on Self-Regulatory Organizations of Stock Market Professional Participants (hereinafter, Regulation) has been developed in accordance with the Civil Code of Ukraine, the Commercial Code of Ukraine, Articles 2, 47 and 49 of the Law of Ukraine On Securities and the Stock Market, Articles 7 and 8 of the Law of Ukraine On State Regulation of the Securities Market in Ukraine, the Law of Ukraine On Financial Services and State Regulation of the Financial Services Market.

The Regulation establishes basic principles and requirements to the operation of self-regulatory organizations of professional stock market participants other than depositories and stock exchanges in Ukraine.

1. General Provisions

A self-regulatory organization of stock market professional participants (hereinafter referred to as SRO) is a non-for-profit association of stock market participants performing professional activities in the stock market, such as securities trading, institutional investors asset management and depository activities (activities of registrars and custodians) at the stock market, set up in compliance with the criteria and requirements established by the Securities and Stock Market State Commission (hereinafter, Commission).

A self-regulatory organization is set up in the organizational and legal forms envisaged by the legislation, acts based on its Charter, founding agreement (unless specified otherwise for a given organizational and legal form) (hereinafter referred to as 'statutory documents'), and the rules of the SRO.

SROs are established in keeping with the following principle: every type of professional activity on the securities market is represented by a self-regulatory organization. Such organization shall unite over 50% of all stock market professional participants representing one of the types of professional activities, other than that of stock exchanges and depositories, which are natural associations of stock market professional participants ~~trading in securities~~.

An SRO's property and funds are accumulated on the basis of contributions of the founders, members and other incoming funds, allowed for non-for-profit organizations by the legislation. An SRO's property and funds shall be spent on or aimed at setting up the SRO exclusively, as well as at the coverage of costs associated with its operation.

For purposes of this regulation, "associated persons" of an SRO member firm include directors of a firm that are actively involved in the securities business of the firm, managers of the firm and employees of the firm who deal with customers, or handle cash or securities.

2. SRO's Basic Functions

SROs shall perform the following basic functions:

- 1) to set forth requirements to the professional qualification of associated persons of ~~specialists~~-SRO members, aimed at ensuring high professional level of stock market participants' activities;
- 2) to develop and approve rules for performance of a relevant type of professional activity;
- 3) to establish standards and rules of conduct, to develop the Ethics Code and to exercise control over compliance by the SRO members and associated persons;
- 4) to develop and perform actions to protect the rights of SRO members and professional interests of the SRO members;
- 5) to arrange professional training and continued education of ~~specialists~~ associated persons of SRO members;
- 6) to inform its members on the legislation concerning securities, and on all amendments introduced to such legislation;
- 7) to introduce effective mechanisms of resolving disputes, such as arbitration, among SRO members and SRO ~~participants~~ members or associated persons and their clients;
- 8) to initiate improvement of the stock market regulatory framework;
- 9) to represent the interests of SRO members and other stock market participants in governmental agencies, courts and other organizations, as well as to protect their interest;
- 10) to foster investor protection by the SRO and its members.

3. The Rights and Obligations of an SRO

In the process of performing its activities, an SRO shall have the following rights:

- 1) to take part in preparation of draft laws and other regulatory acts, governmental programs concerning self-regulation, and send their independent opinions on the results of inspections of laws or regulatory acts to governmental bodies;
- 2) to request and receive historical, normative and technical information (documents), necessary for SROs to accomplish their tasks, from governmental bodies and municipal authorities;
- 3) on its own behalf and in keeping with the legal procedure, to appeal against any acts and (or) actions (failure to take any action) of governmental bodies, municipal authorities, which violate or pose a threat of the violation of the SRO's rights and interests, those of each of its participants or a group of participants;
- 4) in keeping with the effective legislation, to accept authorities delegated by the Commission, which do not stand in conflict with the effective legislation.

Having acquired the status of an SRO, an association of professional securities market participants that is the sole securities trader SRO may set up as separate legal entities stock exchanges, trade and information systems, being considered their only founder, provided,

however, that the SRO may not require as condition of SRO membership that its members must join or participate in such stock exchange, trade or information system.

SRO's obligations:

- 1) to perform only the activity related to the goal of SRO establishment and operation;
- 2) SRO and its managing bodies and associated persons shall comply with the requirements of the legislation, SRO Charter and SRO standards and rules;
- 3) to set up equal terms for entering the organization and suspension of membership in the organization for any professional participant.
- 4) SRO shall not perform activities and take actions resulting in emergence of a threat of a conflict, or in a conflict of interests of SRO with those of SRO participants;
- 5) when performing its activity, SRO shall not limit competition among its founders (participants).

4. Procedure for Acquiring SRO Status

SRO shall be set up in keeping with the effective legislation aiming at protection of interests of its members and stock market participants. The association shall acquire an SRO status as of the date of making a record on it in the SRO register, kept by the Commission.

To acquire an SRO of professional market participants' status, the ~~organization~~ association shall demonstrate to the satisfaction of the SSMSC Commission that it unites over 50% of all stock market professional participants representing one of the types of professional activities, and that it meets the following requirements:

1. to have an office, separated from the offices of other legal entities, owned or rented by the SRO according to a rental agreement for no less than 5 years; the office square shall meet all sanitary standards of room space per employee;
2. to have hardware (no less than 3 computers) and license software;
3. to have telephone and fax lines, and electronic connection, including electronic mail;
4. to provide a 24-hours active web-site;
5. to have no less than 3 employees with working experience in the stock market.

SRO status shall be given by the Securities and Stock Market State Commission (hereinafter, Commission) to ~~the organizations and~~ associations having sufficient resources to meet statutory obligations, which shall not be less than assets of UAH 600,000.

4.1 The procedure of SRO registration (extension of the Certificate's validity) requires filing of the following documents with the Commission:

application;

notarized copies of the certificate of the association's State registration;

copy of organizational chart;

list of affiliations of founders and board members;

[copy of the membership agreement between SRO and member;](#)

[budget;](#)

[procedure handling and recording client complaints](#)

a copy of statutory documents (the charter and the founding agreement);

copies of the documents, certified in keeping with the established procedure, confirming the applicant's ownership right for the office or the right to exploit the office;

financial statements certified by the auditor, the auditor's (auditor firm's) opinion on the composition of the SRO assets, the form of contributions (cash, valuable materials, securities, intellectual property etc.), [including the source thereof, which demonstrate that the SRO meets applicable financial responsibility requirements;](#)

SRO rules that comply with this Regulations;

the list of management of the SRO functioning as a legal entity – information on its president, his/her deputies, and the chief accountant, indicating the following data: the last, first name and patronymics, the title occupied, education, employment record, contacts (telephone, fax, teletype, e-mail), prison record for fraud or abuse of office that has not been cancelled, and availability of court injunctions barring such individuals from occupying certain positions or engaging in certain activities;

information on sanctions imposed by governmental agencies, courts of law, arbitration or tertiary courts on a legal entity for commercial and financial violations within the previous three years prior to the SRO candidate application or establishment, indicating the date of the sanction, the name of the body that imposed the sanction, the cause of the sanction, the type and amount of penalties involved, and the degree of execution of sanctions by the date of application;

a list of all entrepreneurial subjects registered in Ukraine, where an SRO (if it is an association of legal entities) acts as a founder, a shareholder, or a participant, with an additional indication of those where the SRO owns more than 5% of the statutory fund. The list is to include: the YEDRPOU code⁴ of the applicant, the name in full, its location, its stake as an absolute amount and in percentage in each subject of entrepreneurial activity;

an electronic copy of the above documents on a computer 3.5" disc in the format to be determined by the SSMSC.

All the list, data, and conclusions submitted by the applicant shall not be more than two months old as of the moment of application and shall be signed by the applicant's CEO and sealed with a stamp of the legal entity. All pages shall be laced, their numbers indicated.

The applicant shall be responsible for reliability of the information indicated in the documents submitted to be granted the Certificate of registration.

4.2. As a result of reviewing the documents filed, the Commission shall approve one of the following decisions:

⁴ The code number assigned to businesses in the State register of entrepreneurial subjects.

- a) to issue the Certificate of registration of the association as an SRO;
- b) to refuse the issue of the Certificate of registration of the association as an SRO;
- ~~e) to extend the validity of the Certificate of registration.~~

The grounds for refusal to issue the Certificate of registration ~~or to extend its validity~~ can be as follows:

- a) failure of the documents and data submitted to comply with the requirements of this Regulation and of the effective legislation;
- b) unreliable data in the documents submitted;
- c) the presence of valid complaints from registered persons over the association's activities;
- d) an SRO has no sufficient resources to perform its statutory obligations.

The decision to refuse to issue the Certificate ~~or to extend the validity thereof~~ shall indicate the reasons for the refusal. The information about refusal to issue the Certificate or to extend the validity thereof with the indication of the reasons for this decision shall be provided to the applicant in writing.

This decision shall be approved no later than Forty Five (45) days after receipt of the application and the necessary documents.

4.3. A Certificate for registration of the association as SRO shall be issued to the applicant in compliance with the Addendum.

~~A Certificate shall be issued for the term of 3 (three) years and shall be valid throughout the territory of Ukraine. Validity of the Certificate shall be extended in accordance with the established procedure for acquisition of such Certificate.~~

Once the Certificate validity has terminated an SRO shall not continue performing its activity. Once the Certificate validity has terminated, or the association has been liquidated or restructured, the Certificate shall be deemed invalid. Within a three days' term, the SRO is obliged to inform the Commission on liquidation or restructuring.

Chairman of the Commission or another authorized official shall sign the Certificate and attest it with a seal.

Certificates shall be recorded by relevant numbers in the Register of Issued Certificates, kept by the Commission.

Once the registration has been completed, the Certificate shall be issued to the association representative if a trust deed and a copy of the payment document certified by the association are available.

The Certificate shall not be transferred to other persons and used by them.

The fee for SRO registration shall be 100 (one hundred) tax-free minimum citizens' incomes.

5. The requirements to the Bylaws of SRO operation

SRO Bylaws shall be targeted on creating an open and ordered securities market, ensuring proper conduct by its members and associated persons and maintaining a proper balance of interests between the SRO ~~participants~~members and those of public. The statutory documents of an SRO shall meet the requirements set forth in the effective legislation for associations of legal entities.

SRO ByLaws shall require that as a condition and in consideration of being granted membership in SRO and as a condition of employment by SRO member and such member being granted membership in SRO, that the SRO member and each associated person of SRO member shall enter into an agreement with SRO in substantially the following form:

Member firm provision

By its signature below, the undersigned member firm (firm), as a condition and in consideration of its becoming a member of [insert name of SRO] (SRO), submits to the authority of the SRO and agrees to comply, and use its best efforts to ensure that all associated persons of the firm comply, with all requirements of the governing instruments, rules and procedures of the SRO. The undersigned firm further agrees to be comply with all rulings, orders, directives and decisions of, and disciplinary sanctions imposed by the SRO, subject to right of appeal or review as provided by law.

Associated Person Provision

By my signature below, and as a condition and in consideration of my employment by [insert name of member] (member) and member's becoming a member of [insert name of SRO] (SRO). I submit to the authority of the SRO and agree to comply with all requirements of the governing instruments, rules and procedures of SRO. I further agree to comply with all rulings, orders, directives and decisions of, and disciplinary sanctions imposed by the SRO, subject to right of appeal or review as provided by law.

SRO shall include in their bylaws no provisions which can give rise to:

- a) discrimination of the rights of members of their organization or of their customers;
- b) groundless restriction for admission of new members or for terminating membership in their organization;
- c) restrictions that create groundless obstacles for development of competition among their members.

The SRO rules shall ensure representation of the interests of each of its participants~~members~~ in ~~the following procedures:~~

~~a) approval, amendment or cancellation of a rule or provision on SRO;~~

~~b) nomination of candidates to certain positions, election to governing bodies and participation in the SRO governance.~~

The SRO rules shall envisage provisions that obligate their participants to comply with the effective legislation.

The SRO rules shall include requirements to members providing full access to their associated persons and information for inspections performed by the SRO; and to the SRO exercising control over enforcement of sanctions and other action. The SRO rules shall envision penalties imposed by the SRO on its members or associated persons for improper compliance or for failure to comply with the requirements of the SRO self-regulation rules, namely: cautioning; a fine (if envisioned by contracts); suspension of membership in the SRO; and expulsion from the SRO.

Sanctions imposed on an SRO member or associated person shall be in line with the nature of ~~it~~the violation. These documents shall also specify that prior to imposing sanctions the SRO is to inform the member or associated person in question of the intention to sanction ~~it~~, and to provide an opportunity for the member or associated person to give the relevant explanations, acquitting evidence etc. An SRO may propose that the SSMSC impose sanctions or may request that the SSMSC suspend or cancel the license of the member's or the registration of any certified professional of the member ~~license~~ to engage in professional activities in the securities market.

In the event of an SRO imposing sanctions on its member or associated person or in the event of the SRO filing a request with the SSMSC to suspend or cancel the member's or certified professional's license or registration to engage in professional activities in the securities market, the SRO shall send a written notice to the member certified professional or associated person on the violations identified, specifying the grounds for bringing action against ~~the~~ ~~is~~ member or such person. The SRO shall send a brief description of this notice to the SSMSC.

5.1 The list of SRO bylaws shall include, at least, those concerning the following aspects:

the procedure for acquisition and termination of SRO status;

the rights and obligations of an SRO member;

the procedure for keeping a record of SRO members and associated persons;

the procedure for provision of information to SRO members;

Ethics Code of SRO members and associated persons;

the procedure for operation of SRO arbitrary and tertiary courts;

the procedure for considering cases on violations of laws by SRO members and associated persons;

other procedures that may be required by SSMSC regulations.

6. SRO Membership.

Every professional stock market participant shall be member of at least one SRO, which must be the SRO for the type of professional stock market activity in which the

participant is primarily engaged. A professional stock market participant that is primarily a licensed securities trader must be a member of a securities trader SRO.

An SRO shall admit as its members persons holding a license to perform professional activities on the stock market which was issued according to the procedure established by the Commission and meeting the requirements of the SRO rules.

SRO members and associated persons shall gain no profit from the SRO operations.

6.1 An SRO member obligations:

Act in accordance with the legislation and SRO bylaws;

6.2 An SRO member shall have the following rights:

~~To adopt, amend or cancel any SRO rule or regulation;~~

To nominate candidates for executive positions and for elections of officers for governing bodies and participate in SRO governance;

To challenge, under a procedure established by the effective legislation, the refusal to admit a professional stock market participant that was granted a license as an SRO member

An SRO member or associated person may challenge, under a procedure established by the effective legislation, the decision of the SRO to sanction the member or associated person.

6.3 SRO shall maintain the list of its members and associated persons.

The list of SRO members should provide for at least the following data:

The name and EDRPOU identification code of SRO member; location, telephone number, fax and e-mail of SRO member; number, issuance date and validity date of the license to perform the professional activity on the stock market; the date of obtaining the status of SRO member.

The list of associated persons should include the following data:

last name, name and the patronymic of associated person; job (company name - SRO member) and position; number, date of issue and period of validity of certificate of person, that carries out professional activity with securities in Ukraine; information on any violations of legislation or governing instruments of SRO, that my cause such person was denied the right to be an associated person of SRO member.

7. Procedure for Receiving Commission's Agreement on Changes and/or Supplements to SRO Charter, ~~Rules and~~ Bylaws, Rules and Procedures, including ~~and~~ New OnesSRO ~~Rules and~~ Bylaws

All changes and/or supplements (Translator's Note – hereinafter, amendments) incorporated into SRO Charter, ~~Rules and~~ Bylaws, Rules and Procedures within the term of SRO operation as well as new ones ~~SRO Rules and~~ Bylaws shall be agreed with the Commission.

SRO shall be obliged to submit all amendments to be incorporated into its Charter, ~~Rules and~~ Bylaws, Rules and Procedures to the Commission to be agreed upon as well as new ones

~~Rules and Bylaws~~ within the term of 10 days following the date of their approval according to the established procedure.

In order to receive agreement on amendments to SRO ~~Rules and Charter, Bylaws, Rules and Procedures~~ or ~~on new ones SRO Rules and Bylaws~~ the following documents shall be filed with the Commission:

- application to receive agreement on amendments to SRO ~~Charter, Bylaws, Rules and Bylaws Procedures~~ or ~~on new ones SRO Rules and Bylaws~~ in accordance with the Attachment;

- substantiation of reasons for amending SRO ~~Charter, Rules and Bylaws, Rules or Procedures~~ or developing new ones;

- amendments to SRO ~~Charter, Rules and Bylaws, Rules or Procedures~~ or new ~~ones SRO Rules and Bylaws~~;

- comparative table of the old and new language of ~~Charter, Rules and Bylaws, Rules or Procedures~~ being amended.

Proposed amendments to ~~Charter, Rules and Bylaws, Rules and Procedures~~ shall be presented either in the form of separate document or as a new language ~~of effective Rules and Bylaws~~.

Amendments to ~~Charter, Rules and Bylaws, Rules and Procedures~~ as well as new ~~Rules and Bylaws ones~~ shall be filed by SRO in two copies (both original) approved by respective SRO body, under whose competence lies execution of such functions, and signed by chief of this body as well as certified with SRO stamp, their pages shall be threaded and numbered.

Based upon consideration of the filed application and documents the Commission shall make the following decision:

- to agree on amendments to SRO ~~Charter, Rules and Bylaws, Rules or Procedures~~ or on the new ~~SRO Rules and Bylaws ones~~;

- to refuse agreement on amendments to SRO ~~Charter, Rules and Bylaws, Rules or Procedures~~ or on new ~~SRO Rules and Bylaws ones~~.

The decision shall be made no later than within 15 working days following the date of the documents receipt.

Refusal to agree on amendments to SRO ~~Charter, Rules and Bylaws, Rules or Procedures~~ or on ~~the new SRO Rules and Bylaws ones~~ may have the following grounds:

- inconsistency of the filed documents with requirements of the effective legislation;

- availability of inaccurate data in the filed documents;

- availability of provisions in the filed documents that infringe rights of SRO members.

In case of incomplete filing of documents according to the list provided for in Item ----, or inconsistency of filed documents with requirements specified in Items ----, ---- of the present

Regulation, they shall not be considered and shall be returned to the applicant along with Commission's Letter about inconsistency of filed documents.

The decision to refuse agreement on amendments to SRO ~~Charter, Rules and Bylaws, Rules or Procedures~~ or on ~~the new SRO Rules and Bylaws~~ shall indicate reasons of such refusal.

The Commission shall notify SRO about its decision on agreement or refusal in writing within five working days following the date when such decision was made.

Should the Commission make decision to agree on amendments to ~~Charter, Rules and Bylaws, Rules or Procedures~~ or on ~~the new ones Rules and Bylaws of SRO~~, the ~~latter SRO~~ shall have a right to operate taking into account the introduced amendments ~~or new Rules and Bylaws~~ beginning from the date the respective decision was made by the Commission.

In this case Commission's note on agreement shall be put on both copies of respective amendments or new ~~Charter, Rules and Bylaws, Rules or Procedures~~ with one copy being returned to applicant with indication of the date and number of the respective Commission's decision being certified with the Commission Chairman's signature or signature of an authorized person of the Commission and a stamp.

Should the Commission make decision to refuse agreement on amendments to ~~Charter, Rules and Bylaws, Rules or Procedures or new Rules and Bylaws of SRO~~, the ~~latter SRO~~ may not operate with consideration for the specified amendments and/or new ~~Rules and Bylaws~~ ones.

8. Procedure for Generation, Maintenance and Use of Data of the Register of SROs of Professional Stock Market Participants

8.1 Generation and maintenance of the Register of SROs of professional stock market participants (hereinafter, Register) shall be performed by Securities and Stock Market State Commission.

8.2 The Register shall be an information data bank about SRO which contains the data specified by the present Regulation and ensures safekeeping of information constituting the system of the Register and its provision.

8.3 The following data shall be entered into the Register:

8.3.1 Full name of association of professional stock market participants (hereinafter, Association).

8.3.2 Association's Identification Code under EDRPOU.

8.3.3 Number of certificate on state registration of Association.

8.3.4 Association's Location (postal code, city, district, street, house number).

8.3.5 Association's fax number, telephone number, e-mail address.

8.3.6 Association's web page address.

8.3.7 Full name of the Director and the Accountant.

8.3.8 If available, number and date of inclusion into the Register of non-for-profit organizations in accordance with the effective legislation.

8.3.9 Number and date of certificate of Association's registration as SRO issued by the Commission.

8.3.10 Validity of certificate of Association's registration as SRO issued by the Commission.

8.3.11 Date of extension of validity of certificate of Association's registration as SRO issued by the Commission.

8.3.12 Date of Association's inclusion (exclusion) into (from) the Register.

8.3.13 Information as to the quantitative structure of SRO by types of professional activities of its members on the stock market.

8.4 A ground for entering the ~~SRO self-regulatory organization~~ of professional participants of the stock market into the Register is the application which witnesses the intention of the eligible legal person to introduce the ~~self-regulatory organization~~ SRO into the Register.

8.5 Entering into the Register is made by the SSMSC after the verification of documents, on which basis the entry into the Register is made, onto the conformity to the current legislation.

8.6 Changes and additions into the Register shall be introduced under the Commission's decision in case of:

Receipt of certificate of registration of Association of professional stock market participants as SRO by a new non-for-profit Association that replaces a registered SRO;

Cancellation of Association's of professional stock market participants certificate of registration of the Association as SRO.

In other cases amendment of information constituting the system of Register shall be made on the basis of respective documents submitted to the Commission by SRO of professional stock market participants within five days following the date of appearance of changes regarding SRO.

8.7 Presence of unreliable data in the submitted documents may be the ground for refusal of inclusion into the Register or making amendments to it.

SRO shall bear liability for the reliability of data submitted to the Register in accordance with legislation.

8.8 Should any reasons for refusal of inclusion into the Register or making amendments to it be discovered the Commission shall suggest to SRO to take measures to correct discovered mistakes or inconsistencies. In case of deliberate submission of misleading data to the Register such SRO may be excluded from the Register and deprived of SRO status.

8.9 The Commission, in case of receipt, according to the established procedure, of inquiry from the natural or legal person on obtaining the extracts from the Register, shall provide such excerpts, which testify either to inclusion of SRO into the Register or to the absence of respective registration.

The Commission shall publish information on SROs included into the Register system in its official publications or on the official web-site.

9. Powers of Securities and Stock Market State Commission Pertaining to Regulation and Control over SRO Operation

The Commission shall have the right to:

- exercise control over the reliability and disclosure of information submitted by SRO and its consistency with the established requirements;
- perform, independently or together with other eligible agencies, inspections of [financial and business activities of SRO](#);
- send to SRO binding instructions to eliminate violations of securities legislation and require submission of necessary documents according to the effective legislation;
- make decisions to deprive SRO status [for failure to comply with or enforce applicable legislation or regulations, including statutory responsibilities of SRO](#);
- submit proposals as to the nominees of chiefs of executive bodies of SRO;
- set, within the limits stipulated by legislation, requirements obligatory for fulfillment concerning the functioning of SRO;
- require the observance by SRO of the approved procedure of documentation management and documentation custody during the term specified by it that cannot be less than 5 years;
- require the submission of information on the current operation of SRO in accordance with the procedure set by the Commission;
- ~~- perform inspections of financial and business activities of SRO;~~
- in case of violation by SRO of legislation, Charter, [ByLaw](#), ~~Rules~~ or ~~other documents~~ [Procedures](#) which regulate its activity, to warn, to send written demands on elimination of discovered irregularities or violations, cancel registration of SRO as well as to apply other sanctions within the limits stipulated by the legislation;

In case of violation by SRO of the present Regulation and also other regulatory acts on SRO activity, the Commission shall have a right to issue binding instruction with indication of terms for elimination of concrete violations. SRO shall inform the Commission on fulfilling the requirements as to elimination of violations.

In case of repeated or gross violation by SRO of requirements of the effective legislation of Ukraine and this Regulation, the Certificate may be cancelled under the Commission's decision and SRO shall be excluded from the Register of the self-regulatory organizations of professional stock market participants.

**Director, Department of Methodology
of Securities Market Regulation**

O.O. Tarasenko

Suggested Legislative Changes

Article 11 of 1996 Law. It appears that this Article should have been amended when the 2006 Law was enacted to provide the SSMSC with additional authority to fine legal entities for violations of the legislative provisions that were added by the 2006 Law; for example, insider trading and failure of an SRO to discharge its statutory responsibilities. Article 11, as currently in effect, does not appear to authorize the SSMSC to levy fines against legal entities for all of the ways in which the 1996 law may be violated. Finally, the SSMSC should have authority to fine legal entities that are professional securities market participants for violation of the governing instruments, rules and procedures of any SRO of which the participant is a member. This latter authority is particularly important to address the possibility that SROs will not properly discharge their own disciplinary responsibilities. To address all of these shortcomings, we suggest that the first paragraph of Article 11 should be amended to add at the end the following additional clauses:

should a professional securities market participant violate the governing instruments, rules or procedures of any registered self-regulatory organization, the fine shall total up to [5,000] of citizens' assistance tax-fee incomes;

should a registered self-regulatory organization fail to enforce securities legislation or the organization's own governing instruments, rules and procedures with respect to members or associated persons, the fine shall total up to [5,000] of citizens' assistance tax-fee incomes;

should there be a material violation of any other provision of existing securities legislation, including Commission regulations under such legislation, the fine shall total up to [5,000] of citizens' assistance tax-fee incomes;

Article 13 of 1996 Law. For reasons explained in General Comment 3 on the Draft Regulation and in the explanation above regarding amendment of Article 11 of the 1996 Law, the following clauses should be added after the first four clauses of Article 13.

should an associated person, as defined in the 2006 Law of Ukraine on Securities and Stock Market, as amended, violate the governing instruments, rules or procedures of any registered stock exchange, self-regulatory organization, securities depository or trading information system, the fine shall total up to [2,000] of citizens' assistance tax-fee incomes;

should there be a material violation of any other provision of existing securities legislation, including Commission regulations under such legislation, the fine shall total up to [2,000] of citizens' assistance tax-fee incomes.

Also, the paragraph 8 of Article 13 should be amended to refer to clauses 1-7 instead of clauses 1-5.

Article 1 of the 2006 Law. A definition of "associated person" is advisable to clarify the applicability and provide a more certain legal basis for the inclusion of the associated person provisions that we recommend in the Draft Regulation. We are suggesting a somewhat broader definition of "associated person" so that in addition to professional securities market participants the definition also will indicate who are associated persons of registered stock exchanges, securities depositories, and self-regulatory organizations. We believe the SSMSC

would benefit in the future from use of this broader definition. For example, as Ukrainian securities regulation and capital market development evolve, rather than focusing it individual certification and disciplinary requirements on a minimum of three persons per professional securities market participant, we believe that in order to adequately protect investors against unlawful conduct by individuals working in the securities industry, the SSMSC will have to exercise its regulatory authority over a broader class of associated persons. Accordingly, the following definition should be added under Article 1.

associated person – as used with respect to a professional securities market participant or registered stock exchange, self-regulatory organization or securities depository, means “ directors that are actively involved in the securities business of the entity, managers of the entity and employees of the entity who deal with investors, or handle cash or securities.

Article 48 of the 2006 Law. As explained in General Comment 3 on the Draft Regulation, in order remove any doubts as to the applicability of SROs self-regulatory authority to associated persons of member professional stock market participants, the following two minor changes should be made in Article 48.

The second paragraph of Section 2 of Article 28 should be amended by inserting in line three after the word “organization” the phrase “and associated persons of such members”.

Clause 1 under Section 4 of Article 48 should be amended by inserting after the word “organization” the phrase “and associated persons of such members”.

Article 120 of Commercial Code. For the reasons explained in General Comment 4 on the Draft Regulation, either the securities legislation or Article 120 of the Commercial Code should be amended to read as follows:

The provisions of Article 120 of Commercial Code of Ukraine relating to economic associations shall not prohibit self-regulatory organizations authorized by other legislation from administering and enforcing self-regulatory functions with respect to their members, including the establishment of qualification, conduct of business, ethical, disciplinary, and dispute resolution requirements. The anti-monopoly legislation of Ukraine shall apply to such self-regulatory organizations.

If the change is made in the Commercial Code directly, we believe it should be made following the second paragraph of Article 120.